PROFESSIONAL
TAXTALK
South Africa's Leading Tax Journal
Issue 104 January/February 2024

Getting into grips with *SA's Budget issues*

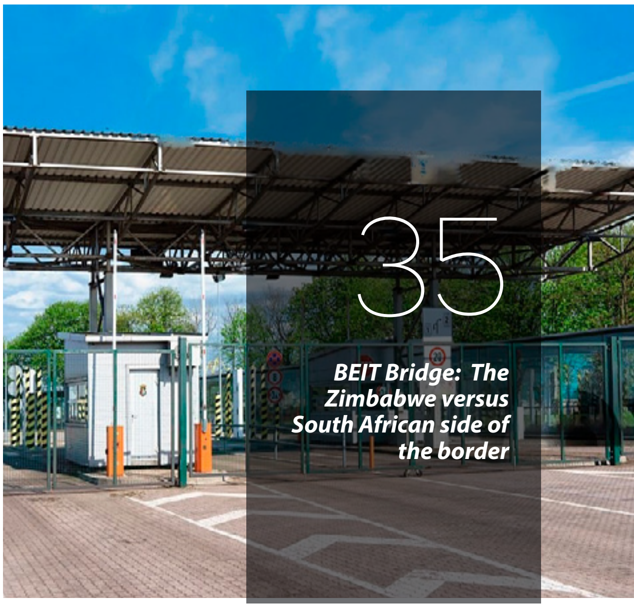
sait
R25 • incl VAT

CONTENTS

4h 30mins CPD
in this issue

JANUARY/FEBRUARY 2024* ISSUE 104

GETTING INTO GRIPS WITH SA's BUDGET ISSUES



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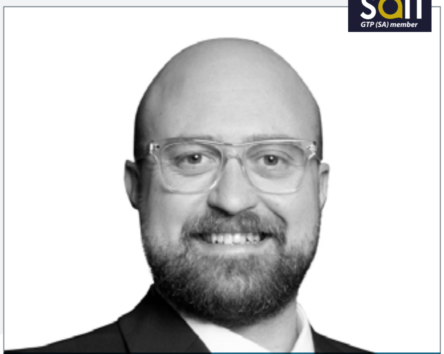

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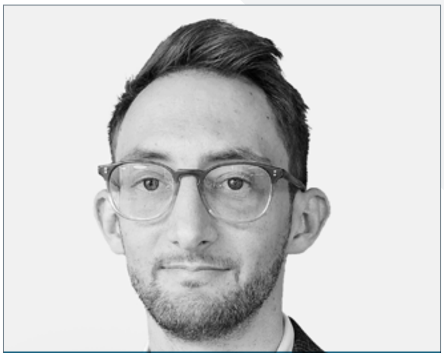

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2024 TAX PROFESSIONALS WISHLIST

We asked the SAIT'S technical work groups for their wish-lists for 2024, and this is what they said:

Increasing various thresholds to align with inflation
Abridged tax invoices can only be issued where the consideration for the supply does not exceed R 5 000.
Wish: Vendors would like to see a substantial increase in this threshold to obtain administrative and compliance relief.

- VAT Tax Work Group

Regulation of the 'cessation of tax residency' process in the TAA
As it stands, there is some legal uncertainty about the process of having tax residency of natural persons confirmed otherwise than by way of assessment.
Wish: For the process of having tax residency confirmed by SARS otherwise than by way of assessment, the process to be codified and decisions by SARS in respect of tax residency of a natural person be made subject to objection and appeal.

- Tax Administration and Dispute Management Work Group

Extension of S12L (energy efficiency tax incentive): It currently expires on 31 December 2025. It needs a 10 year extension to give companies certainty.

- Environmental Tax Technical Work Group

Standardised process and channel for Section 9 review applications
Section 9 of the TAA allows for a review of certain decisions taken by SARS.
Wish: For SARS to implement a prescribed online channel for the submission of Section 9 review applications and to commit to a set turnaround time within which such applications will be considered.

- Tax Administration and Dispute Management Work Group

Our wish is, we would like SARB to issue a follow-up circular to clarify the loop structure. An update on the implementation of the New capital Flow Management Framework implementation date would be great.

- Cross-Border Financial Flows & Tax Reporting Technical Work Group

Exempting Enterprise and Supplier Development (ESD) Grants from normal tax and increasing the budget for the Critical Infrastructure Programme, emphasising alternative energy projects.

- Business Tax Incentive and Grants Technical Work Group

Clarity to be provided on the VAT treatment of metal credits, especially in the context of streaming transactions
This is especially applicable where uncertainty remains in the gold and financial services industries in respect of the classification of unallocated gold for VAT purposes as 'goods' or 'services'; consequently, whether the zero rating can be applied.

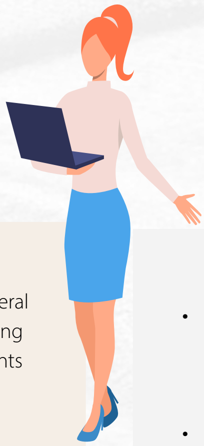
- VAT Tax Work Group

Carbon tax: The allowances are known until 31 December 2025. It is vital that National Treasury makes an announcement on what will happen to the allowances after the end of Phase 1.

- Environmental Tax Technical Work Group

Alternative dispute resolution at objection
The dispute resolution process provides for Alternative Dispute Resolution subsequent to the filing of an appeal.
Wish: For SARS to consider having the Alternative Dispute Resolution or similar process put in place at objection stage to limit the number of disputes going to the appeals stage.

- Tax Administration and Dispute Management Work Group



Introducing new incentives for mineral extraction and general manufacturing with specific support for new entrants and businesses with less than 51% black ownership.

