~ FEBRUARY 2012 ~

BUDGET SYGNALS

2012 BUDGET HIGHLIGHTS

The 2011/12 Budget brought some surprises, both in what it mentioned and in what it omitted. As expected the focus was largely on the economy, job creation and infrastructure spend. There was no clarity on retirement fund reform, while the national health insurance is to be phased in over 14 years. On a negative note further re-distributive measures include a hike in capital gains tax and a 50% increase in the tax on dividends.

Although hailed as a balanced budget, its success will largely depend on the government's ability to keep costs, such as public service wage increases which have been assumed at a 5% level in the Budget, and borrowing down.

The highlights are summarised below.

ECONOMIC AND FISCAL FORECASTS

The South African economy is in a surprisingly good shape given global developments.

- The economy grew by an estimated 3.1% in 2011. GDP growth is expected to slow to 2.7% in 2012 before accelerating to 3.6% in 2013 and 4.2% in 2014.
- Unemployment, at 23.9%, has stabilised. The economy is projected to add 850 000 new jobs over the next three years, with 80% of these in the private sector, lowering the unemployment rate to about 23% in 2014.
- The 2011/12 budget deficit of 4.8% of GDP is expected to decrease to 4.6% in 2012/13 and 3% in 2014/15. Education, health and social assistance remain the largest categories of expenditure in the R1.1 trillion budget.
- The current account deficit is expected to widen from an estimated 3.3% of GDP in 2011 to 4.4% of GDP in 2014 as imports outpace exports on robust domestic demand.
- The rand will remain volatile as investors choose between low-yield "safe-haven" assets such as US government bonds and higher-yield investments in emerging markets.
- Headline CPI inflation is projected to increase from an average of 5% in 2011 to 6.2% in 2012. After temporarily rising above the upper limit of the 3-6% target, inflation is forecast to fall to 5.3% in 2013 and 5.1% in 2014.

TAX REDISTRIBUTION

In addition to the usual increases in sin taxes, the Budget seemed to focus on high net worth individuals who typically receive a larger portion of their income in the form of dividends and capital gains.

- The inclusion rate for individuals and special trusts will increase to 33.3%, shifting their maximum effective capital gains tax rate to 13.3%. The inclusion rate for other entities (companies and other trusts) will increase to 66.6%, raising the effective rate for companies to 18.6% and for other trusts to 26.7%. These changes will come into effect for the disposal of assets from 1 March 2012.

- The primary residence exclusion has been increased from R1.5 million to R2 million, the annual exclusion from R20 000 to R30 000 and the exclusion amount on death from R200 000 to R300 000.

- The dividend withholding tax replaces the secondary tax on companies on 1 April 2012. A rate of 15% will apply, significantly higher than expected, and 50% higher than the 10% STC. Pension funds and companies are exempt.

- The securities transfer tax of 0.25% on purchases of shares will be extended to include brokers who acquire shares for their own benefit from 1 April 2013, albeit at a lower rate. Government will also investigate the feasibility of including derivatives in the base of the securities transfer tax.

- Income tax deductions for medical scheme contributions for taxpayers below 65 years will be converted into tax credits (monthly credit of R230 for the first two beneficiaries and R154 for each additional beneficiary) with effect from 1 March 2012. From that date onwards (apart from those with disabilities), where medical scheme contributions in excess of four times the total allowable tax credits plus out-of-pocket medical expenses combined exceed 7.5% of taxable income, they can be claimed as a deduction against taxable income. Also with effect from the same date, employer contributions to medical schemes on behalf of ex-employees will be deemed a taxable fringe benefit and such ex-employees will be able to claim the appropriate tax credits.

- Micro-businesses have been given a boost through simplification of tax filings and some tax relief measures.

FINANCIAL SERVICES SECTOR

There was very little said about the financial services reform, other than the following points being emphasised:

- The shift towards a twin peaks system for financial regulation, with a separation of prudential and market conduct supervision of the financial sector, was once again highlighted. Consultations will continue this year, with a view to tabling legislation in early 2013.

- A series of discussion papers will be released this year on promoting household savings and reforming the retirement industry. The burning issues include improving governance over pension funds, including more effective interventions to eliminate corruption and fraud, and ways to improve preservation of retirement fund assets.

- Once again the industry was criticised for the high costs of savings products. The “treating customers fairly” initiative will be accelerated to protect customers.

- Reform of the tax treatment of contributions to retirement funds is planned for 2014. Consultations will also be held on a uniform approach to treating retirement fund withdrawals.

INTERESTING ODDS AND ENDS

Access to withdrawal benefits where employees “resign” solely to gain access to employer-provided retirement funds just to be rehired will no longer be allowed.

Tax-preferred savings and investment accounts have been proposed as alternatives to the current tax-free interest-income caps. Returns generated within these savings and investment vehicles (including interest, capital gains and dividends) and withdrawals will be tax exempt. Aggregate annual contributions could be limited to R30 000 per year per taxpayer, with a lifetime limit of R500 000. The design and costs of these savings and investment vehicles may be regulated. Government proposes to introduce tax-preferred savings and investment vehicles by April 2014. A discussion document will be published by May 2012.

National health insurance is to be phased in over a 14-year period beginning in 2012/13. The cost is substantial and has not been included in the Budget apart from a R1 billion pilot project allocation.

From March 2014 an employer's contribution to retirement funds on behalf of an employee will be treated as a taxable fringe benefit in the hands of the employee. Individual taxpayer deductions will be set at 22.5% and 27.5%, for those below 45 years and 45 and above respectively, of the higher of employment or taxable income. Annual deductions will be limited to R250 000 and R300 000 for taxpayers below 45 years and above 45 years respectively.

And finally the tolling to finance the R20 billion Gauteng Freeway Improvement Programme is going ahead, albeit at a lower rate as portion of the cost will be covered by the fiscus. The highest monthly charge for frequent road users has been set at R550.

DISCLOSURE

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