



# Balancing today's demands with tomorrow's opportunities

Budget 2021/22

Pre-Budget Commentary  
South Africa



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# National Budget:

## Tough decisions may be needed to deal with South Africa's fiscal crisis



By **Delia Ndlovu**

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### South Africa needs to continue on a path of fiscal sustainability in order to accelerate economic growth, especially in the wake of the COVID-19 pandemic.

South Africa was already facing a fiscal crisis before the COVID-19 pandemic. Stagnant economic growth, mounting debt and unemployment have characterised recent years. The government intends to close deficits in public finances and lower borrowings as stated in the MTBPS in October. We expect Finance Minister Tito Mboweni to highlight the following themes in the upcoming National Budget Speech, which is expected to be on 24 February:

#### Closing deficits in public finances and lowering borrowings

Closing deficits in public finances and lowering borrowings is likely to be one of the biggest issues that the Finance Minister is grappling with. In the 2020 Medium Term Budget Policy Statement (MTBPS) outlined in October last year, the Finance Minister outlined that he intends to implement large spending reductions of about R300 billion in the next three years, combined with tax increases. In the MTBPS, budget deficit was predicted to peak at 15.7% in 2020/21

but to improve to a figure closer to 7.3% in 2023/24. Debt is projected to stabilise at 95.3% of GDP by 2025/26.

Government should be able to achieve some savings due to winning a recent court case, which allows it not to implement the final year of the 2018 wage agreement. This would start to contribute positively toward reducing the public sector wage bill, which the Finance Minister mentioned in the MTBPS.

#### Increasing tax revenues

Minister Mboweni has previously stated that he is aiming to generate tax revenue of R5 billion for the 2022 fiscal year and R40 billion over the next four years. Essentially, the main budget revenue to GDP ratio will improve from the current 22.6% to 24.9% of GDP by fiscal year 2024.

Although the MTBPS forecasted a large deficit in tax revenue collection of R312.8 billion, and we are hopeful that this shortfall will decrease by February. This

in light of signs that tax collections are starting to improve as for the first time this fiscal year, the monthly revenue collections in November and December showed an increase in collections from prior year. If this trend continues, the amount of tax hikes required may be reduced.

South Africa is already heavily taxed, with a small percentage of the population bearing a disproportionate share of the country's tax burden. Increasing tax rates would place the already overtaxed tax-base under immense strain and could prove counterproductive to the economy.

Other ways to raise additional tax revenue are being explored such as the once-off 'solidarity tax', or 'wealth' tax. In our view, there is a low probability of government implementing these types of taxes to fund the roll out of the vaccine. Other funding options are likely to be explored first to avoid putting strain on the tax-base. At present details remain vague as to how such a tax would be implemented. If this were to be implemented, it would likely only affect individuals in the top income tax brackets and it would be more palatable if it is seen as temporary measure based on the social compact to limit the effects of COVID-19.

Increasing taxes/duties on alcohol and tobacco is another option. However, the recent bans on alcohol and tobacco

has obviously negatively impacted tax collections and it will not be possible to recover the taxes foregone as a result of these bans. Any future bans would also impact tax collection, so relying on increasing taxes in this area to drive revenue may be inadvisable, depending on whether government will again ban alcohol if COVID numbers increase.

Preserving jobs and, if possible, creating employment, is an absolute imperative for tax revenue collection. Tax on individuals is by far the biggest contributor to tax revenue. The second biggest contributor is VAT – which mainly comprises consumer spending by individuals. Therefore, loss of employment impacts directly on both the biggest and second biggest contributors to our tax base.

### COVID-19 vaccine rollout

It is uncertain how the anticipated vaccine rollout will be funded and this is likely to

be highlighted in the Minister's upcoming Budget Speech. Funding options appear to be limited to either further curbing and reprioritisation of spending or considering a once off "solidarity" tax as a temporary measure.

Reducing spending across departments to reprioritise this spending to fund vaccines may, however, adversely affect economic growth and welfare over time.

### Improving revenue collection capabilities

We believe that improving tax collection methods rather than further burdening compliant taxpayers will help to address the contraction in tax revenue. Increasing revenue collection capabilities should be an important focus point for the South African Revenue Service (SARS). Leveraging digital technologies can assist with freeing-up capacity in order to focus on areas where the tax system is being exploited.

### Stabilising state-owned enterprises (SOEs)

As SOEs will be primarily responsible for the successful rollout of the public infrastructure programme, stabilising them is one of government's top priorities. In the 2020 financial year, a number of bailouts were made to struggling state owned entities. In the 2020 Budget Speech, Eskom remained the top priority with a stable electricity supply. Provisions to get Eskom back on track will require continued financial investment.

### Conclusion

Whilst we are hopeful for a better year ahead for South Africa, we still have a long road to travel on the path of fiscal sustainability in order to accelerate economic growth.



# Economic outlook: South Africa's difficult road to recovery



By **Hannah Marais**

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Over the past few years, South Africa has struggled with weak growth, rising unemployment and mounting public debt. Even before the COVID-19 pandemic, recessionary pressures were acute, with the economy in a technical recession, given two consecutive quarters of negative growth in the latter half of 2019.

COVID-19 worsened the already challenging economic outlook, further exposing deep structural divides in the economy. With strict lockdown restrictions in place since end-March 2020, South Africa prioritised its response to the health crisis by aiming to save as many lives as possible. This saw the country face an almost unique situation in its history – economic activity faced a system-wide shock from both supply and demand sides, coming to a complete halt for a number of weeks in the second quarter across many sectors. Real GDP dropped by 51% quarter-on-quarter (seasonally adjusted and annualised) in Q2 of 2020, after a 1.8% quarter-on-quarter (seasonally adjusted and annualised) contraction in Q1.<sup>1</sup>

According to data released by Statistics South Africa, the economy-wide slowdown was most felt in the manufacturing sector – which contracted 74.9% quarter-on-quarter (seasonally adjusted and annualised) and made the largest contribution to the overall slowdown. The second-largest contribution stemmed from the trade and accommodation sector, which contracted by 67.6% quarter-on-quarter (seasonally

adjusted and annualised). Thereafter was the transport sector, down 67.9% quarter-on-quarter (seasonally adjusted and annualised). The agricultural sector was the only one that posted growth, albeit marginal.<sup>2</sup>

Household spending saw a similar slump given curfews and limitations on movement, as well as lockdown restrictions on retail, leisure, and travel sectors. The biggest spending knocks were seen in semi-durable and durable goods.<sup>3</sup>

Worker layoffs were another adverse result. South Africa's unemployment rate (narrow definition) increased to a record high of 30.8% in Q3 2020, after a record total 2.2 million jobs lost between April and June 2020.<sup>4</sup>

While consumers regained some confidence in Q3 as parts of the economy opened up, consumer confidence remained in negative territory.<sup>5</sup> Deloitte research in December 2020 showed that South African consumers continue to have concerns about making upcoming payments, are delaying large purchases or are worried about losing their job.<sup>6</sup>

Nonetheless, some green shoots were sprouting from the bleak economic landscape in the second half of the year, confirmed by data releases towards the end of the year. In Q3 2020, the South African economy grew by 66.1% quarter-on-quarter (seasonally adjusted and annualised)<sup>7</sup> – an encouraging sign

following the record contraction a few months earlier, although Q4 2020 and Q1 2021 are expected to see flatter growth, particularly with the onset of the second wave of infections and new, although less restrictive, lockdown measures in place since the latter part of December 2020.

Despite this, the economic fallout for 2020 is expected to be severe, with South Africa's National Treasury back in October 2020 expecting a real GDP contraction of -7.8% in 2020.<sup>8</sup> More recently published estimates by the South African Reserve Bank (SARB) are somewhat less pessimistic – the bank revised the forecasted growth contraction upward, to -7.1%.<sup>9</sup>

**“The most immediate challenge now to reviving economic activity in South Africa is the access to funding and distribution of vaccines.”**

National Treasury's October-released projections to 2023 forecast a rebound in GDP growth of 3.3% in 2021 from the sharp contraction in 2020, with growth moderating thereafter (1.7% and 1.5% for 2022 and 2023 respectively).<sup>10</sup> The SARB's more recent (January 2021) estimates also continue to see a still muted yet marginally more upbeat growth path for 2021 at 3.6%, moderating to 2.4% in 2022.<sup>11</sup>

Given the magnitude of the expected contraction in an already-weak economy, the need for concerted action to transition onto a path of economic recovery is urgent. Policy tools, such as the government's emergency fiscal stimulus and an easier monetary policy stance, are likely to only cushion some of the worst impacts.

Although National Treasury proposed in its Medium-Term Budget Policy Statement (MTBPS) a number of options to stimulate growth, including pro-growth reforms, there is a shift of moving from consumption-led toward investment-led growth, with the cornerstone being infrastructure investment; a key focus also was the urgent need to maintain fiscal consolidation given the fast-expanding debt-to-GDP ratio and limited fiscal space.<sup>12</sup>

While the proposed growth-supporting measures were aligned to the South African Economic Reconstruction and Recovery Plan<sup>13</sup> released in mid-October 2020, these measures are likely to face a number of challenges in the immediate term, given the second wave of infections and possible

third and even fourth waves in the middle to latter part of 2021.

