PwC focus on tax revenues for 2018/19 – 18 October 2018

How are tax revenues performing for 2018/19?

A major concern on the minds of business and the public in general is how tax revenue collections are performing and whether we can expect further tax increases in the 2019 Budget. This is particularly the case given the large tax increases seen in recent years and the shortfalls in revenue collections against Budget forecasts. 2014/15 saw a shortfall against the original Budget forecast of R7.3 billion, 2015/16 a shortfall of R11.3 billion, 2016/17 a shortfall of R30.6 billion and 2017/18 a shortfall of R49 billion. The trend of the ever-increasing shortfalls in tax collection is, of course, a worry as it results in upward adjustments in tax rates.

The significant tax increase in the 2017 and 2018 Budgets amounted to R28 billion and R36 billion, respectively. The true tax increases in 2015 and 2016 probably amounted to R18 billion and R15 billion, respectively once fiscal drag is factored in. In this regard, inflation was not fully taken into account in the increases presented in the Budget, resulting in an understatement of the true increases insofar as personal income tax is concerned and an overstatement for fuel levies and excise duties.

Notwithstanding these large tax increases, the tax-to-GDP ratio has stalled at the same level for the last three years (it actually fell slightly in 2017/18), meaning that the tax increases did not translate into increased tax revenues collected by SARS. There are a variety of reasons for this, including the state of the economy, a slippage in tax enforcement and declining tax morality due to a breakdown in the social contract between taxpayers and government.

The good news is that revenue collections for 2018/19 are looking surprisingly good (compared to forecasts) based on the data available to the end of August, despite the economy being in a technical recession. As at the end of August, total gross main budget tax revenues were 11.2% up on 2017/18 on a year-to-date basis against a forecast increase of 10.6%, suggesting collections are on track to exceed the Budget revenue forecast in the year ending March 2019.

The main contributor to the strong growth in revenue collections is increased VAT collections, which are running well ahead of the forecast revenue growth of 16.8% for the year - at 19.5% as at August. If the rate of growth in VAT continues at this level for the rest of the financial year, it

will result in the Budget forecast being exceeded by R8 billion. When broken down into its sub-components, however, the performance of VAT is more revealing. Domestic VAT is growing at 12.1% against a forecast of 12.6% and is therefore lagging slightly behind the forecast growth.

The major contributors to the strong performance of VAT, however, are import VAT and refunds, which are well ahead of forecast growth insofar as imports are concerned (12.9% versus 11%) and well behind forecast growth for refunds (2.3% versus 4.7%). The performance of import duties also reflects the strong performance in import VAT, as expected, and is growing at 14.8% against a forecast of 7%. If growth in import duties continues at this pace for the remainder of the year it would translate into a surplus over the Budget forecast of R3.8 billion. The general fuel levy, which has become an important source of revenue in recent years, is also performing strongly and growing slightly ahead of forecast.

Personal income tax (PIT), the single largest source of tax revenue by some margin, is looking on track to meet the forecast. However, it would appear that the primary reason for this is the higher-than-budgeted public service wage agreement, which is expected to cost an additional R7 billion in 2018/19 and R30 billion over the three years of the medium term expenditure framework. This is not a reason to celebrate as it will be net negative for the budget balance unless steps are taken to keep expenditure within the expenditure ceiling set out in the Budget.

Corporate Income Tax (CIT) is by far the worst performing of the major taxes. As at August, growth in CIT was at 2.8% against a forecast of 6.5% and would translate into a shortfall of R8 billion if this trend continues. Business confidence remains net negative, according to the latest survey by the Bureau for Economic Research (BER), with corporate profits under significant strain.

If total revenue collections continue to perform as they have done in the first five months of the year, it is predicted that the Budget forecast will be exceeded by between R8 billion and R11 billion. The big question is what the outlook looks like for the rest of the financial year. Unfortunately, it is difficult to see much in the way of upside, but plenty in the way of downside risks to the forecasts.

PIT is the most stable and predictable of the main sources of tax revenues and it is expected that National Treasury will largely maintain its forecast in this regard in the Medium Term Budget Policy statement (MTBPS). The general fuel levy is also a relatively stable source of revenue and, although the recent heavy fuel price increases are likely to have a marginal effect on fuel consumption volumes, it is likely that forecast revenues for this tax will be left largely unchanged.

However, that is where the good news probably ends. CIT revenue forecasts are likely to be revised significantly downwards in the MTBPS by between R8 billion and R14 billion as corporate profitability continues to disappoint and the effects of the poor economic performance of the economy in the first half of 2018 filter through into financial results.

The big question is whether VAT and import duties can continue to perform strongly for the rest of the fiscal year. The performance to date has been somewhat surprising given the pressure the consumer is under due to significant tax increases and increases in the fuel price in recent months. Any increase in interest rates (a distinct possibility in coming quarters) will add further

pressure on the consumer and see a further fall in disposable incomes, negatively impacting consumption spending. That said, the higher than budgeted public sector wage settlement will continue to support consumption expenditure in the short term.

It must also be borne in mind that the possibility of an expanded list of zero-rated goods continues to hover in the background. Depending on what is added to the list of zero-rated goods and whether any items are removed from the current list, this could have a significant effect on revenues, both for the current financial year as well as future years.

In light of these factors, we see National Treasury adopting a cautious approach to revising its forecasts for revenues from VAT and import duties, factoring in some cooling off in the rate of growth of revenues for the remainder of the year. Overall, we expect National Treasury to largely maintain its February forecast for tax revenues for 2018/19 in the MTBPS, albeit with a downward revision for CIT largely offset by an upward revision for VAT and import duties.

Tax changes for the year ahead are not normally announced in the MTBPS, these typically being left for the February budget, and we can expect this to be the case once again this year (other than in respect of the possible zero-rating of additional goods). That said, for the first time in a number of years it is looking likely that further significant tax increases may not be required in the February Budget, something that the government would want to avoid in an election year. That, however, depends on the ability of government to fund additional spending pressures, such as the public sector wage settlement, the proposed economic stimulus package and the bailout of state-owned entities through the reprioritisation of expenditure or other measures, rather than through tax increases or increased borrowings.

Kyle Mandy

Tax Policy Leader

At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 158 countries with over 250,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more and tell us what matters to you by visiting us at www.pwc.com.

PwC has a presence in 34 Africa countries with an office footprint covering 66 offices. With a single Africa leadership team and more than 400 partners and 9000 professionals across Africa, we serve some of the continent's largest businesses across all industries.

PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see www.pwc.com/structure for further details.

Media contacts

Kyle Mandy, PwC Tax Policy Leader

Office: + 27 11 797 4977
Email: kyle.mandy@pwc.com

OR

Bontle Mnisi: Account Executive, Change the Conversation, South Africa
Office: + 27 11 083 7735 or mobile: 076 2283796
Email: bontle@changetc.co.za

OR

Sanchia Temkin: Media Relations, PwC Africa
Office: + 27 11 797 4470
Email: sanchia.temkin@pwc.com