IDC

Industrial Development Corporation

Your partner in development finance

National Budget 2018

Committed to fiscal consolidation, restoring confidence

February 2018

Research & Information and Legal Services departments

Contents

Highlights

- Building on the trends set by recent developments in the political landscape and reinforced by President Ramaphosa's State of the Nation Address, the National Budget 2018 is likely to bolster business and investor sentiment further. This should translate into positive economic outcomes, including increased investment, business and consumer spending, higher production activity and job creation.
- The higher growth trajectory on which the Budget 2018 is based, contributes to improved outcomes across several key indicators, such as forecast revenue collections, the fiscal balance, borrowing requirements and debt sustainability ratios.
- Addressing the fragile state of public finances without inhibiting the economic recovery was a priority for National Treasury. The consolidated fiscal deficit is expected to narrow from the 4.3% estimated for 2017/18 to 3.6% over the next two years, reaching 3.5% by 2020/21. The lower than anticipated budget deficit is supportive of containing overall government debt, which is now expected to peak at 56% of GDP in 2020/21.
- National Treasury was forced to identify potential sources of additional revenue to plug the R48.2 billion shortfall. Key amongst these was the one percentage point adjustment in VAT, which is expected to raise an additional R22.9 billion in 2018/19. This tax proposal is likely to be highly controversial due to the impact it will have on the poorer segments of the population.
- Fiscal sustainability demanded the containment of government spending. In total, departmental budgets and provincial conditional infrastructure grants were reduced by R85.7 billion over the three-year outlook period. This substantial reduction also permitted the increased allocation for fee-free tertiary education to households earning less than R350 000 per annum, which will require R57 billion over the MTEF period.
- The public sector spending activity planned for the MTEF period, including expenditure on infrastructure development, will continue to be supportive of economic expansion, diversification and competitiveness. Considerable allocations are aimed at transforming ownership patterns in the economy as well as to promote the participation of historically disadvantaged individuals in its formal sectors.
- Cut-backs in spending on social infrastructure are amongst the unfavourable aspects of the Budget. This will probably be most felt amongst the more vulnerable communities. In addition, tax raising proposals in the form of a higher VAT rate and fuel taxes will have a disproportionately large impact on the budgets of poor households.
- The credit positive aspects of the Budget should provide considerable comfort to the credit rating agencies. As such, and having viewed recent politico-economic developments favourably, Moody's is expected to maintain its rating of South Africa's local currency denominated debt at investment grade, with positive implications for the economy at large.
- An improved macro-economic outlook should have beneficial impacts for the IDC through increased demand for funding, as well as by improving the ability of business partners to service existing funding facilities.
- Public sector spending will continue to present opportunities for the IDC to contribute further to localisation and transformation. In addition, the corporation should leverage on government's considerable incentive programmes targeting a wide variety of developmental objectives.
- More favourable perceptions and assessments of South Africa's investment environment, which could potentially also be reflected in future credit ratings, should translate into an expanding financing pipeline for the IDC, increased investor interest in partnering, as well as in lower costs of funding for the corporation.

Fiscal deficit set to narrow to

3.5% of GDP

by 2020/21

Gross government debt ratio expected to peak at

56% of GDP

in 2020/21

VAT rate hike to 15% expected to generate

R22.9 billion

in additional revenue

Public sector spending on infrastructure to total

R834.1 billion

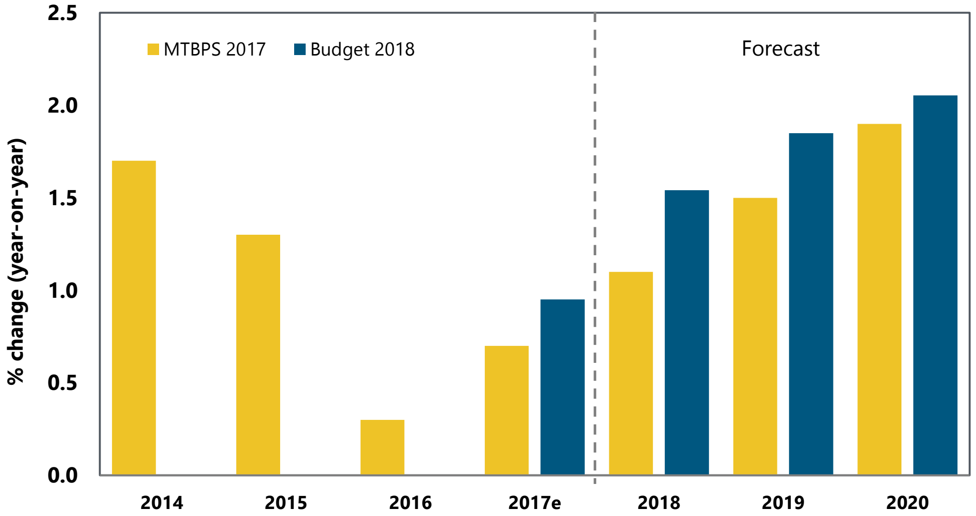
over the MTEF period

Improved economic outlook

Higher economic growth momentum anticipated

The Budget 2018 is based on a significantly better economic growth trajectory than that projected in the Medium Term Budget Policy Statement (MTBPS) of October 2017. The South African economy is expected to grow, on average, by 1.8% per year over the period 2018 to 2020, that is 0.3 of a percentage point higher than in the MTBPS. Nevertheless, the expansion momentum remains quite subdued and well below the pace deemed necessary to address the triple challenges of unemployment, poverty and inequality.

Figure 1: Real GDP growth to gain a stronger momentum over the outlook period



Source: National Treasury

Growth projections revised upwardly

Faster pace of growth to be underpinned by global and domestic drivers

The pace of economic growth is set to rise gradually over the next couple of years, reaching 2.1% by 2020, more than double the expansion rate of 1% estimated for 2017. Compared to the MTBPS projections, by the end of the outlook period South Africa's gross domestic product (GDP) is now expected to be 1.2% larger in real terms.

The factors underpinning the slightly more upbeat growth outlook include the recovery in agricultural output and the support provided by higher commodity prices to mining production. Although the manufacturing sector is still under pressure, improved demand conditions in global markets should benefit its exporting segments.

Improved sentiment to play a crucial role in reviving growth

Importantly, recent developments in the political landscape and the strong commitments to address policy-related constraints, governance and financial sustainability challenges at several state-owned enterprises (SOEs), as well as the move to fight corruption both in the public and private sectors, have been welcomed by the business and investor community, lifting confidence levels across the board.

Improved sentiment is likely to translate into renewed fixed investment, higher production activity and job creation. This should provide the necessary support to attain a higher growth trajectory on a sustainable basis.

Fixed investment expected to recover significantly

Growth in fixed investment has been under immense pressure more recently, particularly by the private sector, whilst public corporations have also been cutting back on capital spending. Looking ahead, however, the rate of expansion in real fixed investment is forecast to rise from an estimated 0.3% in 2017 to 3.7% by 2020.