The most immediate challenge now to reviving economic activity in South Africa is the access to funding and distribution of vaccines. Although globally, vaccine distribution, a low cost of capital and rising commodity prices are tailwinds to growth,<sup>14</sup> Deloitte's Global Chief Economist, Dr Ira Kalish, recently emphasised that the path of the pandemic and how it is managed, the vaccine and how it is rolled out, and governments' responses to this will continue to shape the global economy.<sup>15</sup> Locally, the current uncertainty around the vaccine rollout, but also ongoing weak business and consumer confidence and other structural weaknesses, thus pose some of the biggest risks to the country's immediate to short-term economic recovery.

Linked to South Africa's anticipated vaccine rollout is the uncertainty of how this will be funded, given an already-strained fiscus. This is expected to be addressed in the upcoming February 2021 Budget Speech. Funding options are, however, limited to reprioritising or cutting back further on other spending, raising the expenditure ceiling and thus increasing an already high debt-to-GDP ratio, or raising taxes.<sup>16</sup>

Each of these options comes with its own shortcomings. Already, South Africa has been spending R2.1 billion per day on borrowing costs – the fastest-growing expenditure item in the medium term,

crowding out socio-economic spending. With debt-to-GDP previously expected to peak at 94.6% in 2025-26, additional borrowing could see debt increase to unsustainable levels of above 100% of GDP, and possibly force the country into a debt trap.<sup>17</sup> Government's ability to reign in rising debt has already been curtailed by a sharp expected contraction in tax revenue due to COVID-19, with wide consensus that raising taxes amidst a shrinking tax base is unlikely to bring in additional tax revenue.<sup>18</sup> Raising taxes would thus be limited to possibly fuel levies or implementing a previously mooted wealth tax. Also, the reduction in spending across departments to reprioritise spending to fund vaccines may adversely affect economic growth and welfare especially for the poorest households – arguably the most severely affected by the consequences of the pandemic – over time.

As the vaccine rollout commences, vital focus areas that will require renewed emphasis and consolidated efforts from both government and the private sector, will include increasing spending on infrastructure investment, a reduction in wasteful expenditure and corruption, unlocking efficiencies and opportunities presented by the digital economy, as well as a focus on implementation of outlined urgent growth-enhancing structural reforms. Whichever way, scripting the recovery will require a coordinated and proactive approach by all stakeholders to rebuild South Africa's economy.

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# Prioritisation of the National Budget and healthcare



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The 2021 National Budget is expected to result in pressures across all departments as South Africa continues to require fiscal resources to respond to the COVID-19 pandemic with both pharmaceutical and non-pharmaceutical interventions. Previous public interest in the budget and matters relating to health initiatives have been centred around National Health Insurance (NHI) and the implementation thereof. Now, the focus has shifted to initiatives in response to the COVID-19 pandemic. Standing on the other side of 2020 affords us the opportunity to understand the fiscal requirements underlying a successful response. The 2021 Budget has implications far beyond the single financial year ahead, and correctly prioritising the budget is of paramount importance.

There are some difficult choices that need to be made. On the one hand, the South African economy is in the midst of a low growth trap, facing a unique combination of both supply and demand-side shocks, not to mention structural factors, such as electricity-supply constraints, policy uncertainty and record unemployment rates. On the other hand, the budget must provide financing for not only COVID-19 vaccines, but also the swift and efficient rollout of the vaccination programme – not only to ensure the safety of the population, but also to protect the economy from pandemic-driven stoppages, which has proven to be vastly detrimental to the economy. To prioritise the vaccination programme is by far the most effective

manner of containing the COVID-19 virus and giving South Africa the best possible chance to get back on the road to recovery.

The Supplementary Budget Review 2020 noted that a *“total of R21.5 billion has been reprioritised to public health services”*, bringing the health sector’s share of consolidated expenditure by function to 12.1% (compared to 11.8% in the February 2020 Budget). This reprioritisation was meant to help prepare the health sector for *“a rising number of cases, including expanding capacity and ensuring personnel are protected”*.

Unavoidably, the focus of the health budget has shifted towards COVID-19 rather than NHI, and this will continue to be so for the next couple of years. The failings seen in both the public sector and private sector in responding to COVID-19 through not having effective consolidated data and systems for the country, have further highlighted the need for an effective consolidated healthcare system. COVID-19 has likely reinforced the idea of a National Health system, although the current crisis means that priorities and timing of the NHI rollout, as well as the form and level of cover (related to cost) are likely to shift compared to a pre-COVID world view.

Amongst the many priority initiatives that need to be addressed, the budget will need to make provision for the procurement of COVID-19 vaccines and the subsequent implementation of the rollout thereof. South Africa is targeting to achieve

**“The public health impact of COVID-19 goes far beyond the numbers of COVID-19 cases and related deaths, with the full repercussions only to be fully understood and quantified in years to come. From an economic perspective, the damage has been severe.”**

population immunity by vaccinating 67% of the population, estimated at a cost of R20.6 billion for obtaining vaccines. Costs pertaining to the rollout of the vaccination programme are not included in this estimate, which will likely not be insignificant (government estimates range from R64 to R270 per vaccine).

The public health impact of COVID-19 goes far beyond the numbers of COVID-19 cases and related deaths, with the full repercussions only to be fully understood and quantified in years to come. From an economic perspective, the damage has been severe. Economic activity came to a complete halt for a number of weeks in the second quarter of 2020 across many sectors, with real GDP shrinking by 51% quarter-on-quarter (seasonally adjusted and annualised) in Q2 of 2020. Furthermore, the pandemic and subsequent economic lockdown have had a devastating effect on employment. South Africa's unemployment rate increased to a record high of 30.8% in Q3 2020, following a record total 2.2 million jobs lost between April and June 2020. The largest job losses recorded in a single quarter before this was in Q3 2009 (527 000 job losses), in the wake of the global financial crisis.

A successful and comprehensive vaccination programme will support South Africa in catching the much-needed wave

of economic recovery, which is expected to be seen at a global level as economies start to bounce back from the recessions and contractions seen during 2020. If an adequate vaccine supply (and rollout thereof) is not properly budgeted for, then it is likely that South Africa will see further waves of infections. Each wave will mean economic restrictions renewed, with the accompanying economic consequences thereof in each iteration.

Prioritisation of the national budget to streamline a COVID-19 vaccination effort is the surest manner in which to fast-track an economic recovery. As President Ramaphosa told the nation when first announcing the economic lockdown in 2020, *"As we walk this road together, as we struggle to defeat this pandemic, we remain strong and united and resolved. Much is being asked of you, far more than should ever be asked. But we know that this is a matter of survival, and we dare not fail."*





# Personal taxes:

## Lingering pains for the golden tax goose



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As we embark on 2021, many South African taxpayers eagerly await the delivery of the 2021/22 National Budget Speech. All eyes will be on the Minister of Finance, who this year again will need to walk a tightrope, as he seeks to navigate the country's treacherous tax and spending landscape in order to stimulate inclusive economic growth; while at the same time ensuring that already overburdened South African taxpayers are not unduly burdened with further tax hikes to boost tax collections.

Whilst a gross revenue collection shortfall of more than R300 billion was forecasted for this fiscal year, based on recent information, we are hopeful that this shortfall will decrease – at a time when South Africa is in desperate need of a buoyant revenue base to meet its many challenges.

The COVID-19 pandemic has certainly placed the importance of tax collections and specifically the role of tax authorities and tax policy makers firmly in the spotlight, as the lockdowns compelled governments across the continent to not only implement a range of fiscal relief measures to support its citizens and businesses, but also to expand its future role in looking for sound, alternative avenues to increase tax collections.

### The golden goose

In South Africa, taxpayers continue to feel the lingering fiscal pains on their disposable

incomes and the South African Revenue Service (SARS) 2020 Tax Statistics report (which was published during December 2020) again highlights the continued fragility of the South African revenue collection ecosystem. Our country remains heavily reliant on a relatively small base of taxpayers to generate the majority of the country's revenue collections.

Overall, the report showed that the 2019/20 fiscal year recorded the largest revenue shortfall to budget estimates since 2009/10, and of the R1 355.8 billion revenue collected, personal income taxes continue to be the main contributor to our country's tax coffers, contributing a total of 39% of the total tax revenues.

Notably, whilst 6.3 million taxpayers were expected to submit tax returns for the 2019 tax year, only 4.3 million (approximately 68%) had been assessed (based on data available at the end of October 2020). Of this 4.3 million individuals, 1.8 million individuals earned taxable income in excess of R350 000 (and 1.1 million earned taxable income in excess of R500 000 - the taxable income threshold for submission of tax returns). These individuals contributed 78% of the total personal income tax collected.

These statistics again confirm that a very small percentage of the South African population is financing the country's tax bill and that the "man-on-the-street" is paying a significant amount of tax (both direct taxes, such as personal income tax as well as indirect taxes, such as VAT).

Whilst these statistics should be viewed within the context of South Africa's progressive income tax system (where the wealthy contributes a greater proportion towards supporting the state than the poor, and hence the more you earn, the higher tax you should pay), these taxpayers seem to be bearing a disproportionate share of the country's tax burden, in return for limited services from the state, which is not a sustainable position.

