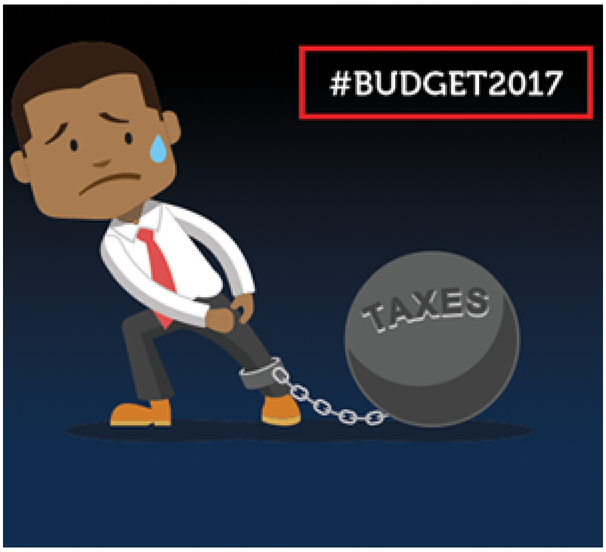
Taxpayers hit with highest marginal rate since ’94



Cape Town – The question for Finance Minister Pravin Gordhan going forward is, can we be sure the spending plans are sufficiently robust to grow the economy and therefore stave off a further tax increase?

With SA’s gross domestic product (GDP) growing slowly and unemployment remaining the same – therefore no new jobs – an increase in tax revenue can only go so far before taxpayers will eventually be paying more and more with no real return to the economy.

This is the view of Marc Sevitz, a member of the National Tax Operations Committee of the SA Institute of Chartered Accountants (SAICA) in reaction to Budget 2017.

Gordhan forecast increases in revenue collection as percentages of gross domestic product (GDP) over the next three years to marginally increase with further small amounts of GDP growth.

“In the current budget, the minister unfortunately faced no choice of what to do. He had to look for revenue and looked deep into the pockets of the wealthy. He finely balanced the needs of the not so wealthy and the need to be taxing the rich," said Sevitz.

"The new super tax bracket of 45% means that taxpayers earning more than R1.5m per year will face a much stiffer tax liability. The minister did not raise the marginal rates on the 18% to 41% brackets and instead provided the smallest amount of tax relief whilst still collecting more money for the fiscus."

He went further by increasing the withholding tax on dividends to 20% from the previous 15%, but thankfully left the CGT rates alone, according to Sevitz. Gordhan "rewarded" taxpayers for saving by increasing the contribution amount on tax free savings to R33 000 – an increase of R3 000 per annum.

"Taxpayers were met with the usual inflation linked increases in their medical tax credits and travel allowance tables, however ominously though warned that these medical credits might soon be decreasing and not increasing in the future," explained Sevitz.

Those taxpayers wanting to enter the housing market were given a welcome reprieve in the form of a transfer duty minimum threshold increase to R900 000 and travellers for work purposes were given quite an increase in the per kilometre claimable amount of R3.55.

Major disappointment

The major disappointment for Sevitz, however, was that there was no announcement on tax changes for small and medium businesses – the tax rates table provides maximum relief of R52 per year now.

"The VAT threshold was not increased, much to the dismay of small business owners who do struggle with cash outlays month on month. The minister did unfortunately have very little wiggle room and taxpayers can only hope these levers are pulled next year in order to provide further relief to small business owners," said Sevitz.

"Overall, the minister hit the individual hard as far as the wealthier are concerned. However, those taxpayers who earn a salary, have one or two benefits and continuously save cleverly will see their fortunes having risen ever so slightly in the face of it. Given the rate of inflation hovering at the 6% to 7% mark, the slow growth and the minimal tax relief, taxpayers celebrating now that they werent hit too badly, should be aware that unless something drastic changes their real income will continue to fall."

Personal tax

According to Barry Knoetze, associate director of PwC Tax Services – as many pundits predicted – Gordhan announced a new 45% tax bracket for individuals, which will apply to taxable income in excess of R1.5m.