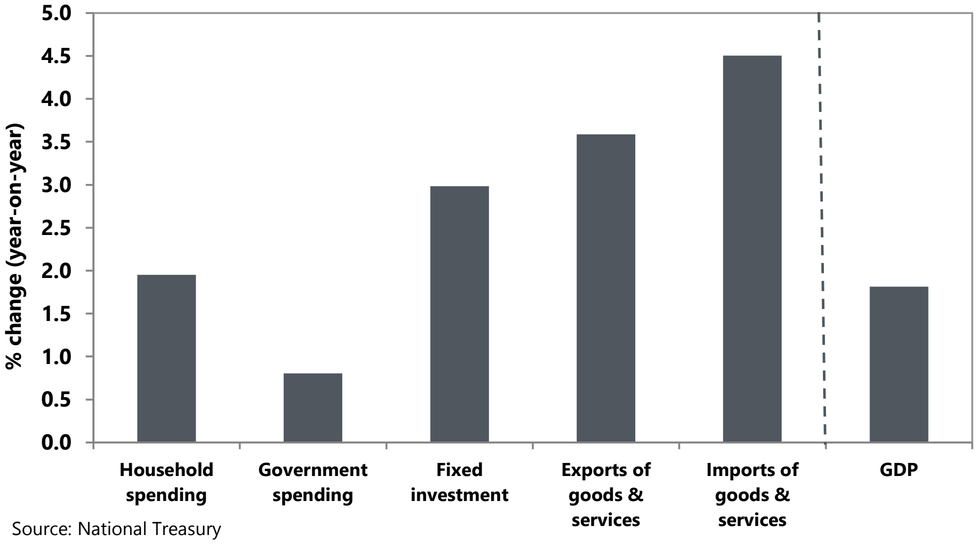
Due to its poor savings propensity, the South African economy will remain heavily reliant on foreign capital inflows to fund its investment activity. An improved economic outlook and political landscape, alongside efforts to address policy uncertainty and consistency, are likely to attract higher levels of foreign direct investment (FDI).

Although consumers are still facing strain, gradually improving economic conditions and increased employment creation should also lift consumer confidence and thus the ability and willingness of households to spend.

Improved global demand to support the domestic export sectors

The anticipated uptick in the world economy's performance and the resultant increased demand for commodities and manufactured goods should benefit the export-oriented segments of the South African economy. National Treasury is forecasting real export growth of 3.8% in 2018, up from the 1.5% estimated for 2017. The deficit on the current account of the balance of payments is expected to remain at manageable levels, widening from -2.3% of GDP in 2018 to -3.2% by the end of the outlook period.

Figure 2: GDP growth by expenditure component over 2018-2020 (average annual growth)



Source: National Treasury

The higher growth trajectory on which the Budget 2018 is based, contributes to improved outcomes across several key indicators, such as forecast revenue collections, the fiscal balance, borrowing requirements and debt sustainability ratios.

Fiscal consolidation of primary concern

Improved fiscal trajectory supported by economic outlook, lower growth in expenditure and higher tax collections

Addressing the fragile state of public finances without inhibiting the economic recovery was a priority for National Treasury. Over the Medium Term Expenditure Framework (MTEF) period, which encompasses the fiscal years 2018/19 to 2020/21, revenue is projected to increase at a faster pace than expenditure, at average annual rates of 8.7% and 7.6%, respectively.

As a percentage of GDP, the consolidated fiscal deficit is expected to narrow from the 4.3% estimated for 2017/18 to 3.6% over the next two years, reaching 3.5% by 2020/21. This is well below the ratios of 3.9% of GDP projected in the October 2017 MTBPS for the entire MTEF period. The lower than anticipated budget deficit is supportive of containing overall government debt, which is now expected to peak at 56% of GDP in 2020/21, compared to almost 60% in the MTBPS.

The fiscal consolidation efforts, as reflected by improved budget deficit and gross government debt ratios, are expected to be viewed favourably by the ratings agencies.

Table 1: Key fiscal metrics indicators and their performance

Fiscal indicator		2016/17	2017/18	2018/19	2019/20	2020/21
Gross loan debt of government as a % of GDP	MTBPS 2017	50.7%	54.2%	57.0%	58.2%	59.7%
	Budget 2018	50.7%	53.3%	55.1%	55.3%	56.0%
Consolidated budget deficit as a % of GDP	MTBPS 2017	-3.3%	-4.3%	-3.9%	-3.9%	-3.9%
	Budget 2018	-3.5%	-4.3%	-3.6%	-3.6%	-3.5%
Expenditure (consolidated budget) as a % of GDP	MTBPS 2017	32.8%	33.5%	33.6%	33.9%	33.9%
	Budget 2018	32.7%	33.2%	33.3%	33.4%	33.4%
Revenue (consolidated budget) as a % of GDP	MTBPS 2017	29.5%	29.2%	29.7%	30.0%	29.9%
	Budget 2018	29.2%	28.8%	29.7%	29.9%	29.9%

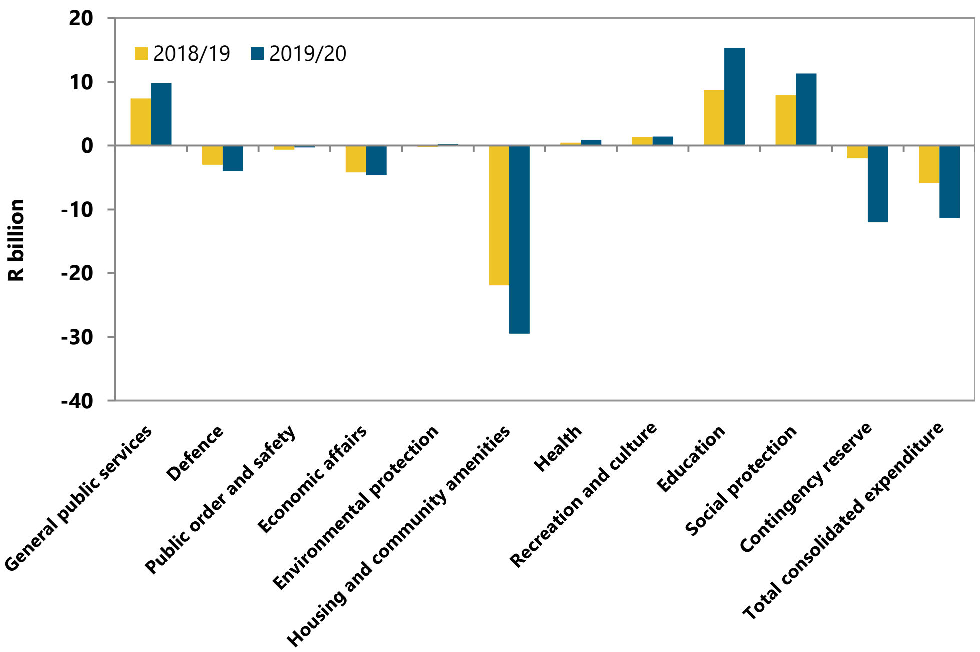
Source: National Treasury

Tightening the reins on expenditure

Education becomes the largest expenditure item, with infrastructure spending reduced

Fiscal sustainability demanded the containment of government spending. In total, departmental budgets and provincial conditional infrastructure grants were reduced by R85.7 billion over the three-year outlook period. This substantial reduction also permitted the increased allocation for fee-free tertiary education to households earning less than R350 000 per annum, which will require R57 billion over the MTEF period.