### A solidarity tax?

Against this backdrop, it would seem unlikely, given the current economic environment and the small tax base, that the maximum marginal tax rate would be further increased (it was increased from 41% to 45% for the 2018 tax year). This would also be in line with findings that an increase in the top marginal tax rate would not yield substantial additional tax revenues for the country.

That said, this does not rule out the possibility that alternative measures could be introduced to generate additional revenue for the fiscal coffers in order to combat the impact of the pandemic. There has been widespread speculation that a once off wealth tax, in the form of a so-called "solidarity tax" may be introduced for a limited period of time on high income earners to assist with increasing revenue collections.

The possible introduction of a wealth tax has been mooted for many years in South

## “One avenue available to increase tax collections in South Africa, would be for SARS to conduct regular lifestyle audits on the tax affairs of individuals who are in the tax net (and those who are not).”

Africa, and whilst globally many countries have moved away from the idea of a wealth tax (for various reasons), recently it seems to have gained popularity as a tax policy again, notably in the United States and United Kingdom.

One of the main issues underlying the wealth tax debate in South Africa is the significant inequality in the income levels between the rich and the poor. The South African debate is further fuelled by the perception that there seems to be a number of very wealthy individuals in South Africa, and the question is whether these individuals are paying their fair share of taxes in the country?

In the World Wealth report issued last year, it was noted that the size of the high net worth individual population in Africa increased by 6.1% in 2019, while wealth increased by 6.5% to US\$ 1.7 trillion. South Africa leads the charge on the continent, having the highest number of high net worth individuals.

Encouragingly, the SARS tax statistics report does however show that the personal income tax concentration curves (which measures the degree of inequality in the tax base over time) for taxable income for the tax periods 2016 and 2019 (based on assessed taxpayers), depict an improvement in the distribution of taxable income amongst SA taxpayers. This is largely due to tax policy measures that were implemented to broaden the tax base and increase the progressivity of the personal income tax system.

Nonetheless, it remains a key priority for our fiscus that high net worth individuals bring all their income (local and offshore, in particular income routed via offshore trusts) into the South African tax net and that they pay their fair share of taxes. That said, it has previously been noted that the

level of filing compliance by high net worth individuals in South Africa was very high.

The obvious advantages of introducing a wealth tax in South Africa are that it will increase fiscal revenue and, at the same time, it would be seen as a measure to reduce the inequality in income levels between the rich and the poor (a key discourse currently in South Africa).

The challenge in South Africa of imposing a wealth tax (or once off solidarity tax) is that we already have a small and fragile tax base of high net worth South Africans, and the introduction of such a tax may well provide further impetus to increasing the number of individuals emigrating from South Africa.

One avenue available to increase tax collections in South Africa, would be for SARS to conduct regular lifestyle audits on the tax affairs of individuals who are in the tax net (and those who are not).

Last year an organisation “Millionaires for humanity” issued an open letter to governments across the world (signed by 83 members), calling on governments to raise taxes on wealthy millionaires, such as themselves (“Immediately, Substantially and Permanently”) in order to help the world recover from the pandemic. Whilst an altruistic and noble gesture, implementation of such a request will present its own challenges.

All is not lost though, as there are indeed various other measures available to our tax authority to raise revenues – a key measure being enhancing SARS’ digital capabilities to increase revenue collections – and it has already made many meaningful strides on its digital transformation journey.

SARS recently presented its strategic plan for 2020/21 – 2024/25, which notes a vision to build “*a smart modern SARS,*

*with unquestionable integrity, trusted and admired”.*

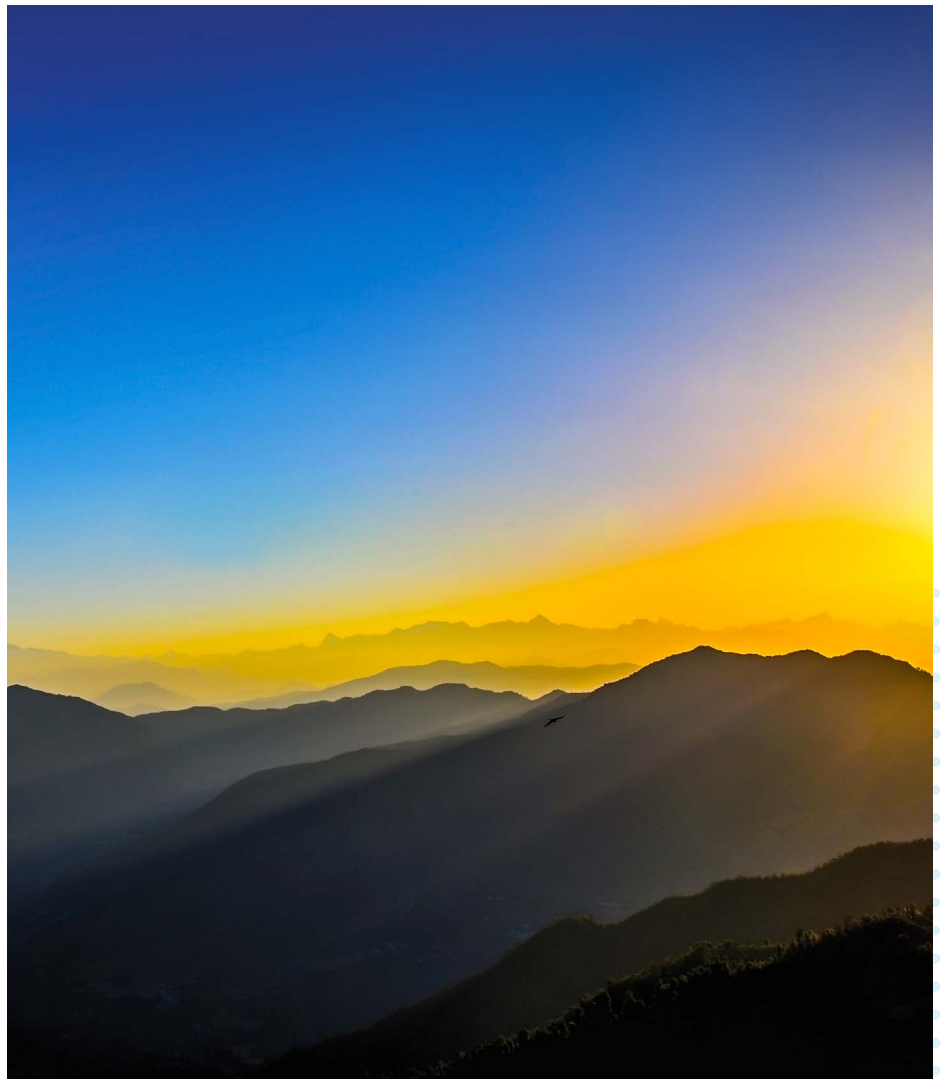
The plan sets out a strategic intent “*to follow the internationally recognized approach of Voluntary Compliance*” and translates this intent into a list of strategic objectives, including:

- modernising SARS’ systems to provide digital and streamlined online services, thereby making it easy for taxpayers to comply with their tax obligations – making it easy for taxpayers to understand what tax to pay, when to pay and how to pay it, combined with making non-compliance difficult and costly to taxpayers would have a direct impact on revenue collections. The self-assessment process that was recently introduced by SARS goes a long way to achieving the ultimate goal of voluntary compliance by taxpayers.
  - working with stakeholders to improve the tax ecosystem and compliance. SARS has many valuable data points on taxpayers and these could be mined using digital technologies and by leveraging off stakeholders to detect non-compliance and increase compliance amongst all taxpayers; from the taxpayer who has simple tax affairs to those who have sophisticated tax schemes.
  - rebuilding staff and system capacities. The taxpayer’s user experience in dealing with their tax affairs and ensuring they are tax compliant can be improved (not only when dealing with SARS via e-filing, but also when dealing with SARS telephonically or in person).
  - building public trust and confidence in the tax administration system. SARS was once the crown jewel of revenue authorities on the continent. Tax administration and governance issues at SARS in the past resulted in below-target revenue collections as well as inefficiencies. SARS is now slowly emerging from this dark cloud, but much must still be done to improve public confidence and taxpayer morality.
- The vigorous pursuit of the above objectives will go a long way in assisting SARS to generate the additional revenue needed to meet its revenue collection targets.

The World Economic Forum's 2021 Davos Great Reset Initiative amongst others, calls for governments to improve coordination (for example in tax, regulatory, and fiscal policy) and to implement reforms that promote more equitable outcomes. SARS is well-positioned to play a key role in this regard. It can leverage its many data points on taxpayers (subject to safeguarding data security and taxpayer confidentiality), and collaborate with other stakeholders and government departments; such as for example the Department of Social Development, the Department of Health, the Department of Employment & Labour etc. to assist them with more meaningful decision-making for the benefit of all South Africans.

### Conclusion

A budget that supports South Africa's future, should go further than just tax increases. Whilst the main component of our revenue base will always be tax revenues, tax is certainly not the only solution. Key parts of the solution must also include enhancing and leveraging SARS digital capabilities, expenditure cuts, curbing the size of the civil service, reducing policy uncertainty, creating jobs and focusing on state-owned entities. No doubt, the fiscal pain continues to linger for South Africa's golden goose.



