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E M Luiz Chartered Accountants (SA) Registered Auditors

Liz Luiz CA (SA), B Comm, Dip Acc, Dip Tax
Suite 4A, Mahogany Court, Redlands Estate, 1 George Macfarlane Lane, Pietermaritzburg, 3201, South Africa
PO Box 3143, Pietermaritzburg, 3200 Tel : +27 33 345 0282 Fax : +27 33 394 0746
Email : info@emluiz.co.za Website : www.emluiz.co.za

November 2017 Newsletter

"REVIEW: MEDIUM TERM BUDGET POLICY SPEECH"

Overview

There was not much good news, with revenue shortfalls projected in 2017/18 to be R50 billion, R69 billion in 2018/19 and R89 billion in 2019/20. So, a collective shortfall over the next three years of over R200 billion, with limited detail on how to fund it. There is mention of the sale of state assets to fund the SAA bailouts etc. There appears to be no concrete plan of action besides the possible sale of some Telkom shares.

We appear to be stuck in a low growth trap, with limited vision for a way forward. There is immense political pressure to act in accordance with the wishes of key political figures and it appears that only a radical change in government leadership will result in the required growth and confidence in the economy that will enable radical economic transformation.

Tax measures

Carbon tax is firmly back on the agenda. In minister Gigaba's speech he comments as follows:

"I am also happy to announce that Cabinet has approved the release of the carbon tax bill to Parliament for formal consideration and adoption."

A revised draft bill will be published for public comment shortly. This probably will be early in 2018 with a view to implement 2nd half 2018.

Funding the current shortfalls in revenue is going to be in part via increased taxes. For instance, the issue of funding the National Health Insurance via adjustments to the existing medical tax credits is still being mooted. The Davis Tax Committee is being consulted on this issue to assess the viability of such changes. ***"Sugar Tax"*** is under consideration in Parliament with a proposed implementation date of 1 April 2018.

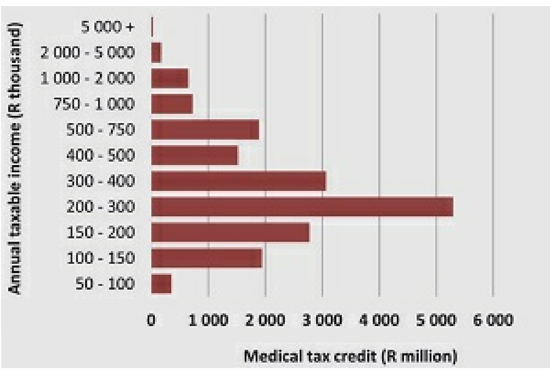
There is no doubt that a lot hinges on the outcome of Decembers political deliberations. The budget in February 2018 promises to be extremely interesting!

MEDICAL TAX CREDIT

To anchor a sustainable budget, structural increases in expenditure must be matched by structural increases in revenue. As stated in the 2015 MTBPS, the expenditure ceiling can be adjusted to accommodate new spending priorities when a permanent source of revenue is found to offset increased spending. For example, government is considering proposals to finance national health insurance (NHI) through adjustments to the medical tax credit as discussed below.

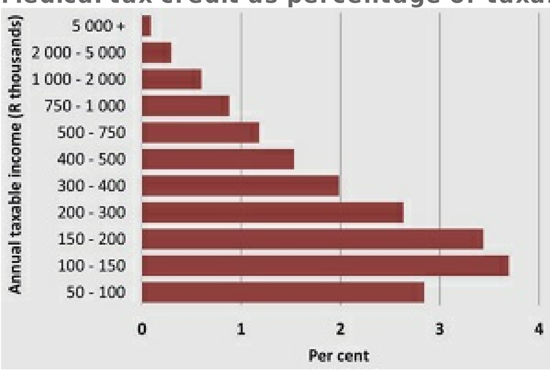
In 2012, government moved from a system of deductions for medical aid contributions and qualifying expenses to a system of tax credits independent of taxable income. In 2014/15, 3 million taxpayers claimed the credit on behalf of 8 million medical scheme members, resulting in a tax expenditure of R18.5 billion. The incidence of these credits is spread across the income distribution: 56 per cent of the total credits claimed accrued to 1.9 million taxpayers who had a taxable income of less than R300 000. This includes many workers who belong to medical aid schemes.