Figure 3: Changes in government expenditure for the next two fiscal years: Budget 2018 compared to Budget 2017



Source: IDC, compiled from National Treasury

The largest cuts were made in housing and community amenities, as the budgetary allocations for 2018/19 and 2019/20 are R21.9 billion and R29.5 billion lower, respectively, compared to those made in the Budget 2017. Other notable reductions pertain to transport and defence, as the respective allocations for 2018/19 are R11.5 billion and R3 billion lower, with similar cuts in 2019/20. These reductions will impact on the ability of the three spheres of government to provide housing and other socio-economic services to communities across the country.

The contingency reserve for fiscal year 2019/20 was reduced from R20 billion to R8 billion. This will constrain government's ability to respond to unforeseen events such as natural disasters. The budgeted increase in compensation of government employees, at an average of 7.3% per year over the MTEF, may prove to be a risky assumption, for it will depend on the outcomes of public sector wage negotiations.

Redistributive aspects of the budget included substantial increases for education, which were the largest at R8.8 billion in 2018/19 and R15.3 billion in 2019/20, and social protection (R7.9 billion higher allocation in 2018/19 and R11.3 billion in 2019/20) which includes social grants. These compensate to some extent for the burden placed on the poor by the higher VAT rate (see below) on non-zero rated products and services, as well as by the increase in the fuel levy. However, a large segment of low-income households may still be negatively affected, on a nett basis, by these tax proposals.

Addressing the revenue shortfall

In light of lower than anticipated tax collections, largely due to an underperforming economy, National Treasury was forced to identify potential sources of additional revenue to plug the R48.2 billion shortfall. In so doing, it weighed various options, as follows:

Limited tax raising options necessitated a VAT rate increase

Tax	Consideration	*Outcome*
Personal income tax	Following increases in personal income tax in recent years, the tax burden on individuals has increased significantly. Recent tax collection data indicated that further increases in personal income tax could result in lower than anticipated revenues, while the impact on economic activity could be substantial.	*Personal income tax adjustments reflect partial relief for bracket creep in favour of lower income earners.*
Corporate income tax	Several countries have been cutting their corporate tax rates, notably the US which reduced it from 35% to 21% at the end of 2017. South Africa's corporate tax rate is relatively high in global terms, which puts it at a comparative disadvantage.	*No change in corporate tax, enhanced efforts to avoid base erosion and profit shifting.*
Value added tax (VAT)	VAT is an efficient tax instrument in terms of administration and collection. Increasing the VAT rate will have a detrimental impact on the discretionary spending of households. Generally, VAT is a regressive tax (i.e. the impact is greatest on the poor), but such an effect is limited by the zero-rating of 19 basic food items and paraffin. Consideration was given to multiple VAT rates (e.g. a higher rate for luxury goods), but the administrative disadvantages were seen to outweigh the benefits.	*VAT rate increased by one percentage point from 14% to 15%.*
Ad valorem duties on luxury goods	Applying ad valorem duties to luxury goods, such as electronic goods, vehicles and cosmetics, among others, instead of a differential VAT rate reduces the complexity of the tax system, while achieving similar outcomes.	*Ad valorem duties on luxury goods increased (e.g. duties on imported motor vehicles raised from 25% to 30%).*

Tax	Consideration	*Outcome*
Estate duty	The Davis Tax Committee recommended an increase in estate duty, which would retain the progressive structure of the tax system.	*The estate duty payable for estates worth more than R30 million are increased to 25%, while a tax of 25% will apply to donations exceeding R30 million per year.*

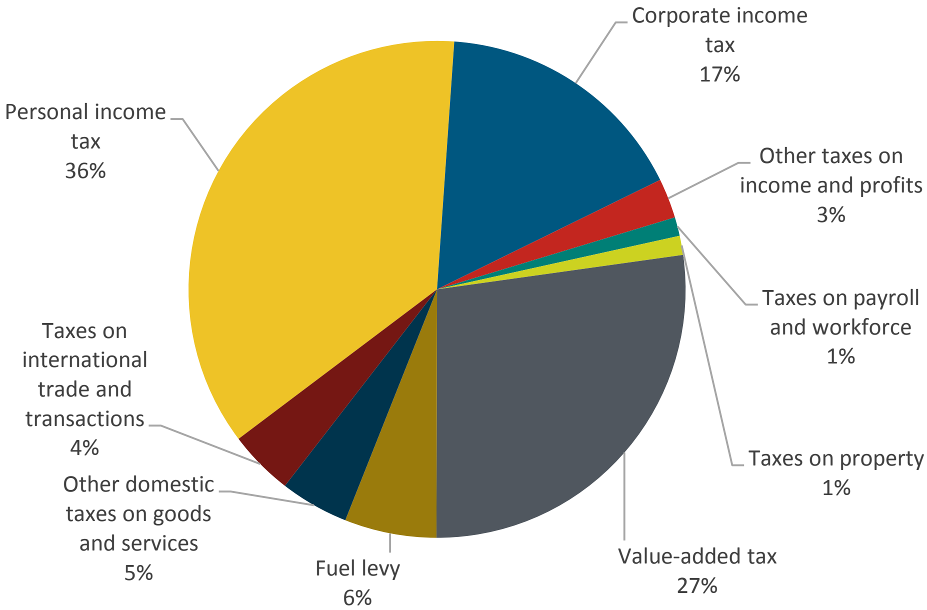
The one percentage point upward adjustment in the Value Added Tax (VAT) rate, which is the first since 1993, is expected to raise an additional R22.9 billion in 2018/19. This tax proposal is likely to be highly controversial due to the impact it will have across the entire population, particularly the poor. The limited adjustments made to personal income tax brackets are projected to contribute an additional R6.8 billion to total revenue. These pertain to income earners below the R555 600 per annum bracket, and amounted to only 3.1%.

The proposed 22c/l increase in the general fuel levy is expected to raise a further R1 billion. Together with the 30c/l hike in the Road Accident Fund levy, this represents a 10.8% increase in the tax component of the overall petrol price, neutralising the reductions in the petrol price in the opening months of 2018. The impact on transportation costs for the poor is likely to be significant, and will be aggravated if fuel prices rise during the course of 2018.

The introduction of the Health Promotion Levy from 1 April 2018, popularly known as the sugar tax, is expected to add R1.9 billion to the fiscus. Alongside proposed increases in excise duties for alcoholic and tobacco products, this new levy is aimed at changing consumer behaviour towards healthier lifestyles.

The overall composition of South Africa's tax revenue collection is still highly dependent on households and their spending activity. This reliance is highlighted in the under-collection of revenue in 2017/18, when weak employment creation, limited wage increases and subdued household spending resulted in substantially lower receipts from personal income tax, VAT and import duties.