# Increasing corporate income tax rate could negatively affect revenue collections



**By Le Roux Roelofse**

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The COVID-19 pandemic has resulted in a massive shortfall in revenue collections and has created a desperate need to raise additional taxes. How best to do this without causing further damage to the economy is a matter of intense debate.

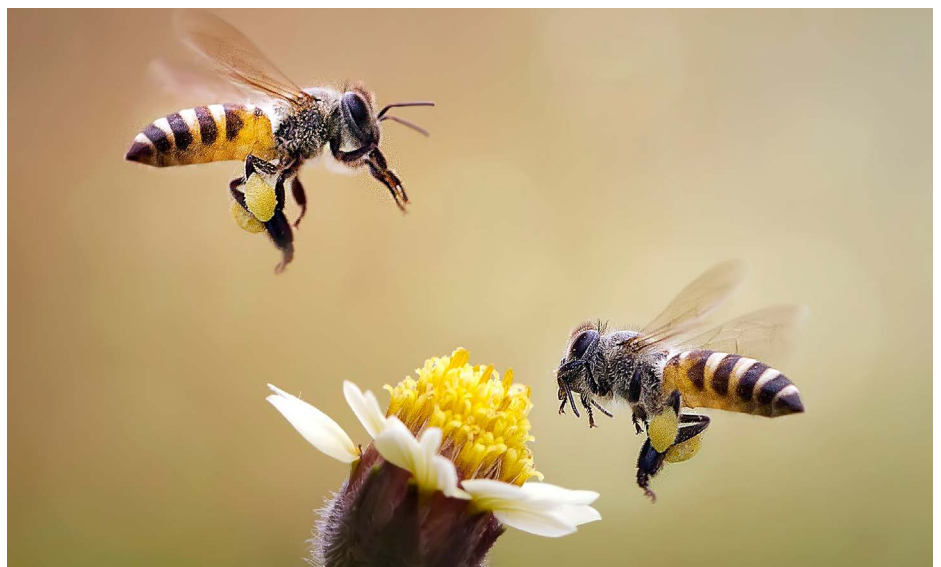
The three key revenue-raising taxes are income taxes on individuals, income taxes on companies and value-added tax (VAT). Nearly everyone agrees that individuals are overtaxed and raising the VAT rate is politically fraught given its regressive nature. This raises the obvious question whether the corporate income tax rate, which is currently at 28%, should not be increased? In fact, that may not be a good idea because raising the corporate rate may paradoxically negatively affect revenue collections. In this regard, it should be noted that South Africa's corporate tax rate is significantly higher than the corporate rate of a number of its important trading partners - raising the rate could only make us even more uncompetitive and may encourage undesirable practices like transfer pricing insofar as it heightens the risk of multinationals trying to "shift" their tax burden from South Africa to lower taxed foreign jurisdictions by pricing intra-group transactions between South Africa, and such lower taxed foreign jurisdictions in the foreign jurisdictions' favour.

Furthermore, increased corporate taxes may have a detrimental effect on boosting

economic growth which ultimately is the real key to unlocking a sustained increase in revenue collections (together with strengthening the South African Revenue Service's capacity to collect taxes). It is also worth noting that increased taxation over the recent past has led to increasingly lower revenue collections – further tax increases are likely to exacerbate this trend.

For these reasons, we believe that it is highly unlikely that National Treasury would increase corporate tax rates at this time, however psychologically soothing it may be for some people. On the contrary, if anything, National Treasury may be tempted to reduce the corporate rate. That would be a bold and imaginative step!

**“The three key revenue-raising taxes are income taxes on individuals, income taxes on companies and value-added tax (VAT).”**



# SARS' shift to the digital era:

## No short cuts to true digital transformation



**By Tumi Malgas**

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Amid the loss of revenue, now exacerbated by the COVID-19 pandemic, the South African Revenue Service (SARS) needs to find ways to close the widening deficit hole more than ever before. We are now in the fourth industrial revolution, and one cannot help but think about how digital innovation could be leveraged to help plug the hole. We believe that this will happen, although maybe not in the current year. However, when done right, the benefits could be incredible and the results will work for the revenue authority and the people it serves. Revenue authorities in some countries have been working on their digital transformation journey for longer and have introduced initiatives such as fiscalisation, real-time reporting, electronic invoicing, etc. However, learning from the best on various approaches to digital transformation and new technologies, our revenue authority could leapfrog into the 4th industrial revolution.

Many revenue authorities across the world are only now digitalising, or carrying out limited digital innovation, and are yet to move to being truly digital. Being digital is not just about technology, as many organisations are fast realising after investing in technology projects that have not helped them move into the fourth industrial revolution in a meaningful way.

When management consultants and digital gurus say "technology is an enabler", it means one needs to get a well-rounded view of everything else (goals/aspirations, culture, people, processes and data) to understand what needs to change overall and how; and then look at what technology can enable them to exponentially reach their goals. It is similar to putting in place building blocks - you need to have a stable foundation. Some technologies assist you to put in place that foundation, some support the foundation and some draw on the foundation to make the processes work.

In establishing this foundation, it is important to look at the revenue authority environment holistically considering:

- main business goals for the transformation.
- its work force.
- taxpayers.
- ever changing business models for organisations.
- all tax types.
- data availability and data quality across all tax types.
- connected ecosystems such as other government agencies, etc.

With the above in mind, determine how this foundation should look, and then make it come alive by assessing which of the new technologies are best suited to make the end-to-end process work more efficiently.

New Zealand's Inland Revenue Commissioner, Naomi Ferguson, said, "It (the need for technology change) was the starting point. But I think once you started thinking about changing 20-year old technology, you realise that actually some of the customer's needs were different, customer experiences were different, business processes that were built 25 years ago don't suit today's world."

It is common for revenue authorities to undertake "after the fact" verification, by performing a number of time-consuming audits. The Deloitte revenue administration playbook advises that this can be reduced by shifting the focus of regulation from the returns submitted to the underlying process as well as relying on the data consumed and produced by the process.

We already see this shift in many countries, where revenue authorities are rethinking the entire process (albeit for a particular tax type only) and inserting themselves into the taxpayer process. When invoices are being generated, for instance, the revenue authority will issue out the invoices to

the taxpayer's suppliers in a standard format from the authority's systems. Direct application programming interfaces (APIs) from organisations to the revenue authority facilitate this process change and enable real-time access to information by the revenue authority. Many say this is moving us to a world where there is no tax return, where tax "just happens" and processes can be relied upon to produce the correct tax outcomes. SARS has made some recent strides in this area when it comes to auto-populating individuals' tax returns with third-party data.

Ronnie Nielson, Deloitte Tax Thought Leader (Denmark), explains that many tax agencies have taken a piecemeal approach to digital-based operations, building stand-alone digital products atop legacy foundations, which has challenges related to cost, ease-of-use, and incompatibility with emerging technologies. He explains further that it is important to build a truly

digital core and that this will require a multipronged approach that can include automating tax submission review workflows and adopting modular, flexible approaches to systems architecture to respond to changing policy mandates.

SARS is already on the journey of digital transformation. Finance Minister Tito Mboweni and SARS Commissioner Edward Kieswetter, have made comments indicating how important digital solutions are to making the revenue authority achieve some of its goals and to move forward into the new era. Innovations in terms of auto-populating the tax returns with third-party data, improving the e-filing portal and SARS app functionality as well as the chat bot on the mobile SARS app, are some of the recent milestones achieved by SARS.

However, digital solutions in disparate small pockets across the revenue authority

cannot result in true digital transformation. It starts with an ambitious digital transformation aspiration (that aligns with its overall mission/mandate) and an all-encompassing, well-thought-out digital transformation plan that has measurable outputs and - more importantly - that can be implemented timeously. This plan needs to incorporate the future of work, in other words, the impact of disruptive technologies on traditional ways of working; as well as how to embark on this digitisation programme while still being very clear on the protection of taxpayer data and data secrecy requirements.

As we grapple with what future the coronavirus pandemic is leading us into, and how do we get digital transformation right, let us take some advice from what Abraham Lincoln said, "***The best way to predict the future is to create it***".





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# Finding a balance in trying times



**By Gaba Tabane**

Director and Government and Public Services  
Industry Leader, Deloitte Africa

Finance Minister Tito Mboweni's stated message for the 2020 Budget Speech was Consolidation, Reform and Growth. In the fiscal year to end February 2021, the State's revenue is projected to grow by 4.9% to R1.58 trillion (29.2% of GDP) with expenditure at R1.95 trillion (36%). This means a consolidated budget deficit of R370.5 billion, or 6.8% of GDP. In this environment of fiscal constraint due to rising government debt, poor growth levels, low revenues and rising public expenditure, further compounded by the onset of the COVID-19 pandemic which has further strained the fiscus; the Finance Minister will have to perform a delicate balancing act to ensure that the 2021 Budget speaks to the national priorities of the country. Key amongst these are:

## Tackling the COVID-19 pandemic

Significant resources will be budgeted to fight the pandemic. South Africa has started the first phase of acquiring the vaccine for COVID-19. An initial payment of R283 million was paid in December 2020 as a deposit to secure the vaccine. With the aim of vaccinating nearly 67% of the population to attain herd immunity, we can expect the bulk of the budget allocation to go towards the health cluster, which will drive the national rollout of the vaccine programme. In addition to acquiring the vaccine, a massive public rollout of the vaccine is also anticipated. Government is expected to centralise this rollout

programme, with added support from the private sector with regards to distribution and administration of the vaccine.