The tax rates below that have remained unchanged and the income levels at which they apply have been slightly adjusted, but not enough to offset the effects of inflation.

According to Gordhan, the impact of the tax proposals are that the additional revenue for the fiscus from personal income tax is R16.5bn, while the introduction of the new tax bracket will result in additional revenue of R4.4bn.

"These new tax rates, combined with increases in the fuel levy as well as the usual increases in 'sin taxes' will hit certain sectors of the economy quite hard. Certainly, taxpayers with taxable income in excess of R1.5m will find themselves significantly worse off," said Knoetze.

Vedika Andhee, tax director at EY, set the impact of Budget 2017 on middle and high income earners as follows:

– Those earning R10 000 a month will take home R11.25 per month more;
– Those earning R20 000 a month will take home R23.83 per month more;
– Those earning R40 000 a month will take home R52.97 per month more; and
– Individuals earning R150 000 per month will be paying R921.58 additional tax per month from March.

Highest since 1994

Mike Teuchert, partner at Mazars, said the 2017 Budget Speech marks the highest marginal tax rate since 1994. The tax increases announced by Gordhan will not only have a significant impact on SAs top earners, but also on the average consumer due to limited relief for bracket creep.

The increase of income tax on individuals earning over R1.5m per year, to 45% will affect around 100 000 income earners which is expected to bring in an additional R4.4bn in revenue. It is worth noting that the top 6.6% of registered taxpayers will now be contributing around 50% of the countrys total personal income tax revenue, said Teuchert.

He notes, however, that average taxpayers will also need to tighten their belts once again, following this Budget Speech, as Treasury will also be taking advantage of the effect known as tax bracket creep.

Treasury usually adjusts the existing tax brackets each year in order to keep individuals who earn inflation related salary increases within the same brackets. However, this year Treasury only adjusted the tax bracket by 1%, while average salary increases will still be in line with inflation at around 5%, he explains.

Effect on the wealthy

Tertius Troost, tax consultant at Mazars, said the 2017 Budget has a greater effect on the wealthy than the lower income earners for a number of reasons.

In particular, the increase of the dividends withholding tax from 15% to 20% paired with the existing corporate tax rate of 28% results in an effective corporate tax rate of 42.4% (up from 38.8%). This essentially means that a business owner will be taxed at an effective rate of 42.4% if the owner wishes to take funds out of the company, said Troost.

This increase in dividend withholding tax is largely a reaction to the increase of the income tax rate for the top bracket income earners to 45% from 41%, he adds.

A significant difference between the top individual tax bracket and the effective company tax rate provides an opportunity for tax arbitrage where business owners will be more inclined to declare dividends to themselves rather than pay themselves a salary. This is one of the many measures being taken to reduce mechanisms for consumers to get around paying tax.

With the VAT and fuel levys collections down by R12.7bn against budget it is an indication that consumers are spending less and are under pressure, he added.

With Pravin Gordhan proposing a 30 cent per litre increase in the fuel levy and a 9c per litre increase in the Road Accident Fund it will put even more pressure on the man on the street.

The fuel taxes will increase retail prices as well as have a negative effect on inflation, Troost concluded.

Surprises for executives

Jerry Botha, executive committee member of the SA Reward Association (SARA) the surprises are more for executives, expatriates and other high income earners.

There is a new tax bracket of R1.5m and where you exceed this amount, you will pay a flat 45% tax rate.

“Whilst it might be argued that this is comparable to other international locations, coupled with the limited tax deductions and exemptions, this makes for a very high effective tax rate. The dividends tax rate has also been increased to 20% (previously from 15%) and, so this is another higher tax impacting share schemes and owner-managed businesses. The effective tax rate on company profits is, therefore, now 42.4%, said Botha.

Tim Mertens, chair of Sovereign Trust said one would have to wait and see whether the increase in withholding tax falls in line with an announcement by the minister to update the Double Taxation Treaties that SA has signed with other countries where there is often dividends withholding tax relief.