Figure 4: Composition of tax revenue in 2018/19



Source: National Treasury

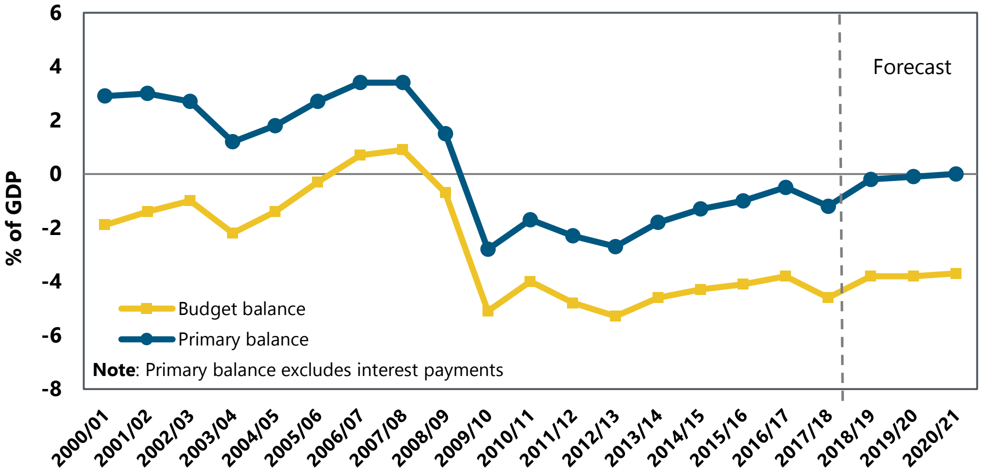
Improving fiscal balances

Efforts to contain government expenditure and to increase revenue collections through various means are expected to result in a smaller budget deficit-to-GDP ratio over the next three years.

Fiscal deficit expected to narrow due to higher revenue collections and cost-cutting measures

The main budget deficit will narrow from an estimated -4.6% of GDP in 2017/18 to -3.7% by the end of the outlook period. In turn, the primary balance, which excludes interest payments, is forecast to return to a relatively neutral position, as a marginal deficit of R0.9 billion is projected for 2020/21. However, the overall funding gap remains quite sizeable at R214.8 billion in 2020/21.

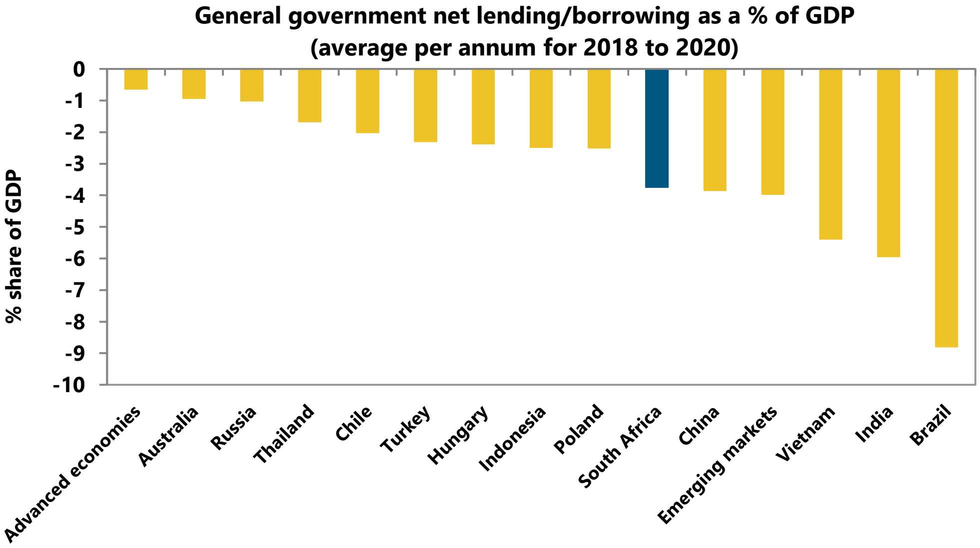
Figure 5: Budget deficit to show a gradual improvement



Source: National Treasury

South Africa's anticipated fiscal deficit over the next three years is more or less on par with the average for emerging markets and developing economies. Although the deficit is substantially larger than those of emerging markets such as Thailand, Turkey, Hungary and Chile, it is lower than those of Brazil and India, among others.

Figure 6: South Africa's budget deficit is roughly in line with the average for emerging markets



Source: IDC, compiled from IMF data

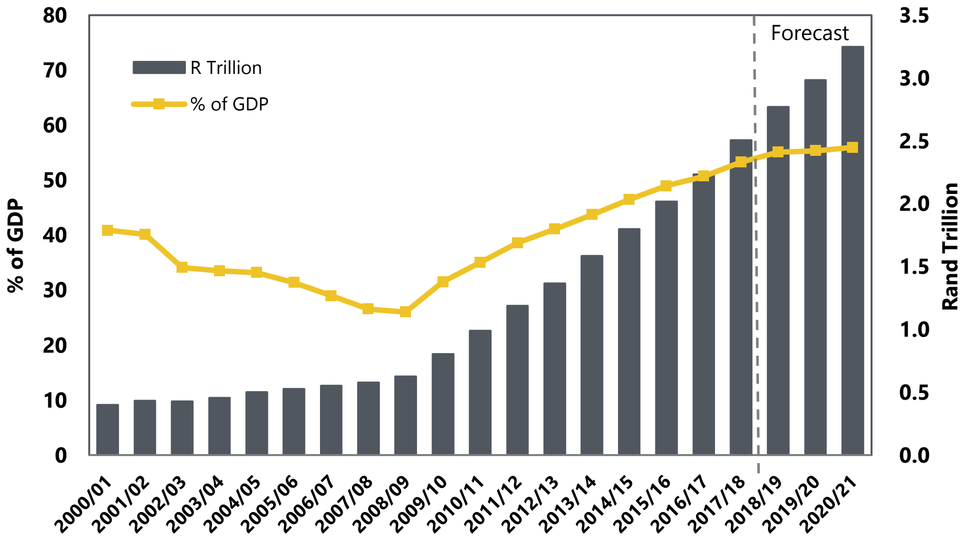
Stabilising government debt

Government debt ratio to stabilise, more needs to be done

An improved fiscal position results in a slower rate of increase in the borrowing requirement relative to what had been projected in the October 2017 MTBPS and, by implication, in lower ratios of gross government debt to GDP going forward.

Gross loan debt is projected to rise to R3.25 trillion by 2020/21, an increase of 29.7% relative to the 2017/18 number. As a percentage of GDP, it will rise from 53.3% in the current fiscal year to 56% by the end of the period, which is much lower than the 60% forecast in the MTBPS.

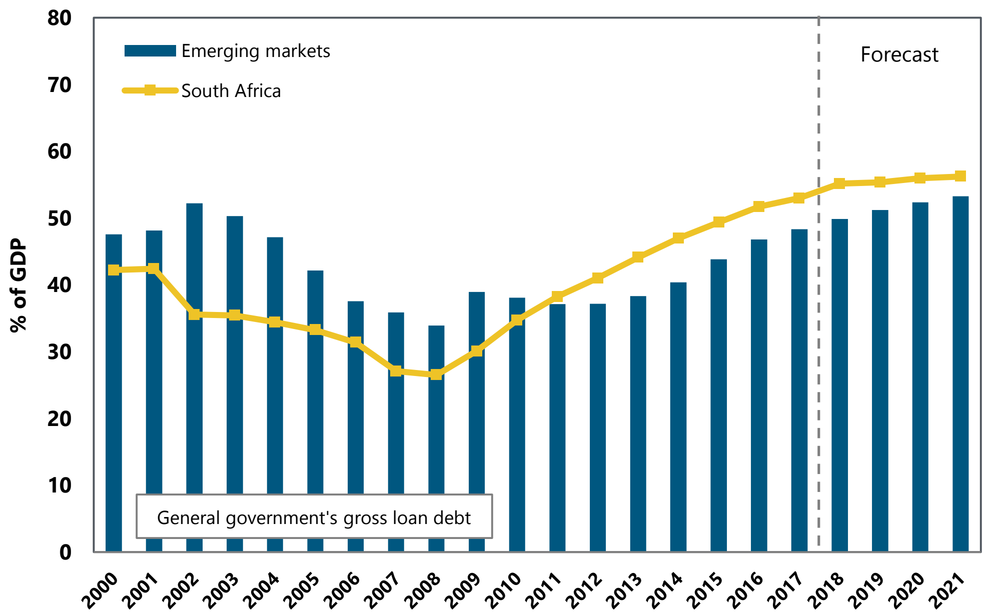
Figure 7: Government's gross loan debt-to-GDP ratio set to stabilise over the outlook period



Source: National Treasury

However, from a global perspective, South Africa's debt-to-GDP ratio exceeds the average for emerging markets, with the gap expected to prevail over the next few years.