## State-owned enterprises (SOEs) bailouts

SOEs play a crucial role within South Africa's economy. In the 2020 financial year, a number of bailouts were made to struggling state owned entities including South African Airways (SAA) and Eskom. In the 2020 Budget Speech, Eskom remained the top priority with a stable electricity supply. The Finance Minister cited this as "our number one task." The beginning of the 2021 calendar year has been met with a new rollout of managed load shedding by Eskom. Provisions to get Eskom back on track have required continued financial investment by the government in the entity. Over the next three years the State will transfer R112 billion to Eskom, compared with the anticipated R69 billion previously budgeted. The State has committed to inject R23 billion annually into Eskom for the following seven years. Since 2008, SAA has incurred losses of R32 billion, and will receive a further R16.4 billion from taxpayers in the next three years, which has been put aside to settle the airline's liabilities and interest. Stabilising our SOEs has become one of government's top priorities as they will be primarily responsible for the successful rollout of the state's public infrastructure programme.

## Public infrastructure spending to boost economic development

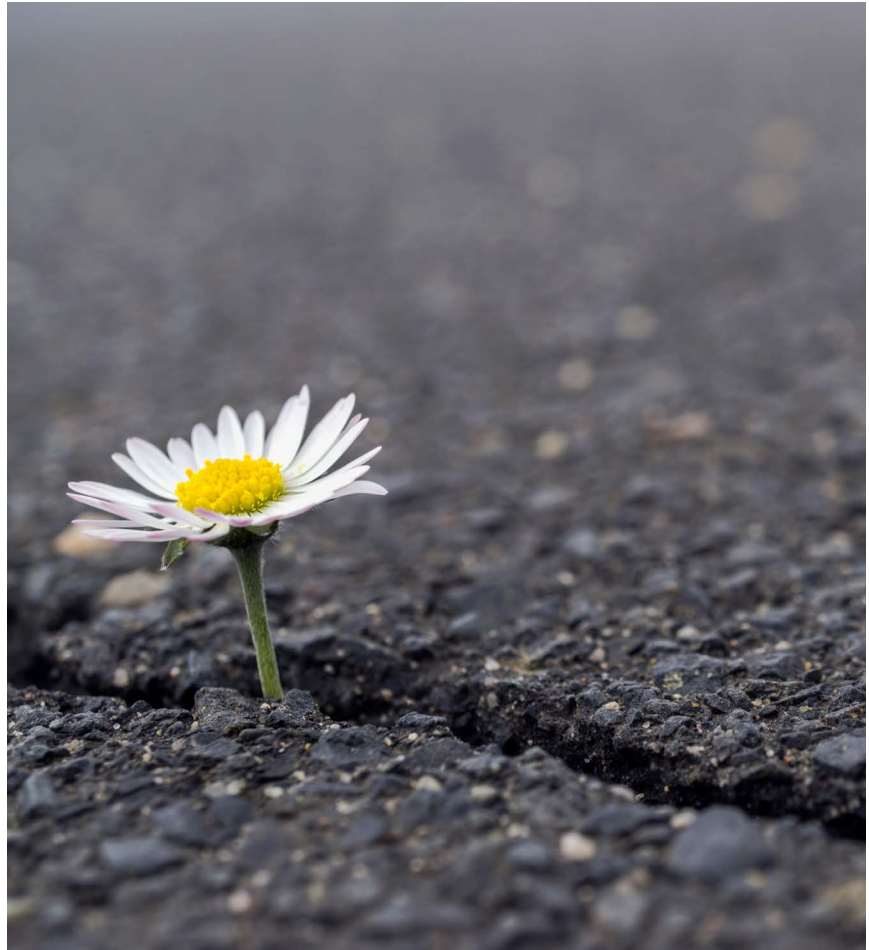
Over the Medium Term Expenditure Framework (MTEF) period, R815 billion has been allocated to infrastructure spending. SOEs continue to be the largest contributor to capital investment, spending a projected R314 billion over the next three years. In the face of wide-ranging cuts to public sector spending, the National Treasury is still committed to capital spending to drive the Government's Infrastructure programme. During his State of the Nation Address, President Ramaphosa reported that the Infrastructure Fund implementation team had finalised a list of "shovel-ready" projects, with a potential investment of R700 billion over ten years. In addition, Minister Mboweni also announced that over the next three years, the Development Bank of Southern Africa (DBSA) will package blended-finance mega-projects to the value of at least R200 billion – in line with the President's announcement. Despite heavy cuts across the 2020 budget, infrastructure spending has been allocated at over R800 billion for the next three years. This allocation should help overcome social and economic infrastructure backlogs (energy, housing, roads and transportation).

## Cutting public spending

In the last Budget Speech, the Finance Minister outlined several cuts aimed



at reducing public spending, with the largest reductions applied to the human settlements and public transport sectors. The need to direct constrained resources to areas that have a high social impact and the largest economic multiplier, while outlining measures to deal with wasteful expenditure; is of great importance. Cuts in the public sector wage bill have also been announced. A recent freezing of public sector salary increases has been met by resistance from the public sector unions. Recent announcements from the unions suggested a protracted legal battle with the government and possible industrial action by the unions could be a possibility.



# VAT obligations for non-residents - The complexities of the “enterprise” definition



**By Severus Smuts**  
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Growing anticipation is placed on whether or not further changes can be expected for the definition of “enterprise”. Over the years, a number of amendments or publications have been issued or proposed to clarify the intent of legislature; including those changes for electronic services, passive income, insurance contracts and telecommunications services.

## Complexities surrounding the definition

For various reasons, it is important to determine whether an activity performed by a business may constitute an “enterprise” in South Africa. The definition of “enterprise” is not dependent on place of residence. Therefore, foreign businesses must consider the impact of their activities in South Africa, whether a person is conducting an enterprise in South Africa and what other requirements must be met.

## How has this impacted foreign businesses?

### 1. The branch of a main business wishes to register for value-added tax (VAT) on the basis of certain activities performed to or for the benefit of its main business outside of South Africa

An amendment was inserted as proviso (ii) to the definition of “enterprise” and promulgated on 24 January 2005,

which deemed the branch and main business to be regarded as separate persons for VAT purposes, in order to deem whether supplies between the local enterprise and the foreign main business are taxable, and thus unlocking input tax deductions. The wording of the legislation indicates that the supplies made by a branch be treated the same as if the foreign business incorporated a subsidiary in South Africa.

In recent times, there has been some doubt as to whether a foreign business with a branch in South Africa that performs certain functions for its main business outside of South Africa, may register as an enterprise for VAT. A VAT registration means that the transfer of goods or provision of services to or for the purposes of the main business outside of South Africa, are deemed to be taxable for supplies that qualify for input tax deductions.

However, current experiences now suggest that there has been a change in policy where the branch in South Africa only makes “supplies” to its main business situated outside South Africa. Where this is the case, SARS is of the view that such a branch may not register for VAT as it is not conducting an enterprise.

Where the South African branch supplies to third parties, such a

branch may register for VAT in South Africa, and provided it meets certain requirements, will be regarded as a person separate from its main business for VAT purposes. The effect of this is that any supplies made by the South African branch to its main business will be deemed to be taxable and any VAT incurred in making these supplies will be deductible.

This treatment seems contrary to the intention of the definition of “enterprise” since the VAT treatment will depend on the legal structure adopted by a foreign business. We don’t think the structure adopted should impact the entitlement to register for VAT or the ability to deduct input tax.

### 2. The foreign business makes staff available to the local operations in South Africa

Even if employees retain their home country employment contracts, in some cases, they can for the duration of their secondment, if under the control and supervision of the operations in South Africa be regarded as employees for the purposes of local Pay-As-You-Earn (PAYE) withholding requirements. Where the employment costs are recharged to the local business as an intercompany cost, it is not clear that the foreign business will be viewed as having conducted an enterprise in South Africa.

The debate centres around whether the seconded employees are furthering the enterprise of the foreign business or that of its local operations. No guidelines are provided to clearly interpret who is responsible for accounting for VAT on these transactions.

The added complexity to this issue is that of whether an obligation to remit VAT on imported services arises. This obligation falls away if the non-resident business is required to register for VAT in South Africa. Therefore, any decision not to remit VAT on imported services must be supported by a conclusive position that the foreign business was required to charge local VAT.

### **3. Foreign business takes flash title of movable goods before they are immediately sold to another recipient outside of South Africa**

Flash title occurs where a local supplier sells goods to a recipient and ownership of the movable goods vests for a moment, before the goods are immediately sold to another recipient outside of South Africa.

Interpretation Note 30 (Issue 3) was issued by the South African Revenue Service (SARS) and provides an example of where both the supplier and first-mentioned recipient are vendors and permitted to zero rate the supply, where the goods are acquired on a flash title basis, and if the necessary export documentary requirements are met.

It would appear – based on the current policy - that where the recipient is a non-resident, there is an obligation to register based purely on the fact that a non-resident enters into a flash title transaction before the goods leave South Africa.

