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Are We Headed for Junk Status or Only Tax Increases?

"We have to show that we will stick to our undertakings on consolidation, but on the other hand we have got to be very mindful that fiscal consolidation in the absence of growth does damage growth further." (Finance Minister Pravin Gordhan in his Medium Term Budget Statement)

Firstly, what is the Medium Term Budget Statement (MTBS)? It's a three year outlook by the Treasury of government finances and an exercise in transparency in governance. Whereas the February Budget each year is Government's actual annual financial plan, the MTBS is an interim statement that highlights government priorities and spending plans, an advance warning if you like of what we can expect in the future.

It's particularly important this year because this is an unprecedented time for the country as we face a ratings downgrade from the ratings agencies, low economic growth and the concerns and uncertainties arising from the Minister of Finance having been charged with fraud.

A ratings downgrade to junk status (currently we are one notch above junk) will increase the cost of debt and will almost certainly lead to a downward spiral of the Rand.

What do the rating agencies say?

There are three major agencies:

- S&P wants to see ongoing fiscal consolidation (curbing the country's debt level) and an end to political turmoil

- Fitch is concerned that the current political ructions could loosen Treasury's grip on fiscal consolidation

- Moody are the most positive of the rating agencies. South Africa has a robust democracy, fiscal stability is working and better economic growth prospects are ahead.

The agencies would also like to see impediments to economic growth, such as restrictive labour provisions, reformed.

Our economy: a report card

Since 2009, we have faced difficult times as commodity prices have plunged. This has limited GDP growth at a time when the country is spreading the net of welfare payments and has faced electricity shortages.

This has led to rising government debt, tax increases and a commitment by Treasury to control government spend.

At present government expenditure is 34% of GDP versus 31% for emerging economies. Tax collections are 30% of GDP whilst the norm is 27%. Finally, government debt to GDP is 46% and rising – the accepted figure is below 50%.

So, Minister Gordhan faces stern challenges.

The Minister's tone and speech were different from previous interim budgets. He spoke of the nation pulling together to create a more just, transparent society which addresses inequality and allows equal opportunity.

The key statistics

- Revenue (taxes we pay) will be R23 billion below budget for this year. This will increase the deficit to 3.4% of GDP (3.2% was budgeted). The Minister forecasts this will drop to 2.5% in the budget period

- To cover the revenue shortfalls taxes will be raised by R43 billion in the next two years of which R28 billion will be implemented next year. The proposed carbon and sugar taxes will almost certainly be in the mix of tax increases

- The ceiling for expenditure will reduce by R10 billion next year and a further R16 billion in the next two years. In prior years Treasury have introduced a level (ceiling) above which spend could not go

- Inflation is forecast at 6.1% this year, 6% next year and falling to 5.9% in the final year

- Government debt to GDP will be 45.8% this year and will stabilise at just below 48% in three years

- GDP will grow 0.5% this year, 1.3% next year and 2% in 2019

- Financial assistance to students will be an extra R17 billion in the forecast period

- The freeze on government posts will remain. This is estimated to reduce government employment by 25,000 in the three year outlook

- Ongoing supply chain measures to improve efficiencies and savings.

In a difficult economic climate, the Minister showed his commitment to fiscal prudence. This is necessary for the economy but is also important for the rating agencies.

The junk status danger: Keeping the ratings agencies happy

As noted above, the agencies want to see measures to grow the economy and reduce political turmoil.

The Minister announced:

- The boards of SAA and the Post Office had been reconfigured to strengthen governance and oversight.
- The government intends to bring policy certainty to telecommunications and tourism.
- Progress has been made with labour relations as shown by a drop in strike activity following negotiations with union leaders.
- Ongoing supply chain savings following the introduction of a centralised procurement data base. Negotiations are under way with key suppliers to save R25 billion a year by 2019.
- Communications with CEOs has proven successful with R1.5 billion made available to grow small business. Ultimately, the goal is to get the private sector to start investing in the economy – private sector investment is currently very low.
- R45 billion has been set aside for industrialisation and sustainable resource management.
- R58 billion will be invested by Independent Power Producers for new energy projects which will add 2 354 MW to the power grid.
- Over R900 billion set aside for infrastructural projects.

These will remove impediments to growth in the next few years.

So how will all this affect us?

- Taxes will definitely go up. We will only learn the specifics of what taxes, and how, in the Budget Speech next February.
- Our household budgets will come under increasing strain, particularly if we sink to junk status. If that happens, prepare for a jump in interest rates, a weaker Rand, higher inflation and price increases.
- Overall, however, the Minister has lived up to the quote above and there is hope in that. The currency has (at time of writing) maintained its levels indicating that overseas and local investors are not dissatisfied with the budget.

When Your Lease isn't a "Lease": Beware, the National Credit Act's Protections Don't Always Apply

"In effect, [the High Court] held that the particular lease was not a lease. This may sound like a fragment of Alice in Wonderland. If that is so, it is because the [National Credit] Act itself could have been written by Lewis Carroll so peculiar are some of its provisions" (extract from

Supreme Court of Appeal judgment below)

If you are about to enter into a rental or lease agreement for a moveable asset, such as a printer, be sure you know how the National Credit Agreement Act (NCA) treats such agreements. The trap here is that a lease isn't always a "lease" for the purposes of the Act.

The implications

The NCA aims to promote fair and responsible lending practices to consumers when they enter into credit agreements. It covers most leases, mortgages, instalment sales, credit cards, suretyships and other similar methods of borrowing, and provides strong protections for credit consumers.

When you enter into an agreement which is covered by the NCA, you can generally feel confident that you won't have a loan shark to deal with.

However, if the agreement is not covered by the NCA, then these protections fall away.

For example…..