Figure 8: South Africa's debt situation worsened from a global perspective



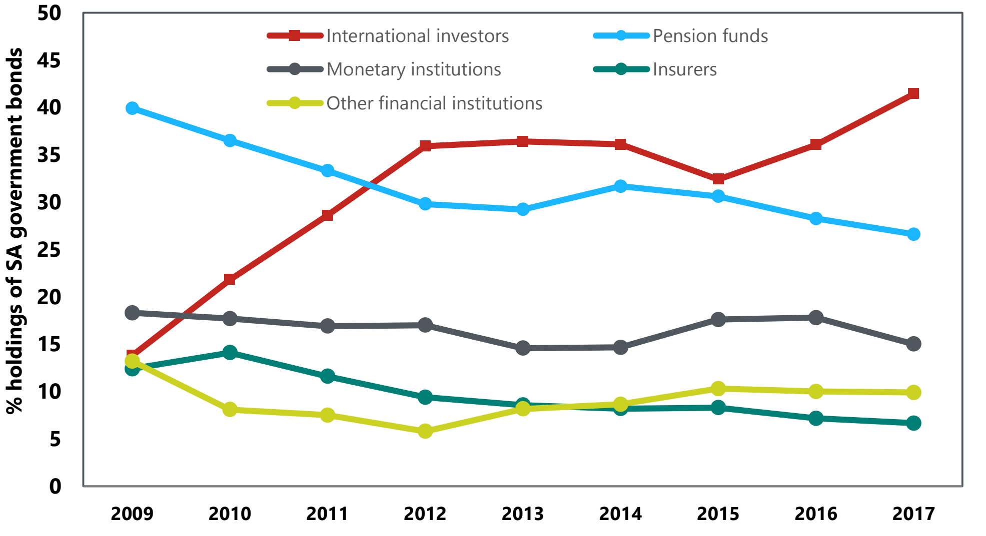
Source: IDC, compiled from IMF data, Budget Review 2018 for South Africa's forecasts

Government will continue to rely mainly on domestic capital markets for its borrowing requirements. The funding requirement for 2018/19 is projected at R224.2 billion, peaking at R301.5 billion in the following year, before declining to R282.3 billion in 2020/21. Domestic debt is anticipated to account for just over 90% of overall gross loan debt, with the remainder being foreign debt.

Due to the substantial debt burden, debt-servicing costs are on the rise. In the 2017/18 fiscal year, overall debt-service payments are estimated at R163.2 billion, increasing to R213.9 billion by the end of the outlook period. Over the next three years, debt-servicing costs will average 13.8% of total revenue, compared to 11.9% in 2014/15. However, the pace of increase in debt-service costs will decelerate from 13.7% in 2016/17 to 8.2% by 2020/21.

International investors have become increasingly involved in the domestic bond market, holding 41.4% of South African government bonds at the end of 2017. This is a significant change from the 13.8% share recorded in 2009 and highlights the importance of retaining an investment grade rating from Moody's for South Africa's local currency denominated debt.

Figure 9: International investors have significantly increased their holdings of government bonds



Source: National Treasury

Impact on individuals

Increase in the VAT rate

The VAT rate will rise from 14% to 15% with effect from 1 April 2018. The additional VAT on purchases of goods or services will have a significant impact on the already tight budgets of most households.

Although the VAT proposal will increase the cost of living for households, the zero-rating on 19 basic food items and paraffin cushions the impact on the poor. This should also be seen within the context of 30% of the highest earning households contributing 85% of VAT revenue.

Limited adjustment to tax brackets

Limited adjustments will be effected to the personal income tax brackets. The highest four income tax brackets will remain unchanged, whereas the lowest three income tax brackets will be adjusted with a rate below inflation (i.e. by 3.1%). Contrary to what had been expected, there was no increase in the maximum marginal tax rate (i.e. 45%).

Table 2 - Income tax payable in 2018/19 (taxpayers below age 65)

Taxable income (Rand)	2017/18 rates (Rand)	Proposed rates for 2018/19 (Rand)	Tax reduction (Rand)	% change (2018/19 vs 2017/18)	Average tax rate (2017/18)	Average tax rate (2018/19)
85 000	1 665	1 233	-432	-25.95%	2.0%	1.5%
90 000	2 565	2 133	-432	-16.84%	2.9%	2.4%
100 000	4 365	3 933	-432	-9.90%	4.4%	3.9%
120 000	7 965	7 533	-432	-5.42%	6.6%	6.3%
150 000	13 365	12 933	-432	-3.23%	8.9%	8.6%
200 000	23 174	22 265	-909	-3.92%	11.6%	11.1%
250 000	36 174	35 265	-909	-2.51%	14.5%	14.1%
300 000	49 347	48 265	-1 082	-2.19%	16.4%	16.1%
400 000	80 347	78 972	-1 375	-1.71%	20.1%	19.7%
500 000	115 824	113 807	-2 017	-1.74%	23.2%	22.8%
750 000	212 490	210 473	-2 017	-0.95%	28.3%	28.1%
1 000 000	314 990	312 973	-2 017	-0.64%	31.5%	31.3%
1 500 000	519 990	517 973	-2 017	-0.39%	34.7%	34.5%
2 000 000	744 990	742 973	-2 017	-0.27%	37.2%	37.1%

Source: National Treasury

Tax rebates	**Tax-free thresholds**	**Tax-free annual interest income**
Primary: R14 067 (2017: R13 635)	Age < 65: R78 150 (2017: R75 750)	Age < 65: R23 800 (2017: R23 800)
Secondary: R7 713 (2017: R7 479)	Age 65 and over: R121 000 (2017: R117 300)	Age 65 and over: R34 500 (2017: R34 500)
Tertiary: R2 574 (2017: R2 493)	Age 75 and over: R135 300 (2017: R131 150)	

Source: National Treasury

Increase in estate duty and donations tax

The estate duty, which is currently levied at 20%, will increase to 25% for estates above R30 million, effective from 1 March 2018. To prevent avoidance of the higher estate duty through donations, all donations collectively amounting to R30 million or more in one tax year will also be taxed at 25%, instead of 20%. However, the first R100 000 donated by an individual in any tax year remains exempt from donations tax.

Plastic bag levy increases

The levy on plastic bags will increase by 50% to 12 cents per bag effective 1 April 2018.