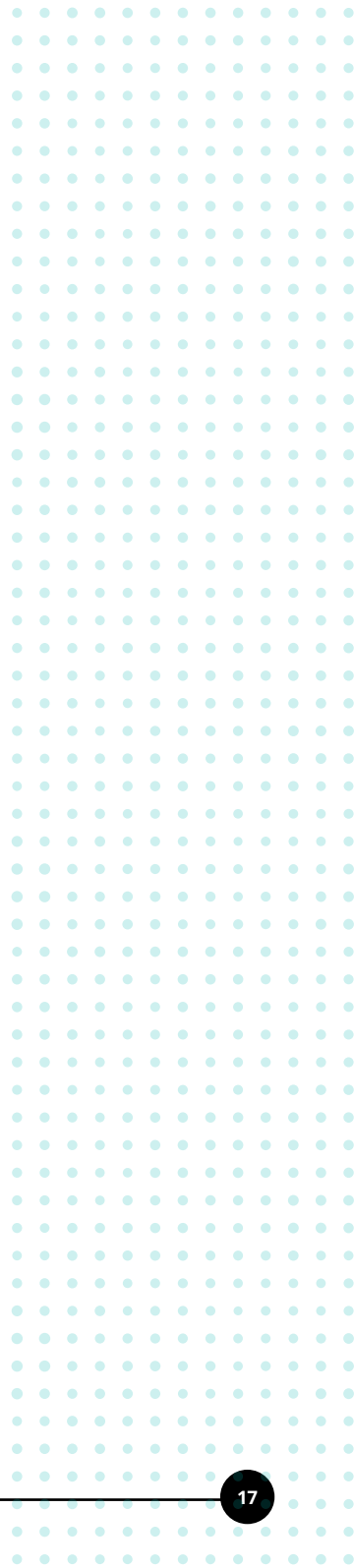
The impact for foreign businesses is the uncertainty of whether there is a requirement to register and account for VAT in South Africa. Where it turns out that there was a requirement to register and therefore a requirement to substantiate its zero rated transactions, it means that any retrospective obligation of having to do so may result in assessment of tax, penalties and interest on the basis that the foreign business will not be in a position to support the zero rate.

In this case, where it transpires that there was a requirement to register, it means that the non-resident vendor will effectively submit nil VAT returns with the added responsibility of having to rely on the documents obtained by the supplier to substantiate its entitlement to apply the zero rate.

#### **What is the impact on local businesses?**

Given the number of rulings in this specific area, and challenges faced by foreign businesses to ascertain whether or not activities in South Africa have given rise to an obligation to register, points to a vacuum in the law and a need for certainty.

In the interest of applying the rules equally to all foreign businesses operating in South Africa, clear guidelines or amendments to the law may be needed to gain insight as to the intention of legislature. This will also provide much needed certainty as to whether the non-resident business or local South African recipient should account for the VAT.



# Business incentives dwindle amid pandemic



## By Tumelo Marivate

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To facilitate the management of the COVID-19 pandemic in 2020, government introduced temporary, targeted relief measures as an immediate response to try and preserve the economy. To fund this, the government used surplus funds from the Unemployment Insurance Fund as well as shifted funds from existing programmes; with the Department of Trade, Industry and Competition - the leading department for supporting private sector development - losing 21% of funds previously allocated to support private enterprises to make new investments and create jobs. The intended second phase of this COVID response plan was to focus on economic recovery, through stimulating investment and employment creation. However, the COVID-19 second wave and the associated constrained economic activity is likely to lead to an even greater shrinkage in the tax base than was anticipated at the time of the Supplementary Budget delivered in June 2020. The necessary COVID-19 health and social spending, the choice to prioritise support for state-owned enterprises, and increased cost of debt funding, will mean the country is unlikely to emerge from the first phase of managing the pandemic, that is, preserving the economy.

The elusive economic recovery and the requisite allocation of government budgets to programmes that support sustained investment and job creation are likely to mean, at best, protecting funding for public infrastructure investment and what are

considered to be the more employment intensive sectors – tourism and agriculture, as well as creating social employment opportunities. In terms of enabling private sector capital investment, the manufacturing sector, which traditionally, from our view, has taken the lion's share of financial incentives available for private enterprises, has had direct funding reduced by more than a third since 2017. However, given the country's Economic Reconstruction and Recovery Plan's focus on driving industrialisation through localisation, it is expected that allocations to programmes in the manufacturing sector will remain flat, although there may be pressure to revise these programmes in order to increase their impact and better support the inclusion of small and medium enterprises (SMEs) in various supply chains. Some of this funding for industrialisation programmes is most likely to be directed at Development Finance Institutions such as the Industrial Development Corporation to support loan guarantees, loans and equity injections in the industrial sector.

The disruptive nature of COVID-19 has shone the spotlight on the potential of the information and communications technology sector. Notwithstanding this, post the National Budget, we will likely continue to lament the lack of support for start-ups and SMEs to drive the digital economy, although support for key institutions that drive innovation, such as the Council for Scientific and Industrial Research, will continue. The economic

plan also promises green economy interventions, but we will have to wait for the Budget Vote to see what this means in real terms.

In an economy where the tax base cannot afford to give a real economic stimulus to kick-start private sector investment across different sectors in the economy, the international donor agencies may be a sensible door for government to knock on for private sector support programmes to complement government's drive to invest in public goods and social employment.

**“...the international donor agencies may be a sensible door for government to knock on for private sector support programmes to complement government's drive to invest in public goods and social employment.”**

# Carbon tax: Will allowances, after 2022, be reduced or removed?



**By Izak Swart**

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South Africa is one of the first developing countries to introduce a comprehensive carbon tax system in its fight against climate change. When introduced in 2019, the rate of the tax was set at a relatively low rate of R120 per tonne to minimise the impact of the tax on industry.

To provide industry with certainty on future carbon tax liabilities, the rate of increase of

the tax was included in the legislation. For the first phase of carbon tax (2019 to 2022), the rate will increase with consumer price index (CPI) plus 2%, and thereafter with CPI.

Worldwide consensus is that a carbon tax rate of at least \$50 per tonne or higher is required to minimise emissions and climate change. South Africa's carbon tax rate after taking into account tax free allowances is roughly \$3.5 per tonne.

From a worldwide perspective, South Africa's carbon tax rate will need to increase substantially in future years. Two methods can be used to increase the carbon tax rate. One is to simply remove the clauses dealing with rate increases. The other is to remove the tax-free allowances that are allowed. For example, all emitters benefit from a 60% tax-free allowance. The allowance can be reduced or removed.

It is understood that during the second phase of the carbon tax, after 2022, that the allowances will be reduced or removed. However, to get to a carbon tax rate of \$50 per tonne or R750 per tonne, allowances will need to be removed and significant rate increases will be required. It is unlikely that the rate will increase to R750 per tonne in the short-term or medium-term, as industry will not be able to afford it.

It is not expected that significant changes will be made to the carbon tax during the 2021 Budget Speech. Some direction might be provided on what to expect in the future after 2022 when the second phase of the carbon tax will be implemented, which includes a carbon budgeting system.

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# Advance Pricing Agreements: Greater urgency needed



**By Billy Joubert**

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## The South African Revenue Service (SARS) recently issued a Discussion Paper on Advance Pricing Agreements (APAs). APAs are agreements with revenue authorities concluded in respect of future transactions regarding the pricing of such transactions.

APAs are agreements with revenue authorities concluded in respect of future transactions regarding the pricing of such transactions. The process of obtaining an APA is typically very onerous and can take several years. Therefore, it is only worth applying for APAs in respect of very significant transactions affecting a multinational enterprise (MNE). APAs are initiated by a taxpayer and require negotiations between the taxpayer, other group companies and one or more tax administrations. APAs are typically valid for an agreed period (e.g. three years).

APAs can be divided into unilateral, bilateral and multilateral APAs. Unilateral APAs would be concluded between the taxpayer and the revenue authority of a single country, whereas bilateral APAs and multilateral APAs would bind the revenue authorities of two or more countries respectively. Bilateral or multilateral APAs give a multinational enterprise (MNE) a

much higher degree of certainty than unilateral ones since the agreement reduces the risk of a transaction being challenged in one country, despite having been accepted in another. However, since bilateral or multilateral APAs require the involvement of two or more countries in the process of negotiation, they are also correspondingly more difficult to negotiate and reach agreement on.

A related procedure is the so-called mutual agreement procedure (MAP), which is embedded in most (if not all) of the double tax agreements (DTAs) concluded by South Africa. MAPs are provided for in Article 25 of the Organisation for Economic Co-operation and Development (OECD) Model Convention. MAPs differ from APAs in that:

- A MAP process would typically be provided for in a DTA, whereas an APA process would not.

- A MAP would be initiated only once a dispute has arisen between an MNE and a tax authority, whereas an APA process is designed to reduce the risk of such a dispute – by obtaining prior agreement regarding the pricing.

Because MAPs are provided for in the DTAs which SA has signed, SARS is obliged to engage in them. However, SARS has to date not implemented an APA programme.

The paper notes that SA has an advance tax ruling (ATR) programme. However, transfer pricing matters are expressly excluded from the ATR process.