Medical Tax Credit per income group



Source: National Treasury calculations, 2014/15

Medical tax credit as percentage of taxable income of taxpayers*



****Sample only includes taxpayers that claimed medical tax credits (Source: National Treasury calculations, 2014/15)***

The 2017 Budget Speech stated that "consideration is being given to possible reductions in this subsidy in future, as part of the financing framework for national health insurance(NHI)". The National Treasury is considering changes to the design, targeting and value of the medical tax credit as part of the policy development process for the 2018 Budget.

Tax data, however, indicates that the program is well-targeted to lower and middle-income taxpayers. The National Treasury will seek input from the Davis Tax Committee on the feasibility of proposals to adjust the medical tax credit to fund NHI. We should get further clarification in next year's budget speech and will keep you informed of any updates in this regard.

MEDIUM-TERM EXPENDITURE OUTLOOK

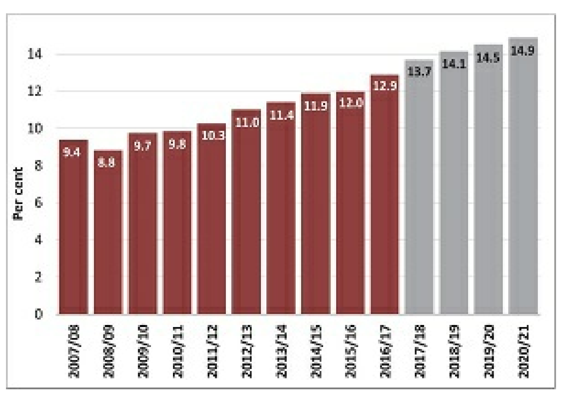
To offset revenue shortfalls and reduce borrowing, government has had to reduce its reserves. This leaves government with little room to maneuvre should risks to the expenditure ceiling materialise. Moreover, further reductions in the ceiling may be required to stabilise national debt. Various risks and pressures need to be taken into account over the medium term:

- Additional spending commitments may emerge from policy processes underway. Government is evaluating the implications of providing fee-free higher education and training to poor and middle-income students. Other policy commitments include NHI, proposals in the Defence Review, improved early childhood development, accelerated land reform and several large infrastructure project proposals.
- The inflation outlook has been revised down compared with the 2017 Budget, relieving pressure on inflation-linked expenditure such as the wage bill. However, public-sector remuneration budgets pose a large and imminent risk, with the possibility that some national and provincial departments will exceed compensation ceilings.
- A new civil service wage agreement in which salary increases exceed CPI inflation, and without headcount reductions, would render the current expenditure limits difficult to achieve.
- Several state-owned companies persistently demonstrate operational inefficiencies, poor procurement practices, weak corporate governance and failures to abide by fiduciary obligations.

Debt-service costs

At a time when revenue is under pressure, an increasing share of tax collection will be diverted to settle interest payments. As gross debt expands, debt service will remain the fastest-growing category of spending over the next three years. Relative to the 2017 Budget projections, debt-service costs will be R1 billion higher in 2017/18, R2.4 billion higher in 2018/19 and R6 billion higher in 2019/20. By 2020/21, government projects that nearly 15 per cent of main budget revenue will go toward servicing debt. This crowds out the space to fund social and economic priorities.

Interest payments as a share of main budget revenue



Source: National Treasury

TRUSTS - TAXATION LAWS AMENDMENTS BILL 2017

At the time of the Medium-Term Budget Statement minister Gigaba also signed the Taxation Laws Amendments Bill 2017, which gives effect to various bits of legislation, one of which is the issue surrounding interest free or low interest loan accounts to trusts. Many commentators have stated that the wording is incorrect and could give rise to unintended consequences. We will keep you informed of developments in this regard. Should you have any queries in this regard please do not hesitate to contact us.

Sincerely,

E M LUIZ
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