Transportation related tax adjustments

South Africans will again be hard-hit by another increase in the general fuel levy and Road Accident Fund levy as from 4 April 2018. Government proposes to increase the general fuel levy by 22c/litre to R3.37 per/litre of 93 octane petrol and the Road Accident Fund levy by 30c/litre to R1.93/litre. The small customs and excise levy of 0.4c/litre remains the same. South Africans will therefore be paying a total of R5.34 (2017: R4.82) in taxes per litre of petrol and R5.19 (2017: R4.67) per litre of diesel. The impact will be felt directly and/or indirectly by all, whether motorists or public transport users, as well as through increases in the prices of goods and services due to the associated inflationary impact.

The vehicle emissions tax will be increased to R110 for every gram above 120 gCO_2/km for passenger vehicles and R150 for every gram above 175 gCO_2/km for double cab vehicles, effective 1 April 2018.

Higher ad valorem excise duties on luxury goods

Luxury goods consumed mainly by wealthier households (e.g. cosmetics, electronics, etc.) will be subject to higher ad valorem excise duties. The maximum ad valorem excise duty for motor vehicles will rise from 25% to 30% effective 1 April 2018.

“Smart phones” will be reclassified as cellular phones to ensure that they attract ad valorem excise duties, and the ad valorem excise duty rate will increase to 9%. Government will consult with stakeholders on a proposal to replace the flat rate applicable to cell phones with a progressive rate based on their value.

Higher sin taxes

Specific excise duties on alcoholic beverages will increase by between 6% and 10%, while specific excise duties on tobacco products will rise by 8.5%. Some of the most notable increases are:

Malt beer: 15c per 340ml can

Unfortified wine: 23c per 750ml bottle

Fortified wine: 28c per 750ml bottle

Ciders and alcoholic fruit beverages: 15c per 340ml bottle

Sparkling wine: 73c per 750ml bottle

Cigarettes: R1.22 per packet of 20 cigarettes

Medical tax credits adjustment below inflation

Medical tax credits will be adjusted below inflation over the next three years to fund additional expenditure for National Health Insurance (NHI).

Monthly medical tax credits for medical scheme contributions will increase to R310 (2017: R303) for the first two beneficiaries and R209 (2017: R204) for each additional one (effective 1 March 2018).

The current medical tax credit applicable to contributions to an approved medical scheme is susceptible to abuse. SARS noted that some taxpayers are excessively benefiting from the rebate, specifically in instances where multiple taxpayers contribute toward the medical scheme or expenses of another person (for example, adult children jointly contributing to their elderly mother's medical scheme). It is proposed that where taxpayers carry a share of the medical scheme, contribution or medical cost, the medical tax credit should be apportioned between the various contributors.

Removal of fringe tax benefits for preferential interest rates on housing loans to employees

To promote the provision of housing, it is proposed that the fringe benefit tax applicable on loans made by employers to employees earning less than R250 000 per annum be removed. This is specifically for loans at preferential interest rates and for a value of less than R450 000, if such a loan is used solely for housing.

Retirement reforms

The contributions to retirement funds situated outside of South Africa will be reviewed to ensure that these will be deductible only where the benefits (currently exempt) are taxable (taking into consideration the interaction between the double taxation agreements and other provisions of the Income Tax Act).

The tax treatment of different types of retirement fund withdrawals upon emigration will be aligned. Currently, individuals can withdraw the full value of their retirement annuity, after paying the applicable taxes, but not the proceeds of a preservation fund.

Legislation will be amended to allow transfers from pension and provident funds, after the retirement date of an employee, to pension preservation or provident preservations funds. The 2017 amendments only provide for transfers to a retirement annuity fund.

Unintended tax consequences arose for certain members from the transfer of retirement funds between funds at the same employer. The legislation will be amended retrospectively to correct the unintended tax liabilities.

The above mentioned retirement reforms are aimed at treating all fund types equally.

"Official rate of interest" to be changed

The "official rate of interest", currently the repurchase ("repo") rate plus 100 basis points, which is used to quantify the fringe benefits associated with low interest rate loans provided by employers to employees, as well as the amount of a donation for low interest loans to a trust by connected persons, will be increased to a level closer to the prime rate of interest. This will have an adverse effect on employees as the quantum of the fringe benefits will increase, resulting in a higher tax payment.

Impact on companies

Increase in the VAT rate

The increase in the VAT rate from 14% to 15% with effect from 1 April 2018 will have an adverse effect on the cash flow of businesses. The implementation of the VAT increase for certain businesses may be complex (and costly), while the implementation date of 1 April 2018 does not leave much time to allow businesses to effect the necessary system changes and enhancements.

Tax incentives to complement growth initiatives

Six special economic zones – namely, Coega, Dube Trade Port, East London, Maluti-a-Phofung, Richards Bay and Saldanha Bay - will be approved by the Minister of Finance to benefit from attractive and additional tax benefits with the aim of encouraging investments in the manufacturing and tradable services sectors to support exports, economic growth and job creation.

The attractive benefits will include a reduced corporate tax rate for qualifying firms and an employment tax incentive for workers of all ages. However, legislation will be reviewed to prevent local companies from shifting their activities to benefit from a reduced tax liability.

All tax incentives and grants are currently being reviewed by the Department of Planning, Monitoring and Evaluation to ensure that they are aligned with inclusive growth objectives. If not, they will be redesigned or removed.

The research and development incentive, which allows taxpayers to deduct 150% of expenditure on qualifying projects, will be revised further to remove aspects of the legislation that created unnecessary complexity.

The employment tax incentive, which expires on 28 February 2019, will be reviewed. It appears to have had a consistently positive impact on smaller firms, and a lower to negative impact on large firms.

The beneficiaries of the tax incentive for venture capital companies, which is aimed at encouraging investment in small- to medium-sized business, have grown from one company in 2008 to more than 90 registered companies (with a total investment of R2.5 billion) at present. However, administrative and technical issues with regard to the applicable legislation are obstructing increased uptake. It is proposed that the rules relating to the incentive be amended.

Write-off period for electronic communication cables to be reduced

Companies that provide telecommunications infrastructure are currently allowed to write off lines or cables used for transmission of electronic communications over a period of 15 years under section 11D of the Income Tax Act.

It is proposed that the write-off period for electronic communication lines and fibre optic cables be reduced. Government intends to align the tax system with technological advances (moving from copper to fibre optic cables) and international practice, and will consider further alignment between taxpayers that own these assets and those with the right to use them.

It is expected that a more beneficial tax allowance system will boost additional investment in fibre optic infrastructure, which in turn would stimulate business growth.

VAT on E-services amended

Regulations prescribing foreign electronic services subject to VAT and other supporting amendments will be broadened to include cloud computing and other online services. It is proposed to expand the current ambit of "electronic services" to include "any services supplied by means of an electronic agent, electronic communication or the internet for any consideration". The result is that non-resident suppliers of electronic services, except for telecommunication and educational services supplied by a person regulated by an educational authority in a foreign country, are required to register for VAT in South Africa where the value of the sales exceeds R50 000 in any consecutive 12-month period.

Further amendments are proposed for intermediaries and platforms to register as vendors and to account for the VAT on sales made through such platforms, provided that the platform/intermediary facilitates the supply and is responsible for issuing the invoice and collection of the payment. These amendments are proposed to come into effect on 1 October 2018.