The paper notes that the Davis Tax Committee (DTC) recommended the implementation of an APA programme in SA. However, the DTC noted the capacity constraints faced by SARS with regards to negotiating and concluding APAs. The DTC recommended some kind of specialist outsourcing arrangement. However, the paper stated on page 3 that *"...no suggestions were made regarding how this could be funded or how conflicts of interest within the very small transfer pricing community in South Africa would be managed."*

The paper considers to what extent there are APA programmes in place in various countries around the world. Specifically with regards to Africa, it is noted that South Africa appears to have fallen behind its

peers on the African continent in terms of putting such a programme in place. SARS states that this could adversely affect SA's status as a leader on the African continent as well as its position as a gateway for investment into Africa.

SA should start with considering a bilateral APA programme. Only once that is in place can it be considered whether to extend it, to cater for unilateral and multilateral APAs or not.

The paper indicates that, while an APA programme is considered important, there are other priorities which need to happen first. These include curtailing base erosion, profit shifting and building transfer pricing capacity. It is estimated that it will take three to four years to implement an APA programme.

The paper is quite comprehensive and we agree with many of the points made. However, we believe that the conclusion (that there are other priorities and that it is likely to take three to four years to implement an APA programme) tends to overlook, or at least to underplay the significance, of the following key point made under heading 8 of the Conclusion: "Tax certainty is one of the fundamental requirements for foreign direct investment." In the current economic climate attracting foreign direct investment will be crucial. The country does not have three to four years in order to implement a programme as important to making SA more attractive to foreign investors.

The following additional points are also worth considering:

- APAs are intended to avoid disputes. While APAs are time-consuming (and might be expensive if SARS is required to rely on external specialists), the time and expense of a dispute is even greater. Therefore, justifying the non-implementation of an APA programme by referring to capacity constraints is contradictory; those same constrained SARS resources are the ones required to initiate and conduct lengthy disputes.
- SARS envisages starting with bilateral APAs and then adding on unilateral and multilateral ones. Both bilateral and multilateral APAs require the involvement of other tax authorities, whereas unilateral ones would only involve SARS and the taxpayer. The simpler process of implementing a unilateral APA would seem more logical as a starting point, followed by bilateral and multilateral ones. While ATRs are different from APAs, there will be some overlap (perhaps even a significant overlap) between the process of applying and obtaining an ATR as well as applying and obtaining a unilateral APA.
- as regards funding of external specialist consultants, SARS would presumably charge for APAs (as it currently does for ATRs). Therefore, this cost could be self-funded via the APA process itself, rather than requiring SARS to incur higher fixed costs by needing to employ additional skilled resources fulltime.

- the process of working together with skilled external consultants on APAs should achieve significant skills transfer to the SARS personnel involved.
- the perceived potential conflicts of interests applicable in the relatively small transfer pricing community in SA are also not necessarily as significant as SARS indicates. The same specialists are required to do different types of other transfer pricing work (including planning, documentation and assistance with dispute resolution) for a variety of clients and are accordingly used to having to manage potential conflict situations.
- retired professionals or professionals from outside SA could be used in response to the potential conflicts of interest concerns raised.
- the points made by the paper regarding the absence of an APA programme adversely affecting SA's status as a leader on the African continent and the attractiveness of SA as a gateway for investment into Africa are also crucial. Again, it seems tardy to only commit to a three to four-year timeframe for remedying this shortcoming.
- the APA programme does not have to be perfect from the start. It would be preferable to implement a programme, and then to refine the programme on an ongoing basis, rather than to wait for the perfect conditions for such a programme (which might never exist).

In summary, while the paper represents a significant step forward, SARS should look to prioritise the implementation of a South African APA programme.



# Home office expenses – Claiming a tax deduction



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The COVID-19 pandemic has necessitated many employees to work remotely from their homes during the lockdown period. This in turn has meant that employees have had to ensure that a space, or part of their home, was set up in such a manner that it was conducive for them to work from home effectively and productively.

As a result, many employees have over the last few months incurred additional expenses that they would not have ordinarily incurred had they continued to work from the employer's office. Since some of the cost of doing business has essentially been transferred from the employer to its employees, many employees are now assessing whether they would be able to claim certain of these expenses incurred in connection with the running of their home office as a tax deduction.

In this article, we provide a brief overview of the requirements that need to be met in order to claim a tax deduction for home office expenses.

## What constitutes home office expenses?

Home office expenses will typically include

rental paid in respect of your home (if you rent your home), rates and taxes, interest on the property bond, cost of repairs to the premises, cost of stationery, office equipment, cost of business calls made from your private home telephone, cleaning and other expenses in connection with the domestic premises etc.

In addition, wear-and-tear allowances in respect of assets used for purposes of the home office may also qualify for a tax deduction.

## What requirements must be met for home office expenses to be deducted for tax purposes?

If you are required to work at home and you have set aside a room or part of your home to be occupied for purposes of your "trade", you may be allowed to deduct certain home office expenses for tax purposes calculated on a pro-rata basis. A room or "part" of your home or dwelling will be considered to be occupied for the purposes of trade if both of the following requirements are met:

- Such part is specifically equipped for the purposes of your trade, namely your employment, profession, etc.; and

- Such part is regularly and exclusively used for the purposes of your trade.

Importantly, in addition to the above requirements, should the room/part of your home/dwelling meet the above requirements and your trade constitutes employment or holding of an office (i.e. you are a salaried employee), a tax deduction will only be granted to you in respect of your home office expenses if:

- a) the income from your employment or office is derived mainly (i.e. more than 50%) from commission or other variable payments and you do not perform your duties mainly (more than 50% of the time) in an office provided by your employer; or
- b) you mainly (more than 50% of your working time) perform your duties in your home office (i.e. that room/part of your home/dwelling that is occupied for purposes of trade). No deduction is allowed when salaried employees perform only some duties at home, but work mainly from an office provided by their employers (such as teachers, for example).

## Tax tips – Home office expenses

- It is apparent from the above that in general relatively few employees (who earn salary income only or no/limited commission income) would qualify to claim a tax deduction for home office expenses. You should therefore only claim such a tax deduction if you are able to demonstrably prove to the South African Revenue Service (SARS) that you have met the above requirements. If you are unable to do so, rather err on the side of caution and do not claim the tax deduction.
- Be sure to document in your employment contract/agreement with your employer that you are required to use a room or part of a room in your house for trade/business purposes. This will strengthen your tax position should SARS request you to prove this. If you are a salaried employee who qualifies for a home office tax deduction, you should ideally receive an allowance from your employer against which you can claim the tax deduction in your tax return.
- You need not necessarily set aside an entire room for use as a home office. You may set aside only part of a room, provided that part is specifically equipped for the purposes of your trade and regularly and exclusively used for this purpose.
- Household expenses that may be included in your home office tax deduction include your bond interest (or if you are renting a house, the rent payable by you), rates and taxes, electricity, insurance, domestic worker's wages, cost of repairs etc. incurred in respect of the home office. In addition to household expenses, other amounts that may be claimed include wear-and-tear on furniture, fittings and equipment used in your office for business purposes. The cost of these assets may be written off over their anticipated useful lifespan for tax purposes. The cost of business calls made from your private home telephone line may also be claimed as a tax deduction.
- Your tax deduction for home office expenses is generally calculated on a pro-rata basis, taking into account the size of the home office (namely, that part which meets the above requirements) relative to the size of your entire home (in square metres).
- It is important to note that claiming a tax deduction for home office expenses may have adverse capital gains tax implications when you sell your home. This is because any capital gain derived upon the sale of the property will be apportioned with reference to the extent to which the property was used for business purposes and the R2 million 'primary residence' exclusion (for natural persons and special trusts) will only be applied to the portion of your home relating to domestic use.
- Capital expenditure – Note that whether or not an employee's remuneration is derived mainly from commission, an expense that is of a capital nature that does not qualify for a wear-and-tear allowance – e.g. buildings and other structures of a permanent nature – may not be deducted as home office expenditure for tax purposes. The cost of any portion of the employee's domestic premises and improvements thereto may, therefore, not be deducted. Note that as the distinction between a deductible repair and an improvement is sometimes difficult, it is recommended that professional advice be sought in the case of uncertainty.

## Current developments

Given that most salaried employees are required to work from home and would likely not be able to claim a tax deduction for home office expense based on the legislation as it currently stands, a proposal has been submitted by various stakeholders to National Treasury, requesting that relief be provided to taxpayers who are forced to work from home and who incur business-related expenditure as a result.

To avoid taxpayers having to keep detailed records, it has been proposed that a deemed tax deduction be permitted, for example, by permitting taxpayers working from home to claim an income tax deduction at a prescribed rate per hour.

# Electronic services and VAT – More clarity on the horizon?



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The intention of the 2019 amendments to the Value-Added Tax (VAT) Legislation was to broaden the scope of the regulation dealing with electronic services, and to remove some uncertainties created by the legislation in place at that point in time. Whilst the 2019 amendments achieved the widening of the application of the regulation to apply to all “services” which are provided by means of electronic agent, electronic communication or the internet, the practical application of the new provisions as a whole proved to be challenging.

