South Africa's high corporate income tax rate

The National Budget for 2018 details the high level of expenditure demands on the South African Treasury. Despite cutting its expenditure projections by a cumulative R85 billion over the next three fiscal years, including a decline of close to R40 billion in capital transfers, the ratio of consolidated government expenditure to GDP remains unchanged at more than 33 % of GDP. Meanwhile, it remains unclear to what extent (or when) the implementation of National Health Insurance will impact government expenditure.

Given South Africa's unemployment rate of 27% and an excessively high level of income inequality, it is unlikely that pressure on government to spend more will abate. Hence, the focus reverts to the Treasury's ability to find more revenue. Even though the nascent economic recovery is helpful, the ratio of taxes to GDP is expected to increase from 25.9% in 2017/18 to 27.2% in 2020/21.

For fiscal year 2018/19, the National Treasury announced revenue-raising measures amounting to R36 billion, which is no less than 0.7% of GDP. Equally interesting, though, is the increased emphasis on taxing consumption rather than savings and income (although the Treasury did not fully compensate for fiscal drag, implying an effective increase in the personal income tax rate). The increase of 1% in the VAT rate (the first increase since 1983) must have been a tough decision for the Treasury officials. The tax is broadly considered to be regressive, since low income earners spend a larger share of their income on consumption than high income earners. However, the regressive nature of the tax is reduced, given exclusions and the zero-rating of certain products.

Admittedly, the increase in VAT can be expected to increase inflation, temporarily at least, and therefore constrain real household income. Nonetheless, from a long-term perspective taxing consumption, rather than savings and income (the reward for labour), implies the tax structure is better aligned with South Africa's growth objective.

The Treasury's 2018 Budget Review also provides details on potential changes to the tax regime under consideration. As regards the corporate income tax rate, the Treasury points out that South Africa, at 28%, is becoming an outlier relative to the rest of the world. Specifically, it notes corporate income tax rates have declined in, for example, the United States and the United Kingdom, while China's corporate income tax rate is 25%. And, even though countries in the rest of Africa have similar, or perhaps even higher rates than South Africa, their effective tax rates are reduced through incentives.

The Treasury indicates that the key point is the implied loss in competitiveness of South African companies. By implication, although nothing is certain, it appears to be indicating that an increase in the South African corporate income tax rate is not on the cards. Indeed, it states it will approve additional tax incentives for qualifying companies in six special economic zones (not intended as an opportunity for domestic firms to relocate and reduce their tax liability, though!).

Meanwhile, the Treasury's stance on corporate income tax squares with the view that corporations, faced with tax increases, may shift the burden, by raising prices or retrenching workers, as opposed to lowering dividend payments to shareholders.

2/…

The flip-side of the above is that the National Treasury is also reviewing existing tax expenditures, that is, tax revenue it foregoes by offering tax incentives, subsidies and grants. For example, the 2018 Budget Review notes that, although the employment tax incentive appears to have delivered positive results, the favourable impact has been skewed towards smaller rather than larger firms. The Treasury intends to review this incentive before it expires on 28 February 2019.

Another aspect of the tax regime under review is the tax treatment of excessive debt, arguing that "the tax deductibility of interest payments on debt acts as an incentive to use debt rather than equity funding, and can be used to strip profits from high tax countries".

Elsewhere, the Department of Trade and Industry is reviewing the Automotive Production Development Programme. The tax expenditure on this item (including the import rebate credit certificate) amounted to R26.936 billion in 2016/17.

Amongst other tax expenditures, the Department of Trade and Industry and the National Treasury are also reviewing the tax incentive for industrial policy projects.

Overall, whereas the Treasury's stance on the corporate income tax rate is welcome, it is clear it remains under pressure to find additional resources, which may prompt cuts in subsidies and incentives. Ostensibly, this introduces an element of uncertainty.

As such, a firmer commitment to corporate income tax restraint than that implied in the Budget Review is worth considering. Tax is, after all, an important component in determining the user cost of capital and, therefore, the incentive to invest.

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