Supporting the economic recovery and transformation

Through various initiatives, policy support programmes, incentives and partnerships with key stakeholders, the South African government continues to support economic expansion, inclusive growth and transformation. Some of the key initiatives are summarised below.

Public-sector infrastructure spending and procurement

Relatively high levels of capital spending are still envisaged over the three-year period to 2020/21. Public sector expenditure on infrastructure is expected to total R834.1 billion over this period, compared to an estimated R771.2 billion over the three-year period to 2017/18. However, in real terms (based on IDC calculations), overall infrastructure spending is forecast to decline by 0.5% per annum, on average, over the MTEF period.

Public sector spend on infrastructure to total R834.1 billion over MTEF

Nevertheless, in light of the drought conditions that are still affecting various parts of the country, investment spending on water and sanitation infrastructure is expected to rise at a fast pace of 6.3% per year, on average, over this period. The transport and logistics sector should see the highest growth in spending on infrastructure, at an average of 8.3% per year.

Table 3 - Public-sector infrastructure expenditure and estimates

Investment area	2017/18 estimate	MTEF forecasts (R billion)			MTEF period		
	R billion	2018/19	2019/20	2020/21	Average annual growth	Total R billion	% of total
Transport and logistics	84.9	86.9	93.7	107.6	8.3	288.2	34.5
Energy	62.0	74.1	81.1	63.6	2.5	218.8	26.2
Water and sanitation	35.6	36.9	38.5	42.8	6.3	118.2	14.2
Other economic services	6.7	4.6	3.2	3.0	-22.4	10.8	1.3
Health	11.1	10.4	10.8	11.4	1.0	32.6	3.9
Education	18.7	15.5	15.6	15.8	-5.0	46.9	5.6
Human settlements	20.0	18.2	18.8	20.1	0.5	57.1	6.8
Other social services	11.1	10.0	10.0	10.6	-1.4	30.6	3.7
Administration services	10.0	9.5	10.5	10.9	3.1	31.0	3.7
Total	260.1	266.0	282.3	285.8	3.2	834.1	100.0
% change on previous year		2.3	6.1	1.2			

Source: National Treasury and IDC calculations

Investment spending in the energy sector is projected to decline sharply from 2019/20 onward, as "big-ticket" projects such as the Medupi and Kusile power plants reach completion. Approximately 75% of the total public sector spending on infrastructure is directed towards transport, energy and water infrastructure, which should contribute to increased localised production capacity and other transformational objectives.

REIPPPP set to resume

Furthermore, the Budget envisages the conclusion of outstanding power-purchase agreements with independent power producers. Renewable energy projects added about 3 774 MW to the grid between 2011 and December 2017, while a total of 6 426 MW has already been procured through seven bid windows. More renewable energy projects are expected to be rolled out, given government's commitment to procure some 14 725 MW in the transition to a low-carbon economy.

Adding further impetus to public infrastructure spending, the budget facility for multi-year large infrastructure projects, which began operating in 2017, should improve efficiencies around the management of large infrastructure projects, particularly with regard to full life-cycle costs. Thirty-eight projects have been technically assessed by this facility and are awaiting implementation.

Sectoral and transformation support

Considerable allocations made in support of sector development and transformation

Allocations and initiatives in support of economic development and industrialisation include:

- Agriculture and rural development
  - Comprehensive Agricultural Support Programme: R5.6 billion allocated over the MTEF period for 435 000 smallholder and subsistence farmers, providing equipment, fencing, fertilisers and seedlings, as well as for repairs to flood-damaged infrastructure.
  - One Household One Hectare initiative: R4.6 billion for the provision of land to the landless, the establishment of agri-parks in district municipalities, as well as for recapitalising existing projects. Provision of mechanised irrigation, inputs and mentorships, to make the redistributed land productive and profitable.
  - Accelerating land restitution claims and land redistribution: allocations of R10.8 billion and R8.8 billion, respectively.
  - Agro-processing support scheme: R1.5 billion over the MTEF period to stimulate investment in the agro-processing sector, including beneficiation activities.
- Construction sector
  - Tirisano Construction Fund Trust: estimated contribution of R490 million over the MTEF period and R1.5 billion over 12 years, having started in 2017. The fund is expected to be managed by the IDC for the benefit of construction firms owned and managed by black people, as well as for bursaries in related industries.
- Other sector-related issues
  - An ICT allocation of R557.6 million to connect schools and public buildings to high-speed internet services.
  - Broadcasting Digital Migration Programme: about 87 000 set-top boxes to be delivered over the MTEF period.
  - Ensuring an enabling environment in the mining sector by addressing bottlenecks in the finalisation of the Mineral and Petroleum Resources Development Act and by reviewing the Mining Charter through a consultative process.
  - Licensing spectrum in the telecommunications sector, so as to improve access to stable, affordable information and communication technology.

SME and entrepreneurial development

In support of small and medium enterprises (SMEs) as well as to promote entrepreneurship, various measures are being put in place, while those previously announced are being implemented, including:

- A R2.1 billion allocation to the Enterprise Development Fund over the MTEF period, for the benefit of SMEs in the early start-up phase. The fund is expected to begin operating in 2019/20.
- The CEO Initiative Fund with commitments of R1.4 billion to support high potential SMEs.
- R1 billion allocated to the Small Business and Innovation Fund in 2019/20. This fund is targeted at businesses in the start-up phase, including for the commercialisation of local innovations.
- Revised public procurement regulations to enable designated groups, including small businesses, to participate in public procurement for contracts above R30 million. The Public Procurement Bill is awaiting Cabinet approval, which is expected in March 2018.
- The Black Business Supplier Development Programme is expected to continue over the MTEF period. This consists of a grant to small enterprises to acquire tools, machinery, equipment and business development training up to a maximum of R1 million per applicant.
- The R100 billion Black Business Growth Fund, which is aimed at assisting black entrepreneurs to finance large deals and was created through the amended Financial Sector Codes.

Industrial development and special economic zones

Although some incentives are under review, government has made allocations over the MTEF period for a number of incentives aimed at improving industrial capacity, enhancing competitiveness and complementing growth initiatives. R18.8 billion has been allocated for these purposes, including:

- R4.9 billion for industrial infrastructure in special economic zones.
- Additional tax incentives, including lower corporate tax rates and employment tax incentives for six special economic zones, namely Coega, Dube Trade Port, East London, Maluti-a-Phofung, Richards Bay and Saldanha Bay.
- The designation of three additional SEZs, specifically in Atlantis, Nkomazi and Mogwase, which will focus on renewable energy and technology, agro-processing, logistics and mineral beneficiation.

Reforming governance of SOEs to ensure sustainability

In an endeavour to ensure the sustainability of SOEs, government will deal decisively with governance and financial challenges in several entities, appointing competent board members and executives. A judicial commission of inquiry has been appointed to investigate allegations of state capture and corruption in the public sector. The budget notes that addressing governance concerns will significantly improve the confidence of stakeholders and consequently improve the performance and sustainability of the SOEs.

To strengthen the capital structures of the SOEs, private sector participation will be required in various projects. The budget does not provide for bail-outs of SOEs, although the government may be required to provide financial support in certain instances. For SOEs facing severe financial constraints, the recapitalisation will be undertaken in a budget-neutral manner, mainly through the disposal of government assets and strategic equity partnerships. In this regard, a government-conducted property audit has revealed that the state owns 195 000 properties with an estimated value of R40 billon.