The policy intention of the widening of the ambit of the legislation, as stated in the explanatory memorandum, is to subject VAT to those services that are provided using minimal human intervention. As the term “human intervention” is not incorporated into the legislation, is not a defined term, and is only noted in the explanatory memorandum and the South African Revenue Service (SARS) FAQ Guide briefly; it has raised questions regarding the application thereof. Where there is a component of human intervention in the service being provided, for example, a livestream training session facilitated by a presenter, the service is clearly to a very large extent dependant on human involvement. In instances such as these where there is significant human intervention, but the content is provided electronically, arguments have been advanced that the service falls within the

ambit of the legislation. The SARS FAQ Guide provides an example of an architect in an export country, designing plans for a house and subsequently emailing these to a person in South Africa. The response in the guide is that this does not constitute an electronic service as the service involves substantial human intervention. The supply is therefore seen to not be dependent on information technology or automation. The email merely constitutes the means of communication.

The 2019 amendments introduced an exclusion of certain supplies within a group of companies as a way of limiting the administrative burden. Electronic services that are supplied by a non-resident company itself, to a resident company that forms part of the same group of companies, are excluded from the regulation if the services are supplied exclusively for the purpose of consumption by the resident company. The interpretation of when the non-resident company “itself” supplies the service, and the extent to which the local group company has to consume such a service, requires more clarity.

A number of uncertainties in the interpretation of the electronic services legislation, such as the above, can be addressed as part of the 2021 amendments in order to provide clarity to non-residents, which in turn is likely to enhance voluntary compliance.

The policy intention “is to subject VAT to those services that are provided using minimal human intervention.”

# Oil and gas industry developments in South Africa



## By Moray Wilson

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The last twelve months have been tumultuous for the industry, with global economic turmoil and ongoing lockdowns and restrictions on travel contributing to a slump in oil prices to historic lows in the early part of 2020. Ongoing uncertainty regarding the economic outlook for the year ahead suggests that 2021 will be similarly challenging.

In the 2019 Budget Review document, National Treasury acknowledged that it had not approved any fiscal stability agreements for oil and gas companies

for some time, despite these agreements (which guarantee that the terms of the tax rules that exist as at the date that the fiscal stability agreement was entered into will apply regardless of any subsequent change to legislation) being a key component of the Tenth Schedule to the Income Tax Act and the Royalty Act. National Treasury also indicated in the 2019 Budget that it would be embarking on a process to review the tax treatment and special rules applicable to companies in this sector. No further indication was given at the time as to the objective of the proposed review and, with no details provided in the 2020 Budget or since, it is not clear if any progress has been made on this initiative in the last year.

In order to encourage investment in the oil and gas sector and the development of new projects, and thereby provide a much-needed boost to the local economy and improve energy security for the country, it would be most useful for meaningful progress to be made on improving regulatory certainty for the industry. In the upstream (exploration) sector, this would include the finalisation of the long-awaited Upstream Petroleum Resources Development Bill and some indication being provided in the 2021 Budget regarding the outcome of the review announced in 2019 of the tax rules applicable to oil and gas companies and, most critically, the resumption of approvals for fiscal stability agreements.

“In order to encourage investment in the oil and gas sector and the development of new projects, and thereby provide a much-needed boost to the local economy and improve energy security for the country, it would be most useful for meaningful progress to be made on improving regulatory certainty for the industry.”

# Foreign employees stuck in South Africa due to COVID-19? Beware of the tax implications



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Many multinational companies have foreign expatriate employees who render services in South Africa on international global mobility assignments. Many of these employees have been unable to return to their home countries at the end of their secondment arrangements due to travel restrictions, and as a result have found themselves stuck in South Africa at the end of their contracts.

This position may result in unintended South African personal tax consequences to the individual and employment tax implications to the foreign employer, particularly if the individual continues to work remotely in South Africa and is remunerated by his/her home-country employer for such work.

The individual, as a non-South African tax resident, will be liable to be taxed on income derived from a South African source (e.g. on remuneration derived from services rendered locally, rental income and capital gains on immovable property located in South Africa etc.); and subject to any relief that may apply in terms of a double tax agreement (DTA) between South Africa and the individual's country of tax residence.

Thus, unless the individual qualifies for relief from tax in terms of an applicable DTA, he/she will be liable for tax in South

Africa to the extent that he/she renders services here. This is irrespective of where in the world an individual may be paid for these services, where the individual's employment contract is signed or where the individual's employer is resident.

If the individual qualifies for DTA relief, he/she will not be liable for tax in South Africa, however, he/she may on a strict interpretation of the tax legislation, still be required to file an income tax return here with SARS (unless certain exclusions apply).

Where the individual does not qualify for DTA relief, or where South Africa does not have a DTA with the individual's country of tax residence, he/she would be liable for tax in South Africa on the remuneration earned for services rendered here. The individual would also be required to register as a taxpayer (and potentially also as a provisional taxpayer) and file income tax returns (and if relevant, provisional tax returns) in South Africa.

The foreign employer may not have an employees' tax (Pay-As-You-Earn [PAYE]) withholding obligation in South Africa in respect of the remuneration it pays the individual for services rendered here, provided it does not have a "representative employer" in South Africa (i.e. it does not have a public officer in South Africa who pays/becomes liable to pay any

remuneration to the individual and it also does not have a resident agent in South Africa who has the authority to pay remuneration).

It is noted that even though the entity may not have a PAYE withholding obligation in South Africa, it may still be required to register as an "employer" for PAYE purposes in South Africa if it pays remuneration to an employee, unless none of its employees are liable for normal tax in South Africa. Importantly, this employer registration requirement exists regardless of whether the non-resident employer actually has an obligation to withhold PAYE in South Africa.

In addition, the foreign employer may also be required to register for, and pay other payroll related taxes (i.e. Unemployment Insurance Fund contributions and Skills Development Levies in South Africa).

It is thus important that foreign individuals and employers who find themselves in these circumstances assess whether there are any South African personal tax or employment tax obligations that need to be accounted for; as non-compliance may result in amongst others, reputational risk and tax penalties being imposed.

# COVID-19 as an 'event of force majeure' in commercial agreements



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“...business owners and business leaders remain concerned about the implications of the inability of their enterprises to provide goods and services to customers, and/or the inability of their suppliers to meet their contractual obligations to supply the inputs required to trade.”

There is no doubt that the disruptions to the global supply chain brought about by the COVID-19 pandemic are still felt almost a year after the declaration of a national state of disaster by President Cyril Ramaphosa, in terms of the Disaster Management Act, 57 of 2002 (the DMA). As a result, business owners and business leaders remain concerned about the implications of the inability of their enterprises to provide goods and services to customers, and/or the inability of their suppliers to meet their contractual obligations to supply the inputs required to trade.

In light of the extraordinary events that occurred in this last year, as the ability of businesses to continue contracting in accordance with the terms of their contracts is constrained, suppliers are looking to their commercial agreements for available avenues for relief from their performance obligations. On the other hand, their customers are assessing their rights to enforce these performance obligations under the same agreements.

A party whose ability to perform obligations under a commercial agreement is negatively impacted by the ever-changing regulations issued in terms of the DMA (the Regulations) may look to trigger a force majeure clause in the agreement in order to avoid being in breach of contract.

Force majeure clauses typically provide for a temporary suspension of the parties'

respective contractual obligations upon the occurrence of a specifically defined event or set of events that prevent a party from performing its obligations. The other party to the agreement is usually prohibited, for the duration of the force majeure event, from instituting a damages claim as a result of the first party's non-performance. It should be noted that force majeure clauses often stipulate that the force majeure event will not operate to suspend the obligation of a party to make a payment if it becomes due and payable under the agreement.

A force majeure clause does not automatically apply to a given set of circumstances that prevent performance. It is only in instances where the event preventing performance is specifically defined in the contract as constituting a force majeure event that a party to a commercial agreement may rely on the event to excuse its failure to perform its contractual obligations. Our recommendation is that any business looking to invoke the provisions of a force majeure clause in an agreement should carefully analyse the wording in their agreements to be certain that such circumstances fall within the contractual definition of force majeure.

Events that are typically defined as constituting force majeure events in commercial agreements are an act of God, fire, flood, riot, strikes, national restrictions, any court order, and any requirements of any governmental authority or other

circumstances that are not within the reasonable control of a party.

Force majeure clauses often include an obligation on the party whose performance is affected to provide advance written notice to the other party to the agreement of the possible occurrence of a force majeure event. These clauses also often allow for termination of the agreement without damages or the renegotiation of the agreement in instances where the force majeure event endures in excess of a specific time period.

Under South African law, where an agreement is silent on the issue of force majeure or where the event preventing performance is not catered for in the definition of force majeure in the agreement, the common law will apply. In such circumstances, the common law concepts of supervening impossibility of performance or undue hardship may be relied upon by a party in the face of a claim for specific performance in terms of an agreement, provided certain

factual circumstances are present. In such cases, a legal analysis of the relevant agreement and the facts will have to be undertaken to establish whether the terms of the agreement are enforceable, notwithstanding a counterparty's inability to perform its obligations.

As the stability of the supply chain is integral to effective scenario-planning and the development of business continuity plans, we encourage businesses to pay particular attention to the potential impact of force majeure declarations by their suppliers as well as the extent of relief that their own declarations of force majeure may provide during periods of uncertainty.

It is critically important that businesses work to maintain the relationships between themselves as well as their suppliers and customers as we navigate the turbulence brought about by the COVID-19 pandemic, as once COVID-19 is behind us, these businesses will have to work together to rebuild their supply chain ecosystems.



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