“It is perhaps disappointing that there is also no further clarity at this stage on which recommendations made by the Davis Tax Committee are to be addressed on the numerous topics mentioned by the DTC, and that the only reference here was for the DTC to draft a governance and accountability model for The South African Revenue Service. We understand that the DTC will complete final reports in March 2017 after which we hope to expect clarification within the DTC model,” said Mertens.

“With the increase in personal taxation and the already punitive taxes being introduced to attempt to reduce effective estate planning opportunities for South African taxpayers across the board, now more than ever, it is advisable to obtain sound advice so that proactive planning can be achieved.”

Refined strategy

Gordhan is aiming to keep South Africas investment-grade credit rating. Hes being forced to do something of a balancing act by imposing higher taxes and reducing government spending in order to try and shore up the economy, according to Gavin

Smith, head of Africa at deVere Acuma.

As Gordhan tries to do this for the country, individuals across SA must try and do the same and refine their own personal financial strategies in response this years budget, in Smith's view.

Increases in estate duty and capital-gains tax could deliver as much as R5bn in extra revenue for the government, but it will also likely impact individuals, particularly high-net-worth individuals.

With this in mind, I would suggest that people need to explore all the avenues available to them to mitigate their increased tax burdens by working with a financial adviser to devise, implement and manage a sound financial strategy, said Smith.

For some individuals, it would also make sense to consider investing overseas, particularly if future retirement, education or business plans will require foreign currency funding."

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Cape Town Finance Minister Pravin Gordhans 2017 Budget Speech was one that was drafted in difficult times amid revenue shortfalls, slow economic growth, increasing government debt and uncertainty about his tenure as political head of the National Treasury.

As was widely speculated, Gordhan announced a new personal income tax bracket for South Africans earning more than R1.5m who will be taxed at 45%, while providing limited relief for fiscal drag.

Gordhan did not raise the marginal tax rates for taxpayers in the 18% to 41% tax brackets, but provided very limited tax relief for this grouping.

READ: Taxpayers foot bill for largest revenue shortfall in 8 years

In addition, he raised the withholding tax on dividends to 20% from the previous 15%. Capital gains tax, however, remained unchanged.

The tax hikes shouldnt have come as a surprise, though. In his medium-term budget policy statement delivered in October last year, Gordhan cautioned that something has got to give to fill the R28bn hole in the fiscal gap and that tax increases would be announced in the next annual budget review in light of the revenue shortfall the largest in eight years.

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Growth outlook

In his speech, Gordhan said GDP growth is still expected to average 1.3% in 2017, increasing slightly to 2% over the medium term.

The projected growth rate however is not high enough to make a significant dent in unemployment, poverty and inequality, Gordhan said, and added that inclusive growth requires broad-based transformation to enable millions of black South Africans to generate income and raise per capita incomes across the board.

Government debt

Although governments gross debt levels fell in the short term, the debt to GDP ratio is still high and is expected to peak just below 53% in 2018/19 before stabilising at 48.2% in 2020/21.

Government debt currently stands at R2.2tr, and debt service cost amounts to R169bn.

Gordhan pointed out that interest payments on debt is a rising share of expenditure and that the country has little choice but to stabilise debt so as to make sure future generations dont have to cough up for current expenses in the next decades to come.

An uncertain future

In addition to the limited fiscal space that allows for little maneuvering, Gordhan had to deliver the 2017 Budget Speech against the background of calls for his resignation (from the ANC Youth League and Womens League among others) and rumours that he could be replaced by former Eskom CEO Brian Molefe who is expected to be sworn in as a member of Parliament soon.

READ: Gordhan, Jonas speak out on Molefe 'noise'

Gordhan, however, appeared to be unfazed by the political undercurrents and told journalists at a media briefing ahead of his speech that he serves at the pleasure of the president.

He made it clear though that National Treasury as an institution remains steadfast in serving the country and that he has executed his duties to the best of his abilities.

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