To improve government's contingent liability exposure, the National Treasury is developing a framework to outline the process of reducing the current levels of guarantees and determining consequences of non-compliance with guarantee conditions.

Will the budget contribute to averting further sovereign credit rating downgrades?

The potential for further downgrades of South Africa's sovereign credit ratings loomed large in the preparations of the Budget and surely influenced the choices made. A clear commitment to fiscal consolidation and sustainable debt management were crucial in this regard. Importantly, the negative sentiment created by the October 2017 MTBPS had to be reversed.

With Moody's being the only ratings agency that has retained an investment grade rating for South Africa's local currency denominated debt, which is necessary for its inclusion in the Citi World Government Bond Index, the results of its ongoing review are very important for the economy. In considering its future ratings for South Africa, Moody's is seeking comfort that the economy's performance, its fiscal standing and management, and the country's institutions are not weakened further.

The economic outlook has improved in the three months since Moody's placed South Africa on review for a downgrade. Third quarter economic growth data highlighted the start of a potential recovery. Subsequently, growth forecasts have been revised upwards by most local and foreign analysts, with major improvements in the political landscape as a key factor. The expected improvement in growth is predicated on a recovery in consumer, business and investor sentiment following the ANC's elective conference.

The action taken to improve governance at Eskom, combined with the drive to bring those associated with state capture to book, as an integral part of the fight against corruption, are very important in reversing institutional decline.

The hard choices made in the budget demonstrate government's commitment to sustainable fiscal management, taking into account the socio-economic challenges faced by South Africa.

President Ramaphosa recently highlighted, in his State of the Nation Address, the importance of policy certainty and consistency. As such, he indicated that amendments to the Minerals and Petroleum Resources Development Act will soon be tabled in Parliament, while the consultative process for the review of the Mining Charter will resume shortly.

The above-mentioned developments and factors are, in our view, likely to support the retention of an investment grade rating for South Africa's local currency denominated debt by Moody's in its forthcoming review, although a negative outlook might be maintained for the time being.

The IDC and the Budget

- The Budget 2018 is likely to bolster business and investor sentiment further. This should translate into positive economic benefits, including increased investment, business and consumer spending, higher production activity and job creation.
- An improved macroeconomic outlook should have beneficial impacts for the IDC through increased demand for funding, as well as by improving the ability of business partners to service existing funding facilities.

- In light of the tax incentives channelled towards Special Economic Zones, considerable opportunities are likely to arise for business enterprises seeking to maximise returns from export-oriented investments. This should expand the pipeline of potential financing opportunities for IDC, assisting the corporation in delivering on its industrial development mandate.

- IDC's funding activity is also likely to benefit from improved circumstances in various sectors, including:
  - Agriculture and agro-processing, due to increased efforts to support land redistribution, increase productivity, the development of black commercial farmers, the establishment of agri-parks, and the leveraging opportunities emanating from the Agro-Processing Support Scheme.
  - Greater policy certainty and consistency in the mining sector.
  - The ICT sector will benefit from the accelerated write-off of telecommunication lines and cables, as well as from the roll-out of set-top boxes.
  - The continuation of the REIPPP programme.
  - The positive impact of the Tirisano Construction Fund Trust on the construction sector's concentration and development potential.
  - The retention of major manufacturing incentives, for the time being.

- The IDC Group's small business development endeavours should benefit from the Small Business and Innovation Fund, the Enterprise Development Fund for SMEs in the start-up phase, as well as the funding emanating from the CEO's Initiative.

- Infrastructure development by the public sector at large will continue to provide business opportunities through localisation initiatives and product designations. Moreover, the IDC's developmental objectives with respect to women- and youth-owned businesses, township and rural enterprises and other designated groups will benefit from public sector support for their participation in especially procurement programmes above R30 million.

- Although details are not yet available, the sizeable Black Business Growth Fund, which will be aimed at assisting black entrepreneurs to finance large deals, should translate into considerable co-financing opportunities for the IDC in pursuit of its transformation objectives.

- More favourable perceptions and assessments of South Africa's investment environment, which could potentially also be reflected in future credit ratings, should translate into an expanding financing pipeline for the IDC, increased investor interest in partnering, as well as in lower costs of funding for the corporation.

Research and Information Department

Legal Services Department

22 February 2018

Annexure I: Other pertinent tax proposals

- To improve tax morality, a commission of enquiry will be established by the President into the functioning of and governance at SARS. It will also seek to improve the accountability of SARS and strengthen the operational independence of the Tax Ombud.

- SARS will release a discussion paper on the potential use of electronic fiscal devices to help revenue administration by monitoring business transactions. Over time, the impact of this intervention will have a major effect on compliance.

- SARS will soon release a discussion document dealing with the tax treatment of excessive debt financing of companies so as to protect and ensure a sustainable corporate tax base.

- Currently the share buy-back and dividend stripping anti-avoidance measures affect some legitimate transactions and arrangements adversely, especially where corporate reorganisation rules apply. It is proposed that these anti-avoidance rules, as well as rules dealing with preference shares be reviewed and clarified.

- The criteria for determining the section 11(j) doubtful debt allowance will be included in the Income Tax Act and not set out in a public notice issued by the Commissioner as previously intended.

- Amounts (other than capital amounts) received by a collective investment scheme are taxable in the portfolio of the collective investment scheme unless they are distributed to participatory interest holders within 12 months of accrual. The tax treatment of amounts received by collective investment schemes that are trading frequently and arguing, contrary to current case law, that the profits are of a capital nature, will be clarified.

- The definition of "international shipping income" will be reviewed to provide for a situation where unintended operational issues necessitate (e.g. a South African ship undergoing maintenance, experiencing port delays or fleet rotations) South African operators to use a replacement ship on a short-term basis, and no South African ship is available. This will prevent a situation where the South African operator will lose the tax exemption if the replacement ship is not a South African ship.

- It is proposed that no dividend tax returns need to be submitted by persons who receive exempt dividends.

- The correction of a tax invoice by a vendor to enable a recipient thereof to use it to deduct input tax (where it did not meet the requirements of a tax invoice), will not be regarded as an offence provided the issuer cancels the original invoice and reissues an invoice with the correct information. A proper audit trail will also need to be maintained.

- An amendment is proposed to provide legal certainty for the collection of VAT from all branches and divisions of a juristic person. That follows the fact that the VAT legislation allows a vendor to register branches or divisions of a juristic person separately and the legislation regards such branches or divisions as separate enterprises, even though they are operated by a single person.

- The legislation will be amended to address the income tax and VAT tax treatment of cryptocurrency transactions, which pose risks to the income tax system as they are extremely volatile. Their sustainability is also uncertain and their supply can cause administrative difficulties in the VAT system.

- A discussion document outlining design options for the proposed acid mine drainage levy to make polluters pay for the cost of environmental damages and to help fund treatment of acid mine water will be published.

- An environmental fiscal reform policy brief will be published soon. The paper will examine fiscal and regulatory options to improve water resource management, mitigate the emission of pollutants and reduce waste.

- The Carbon Tax Bill will be enacted before the end of 2018 and implemented with effect from 1 January 2019.