An experienced and financially astute business owner tells of his disastrous experience when entering into a rental agreement for a photocopier. The charges seemed reasonable but the agreement was complex, in very small print and difficult to understand. He was, he says, persuaded by the salesman to sign the agreement which he did without reading and understanding its terms. After several months, the business decided to terminate the agreement. The owner discovered he had entered unknowingly into 2 agreements and the finance house wanted R15,000 on a machine which cost R7,500 new. This after the finance company had already got the photocopier back!

When the owner sought the protection of the NCA, he got a shock. The finance house was indifferent to his arguments about the NCA. He then learnt of a 2013 Supreme Court of Appeal judgment to the effect that per the definition of "lease" in the NCA, only agreements in which ownership passes at the end of the agreement are covered by the NCA. Although the businessman believed that ownership of the photocopier would somehow pass to his business eventually, the terms of the agreements specifically provided to the contrary - he therefore had no NCA protection and was liable for the R15,000. He might perhaps have had better luck trying for protection under the Consumer Protection Act, which does apply to agreements of this nature, but it wouldn't have been easy.

If you enter into a credit agreement and it is hard to follow, take a step back and ask questions. If you still have doubts speak to your accountant. Don't lose out like this business owner did!

Are You Struggling to Get Your Tax Refund?

There is a feeling that taxpayers are getting fed up over the amount of tax they have to pay. Add to this the adverse publicity SARS has received as one of the focal points of the current political struggles and the string of suspensions/dismissals of senior SARS officials.

Despite this, statistics for the months April to July show that government finances are on track to deliver on the Budget outlined by the Finance Minister in February. True, collections are a little down but this is more than offset by lower government spending.

Tax refund delays – what's going on?

One of the cornerstones of the efficient systems run by SARS is the speed at which tax refunds are paid - normally 48 hours after an assessment is made or a verification process is completed. Yet there is a steady stream of complaints from taxpayers and the financial press of frustrating delays experienced by taxpayers due a refund.

Taxpayers due refunds are finding themselves subject to verification processes which is standard. What frequently happens is a taxpayer being asked to personally go to a SARS office with their FICA and banking details. Many are being asked to do this more than once and discovering there is still no tax refund. Tax practitioners are also finding that their clients have been placed on "Special Stoppers" and neither they nor the client are informed. In many instances the frustration is exasperated by unclear or a total lack of communication and clarification from SARS.

SARS has increased their controls over refunds due to increasing criminal activity and the high amount of fraud taking place. They have been ambivalent, though, in their explanation for the actual refund delays – on the one hand admitting there is a problem but then stating that these delays relate to 5% of tax submissions and taxpayers must expect delays.

Some light at the end of the tunnel - perhaps

SARS has been promising an updated Tax Service Charter which hopefully will be released soon and will address this issue. There is a proposal before Parliament that the Minister may direct the Tax Ombud to investigate "systemic issues" relating to service.

In the meantime, taxpayers suffer the cash flow consequences. This is particularly severe on small businesses and individual taxpayers and addressing fraud without collateral damage is becoming a matter of desperate urgency.

The Special Voluntary Disclosure Programme Begins - What's Changed?

We recently discussed the Special VDP which lets non-compliant taxpayers voluntarily disclose offshore assets and income in order to regularise both their tax and exchange control affairs. As promised, here is an update for you on current changes to the SVDP. Please note that the final amendment Bill has not at date of writing been passed by Parliament, so it is possible there will be some further changes. We'll keep you advised.

The main changes

1. The closing date has been extended. Originally it was from 1 October 2016 to 31 March 2017. The closing date is now 30 June 2017.

2. The original intention was that seed capital and investment profits and/or losses

would be separately worked out. Now there will be one combined calculation.

3. The amount will be determined as 50% of the highest value of all undeclared assets between 1 March 2010 and 28 February 2015 (i.e. a valuation must be done for each of the 5 years). It is to be converted into local currency at the closing foreign exchange rate on 28 February of the relevant year when the highest value was achieved.

4. The "undeclared income that originally gave rise to the assets" above will be exempt from income tax, estate duty and donations tax. Future income on these assets will be taxed.

5. Other taxes – VAT, PAYE, UIF and SDL are not included in the special VDP and taxpayers will remain liable for any such taxes which will have to be dealt with under the normal VDP process.

6. Taxpayers who disposed of offshore assets before 1 March 2010 may apply for special VDP relief.

As you can see this is a complicated matter and it is disappointing that the Special VDP has opened without the enabling legislation in place. **If you think any of this may apply to you, seek expert advice on this highly sensitive topic.**

Inflation's Different Effects on Different Income Groups: The Danger for South Africa

Each month Statistics SA releases the inflation figure (CPI). Currently it is 5.9% which is a considerable improvement on February's 7%.

What is interesting is the CPI figure is a composite of five quintiles of income groups – from the poor to the affluent.

What do the quintiles show?

They show that for the wealthy the CPI is 5.8% but for the poor the figure is 8%. Effectively the poorer sections of the community are far more exposed to inflation. The main culprit is food prices which are increasing by 11.3%. This has a greater relative impact on the poor than the more wealthy.

Perhaps this helps to explain the rising tide of service delivery protests and the general discontent the country is facing.

Inequality is increasing, and that's dangerous

We know that South Africa is one of the most unequal societies in the world and in the medium to long term this is unsustainable. Intuitively, the inflation figures show that inequality is not decreasing but continues to rise.

Whilst we speculate about the various political machinations and student protests that daily hog the headlines, let's not forget that failing to address inequality will come back to haunt us all.

Your Tax Deadlines For November

25 November 2016 is your eFiling deadline if you are a non-provisional taxpayer. If you plan to submit from a SARS' office this is also the due date for filing (non-provisional).

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