- Business Tax Incentive and Grants Technical Work Group

- Industry would like to see that the exportation of silver is added to the new legislation which applies to gold exports.
- The addition of certain protein foods to the basket of zero rated food items, e.g. raw and unprocessed chicken.

- VAT Tax Work Group

Extension of S12BA: This 125% allowance for renewable energy assets is for a two-year period and ends on 31 March 2025. Most large renewable projects in their planning phase will not be commissioned by 31 March 2025; so, it is vital that this is extended for another two to three years to have a real impact on decisions now being made.

- Environmental Tax Technical Work Group

Input tax deductions to be permitted for the overpayment of VAT on imported services (e.g. when a foreign e-service provider registers retrospectively for VAT and the South African recipient has already declared the supply under the reverse charge provisions which results in double taxation).

- VAT Tax Work Group

SARS' accessibility to tax practitioners
Tax practitioners struggle to contact SARS through the channels meant to ease the communication between the parties.
Wish: For the access to the number of appointments, calls and other communication channels for tax practitioners to be improved.

- Tax Administration and Dispute Management Work Group

Extensive turnaround times for the finalisation of debt compromises and settlements
The turnaround time for the finalisation of applications for debt compromise and consideration of settlement proposals takes too long, with no prescriptive timelines on the turnaround of the consideration of these applications.
Wish: For these applications to be expedited to assist SARS in increasing revenue collection and for a prescriptive turnaround time to be communicated.

- Tax Administration and Dispute Management Work Group

The VAT registration threshold is currently at R1m for supplies made in any twelve-month consecutive period.
Wish: Industry would like to see a substantial increase to provide compliance relief for smaller businesses who cannot afford the additional compliance costs of being a VAT vendor.
The above thresholds have not been regularly increased to align with inflation and a R1m compulsory VAT registration threshold of more than 30 years ago does not equate to the same revenues in today's terms.

- VAT Tax Work Group

- Streamlining the tax incentive framework for accessibility and growth across industries.
- Enhancing transparency in grant allocations and simplifying compliance procedures for swift business leverage.

- Business Tax Incentive and Grants Technical Work Group

Non-adherence to service timelines
The Service Charter in its current form is inadequate as SARS 'endeavours' to finalise cases timeously 8/10 times, while taxpayers are, by law, required to adhere to the rules 10/10 times. Taxpayers often have to resort to, or threaten, litigation to enforce SARS' compliance with prescribed timelines.
Wish: For the Service Charter timelines to be prescriptive in line with legislative provisions and for ramifications for employees who wilfully ignore timelines.

- Tax Administration and Dispute Management Work Group

15 minutes CPD

PREDICTING THE THEMES OF SOUTH AFRICA'S NATIONAL BUDGET

▶ **PROF DAVID WARNEKE,** Partner at BDO South Africa

As we anticipate Minister of Finance Enoch Godongwana's upcoming national budget speech, it is crucial to analyse key factors that will shape South Africa's economic trajectory. The budget is not just about numbers on a spreadsheet; it is a reflection of our nation's priorities and commitments. Here, Professor David Warneke, Partner at BDO South Africa, shares his insights into what we might expect and the resulting implications for our country's economic future.

As intimated by the President in his SONA address, the Minister is likely to announce a continuation of the Social Relief of Distress Grant. Having already factored in an extension of the grant in the medium-term budget until March 2025, it is unlikely the minister will go back on this and will likely announce an inflationary increase to the amount of the grant. The reason for this is simple. This grant, vital for more or less nine million South Africans and costing approximately R44 billion per annum, underscores the government's commitment to supporting vulnerable segments of society, especially in an election year. That said, the long-term sustainability of supporting so many of South Africa's households through grants merits careful consideration.

Dreams of many of a basic income grant are likely to remain deferred, given current economic constraints. In the past, Minister Godongwana rightly emphasised the need for sustainable economic growth to finance such initiatives. Implementing a basic income grant requires a stable economic foundation, which we must prioritise building before introducing such a measure into the budget.

"The current trajectory of our public debt, especially given the high cost of interest, is a point of concern. It is important, then, that whatever measures the Minister proposes to fund current expenditure does not come at too great a risk to long-term sustainability—or the scales will be further tipped against us"

Perhaps a more contentious issue will be the question of public service wages. Last year's budget projected a 0% increase, with subsequent negotiations resulting in a 7.5% raise. As we approach another election cycle, the government may seek to limit tensions amongst public servants and go directly ahead with proposing an inflationary increase of around 5–6%.

Any kind of increase, however, does raise concerns concerning the sustainability of our public wage bill, particularly when compared to international standards. South Africa has one of the highest-paid public sectors in the world, with a total wage bill 3.5% higher than the average of OECD countries. This makes up approximately a third of total government expenditure and it is not performance-based, meaning increases are applied across the board.

The National Health Insurance (NHI) Bill looms large, yet substantial budget allocations are likely to be deferred.

Hopefully, a comprehensive cost-benefit review of state-owned enterprises (SOEs) will be announced. Any decisions in this regard must balance fiscal responsibility with the need to streamline operations and improve efficiency. Once again, given elections, it is doubtful that closures or mergers of SOEs will be announced, as it would likely imply job cuts.

Two SOEs whose underperformance continues to weigh on the economy, which will doubtlessly be addressed in the budget, are Eskom and Transnet. For some time now, private sector involvement in Transnet has been put forward as a potential solution to its infrastructure and operational woes, with the previous announcement of a R47 billion guarantee given to Transnet to enable it to raise funding. An update on the progress in restructuring Eskom is expected.

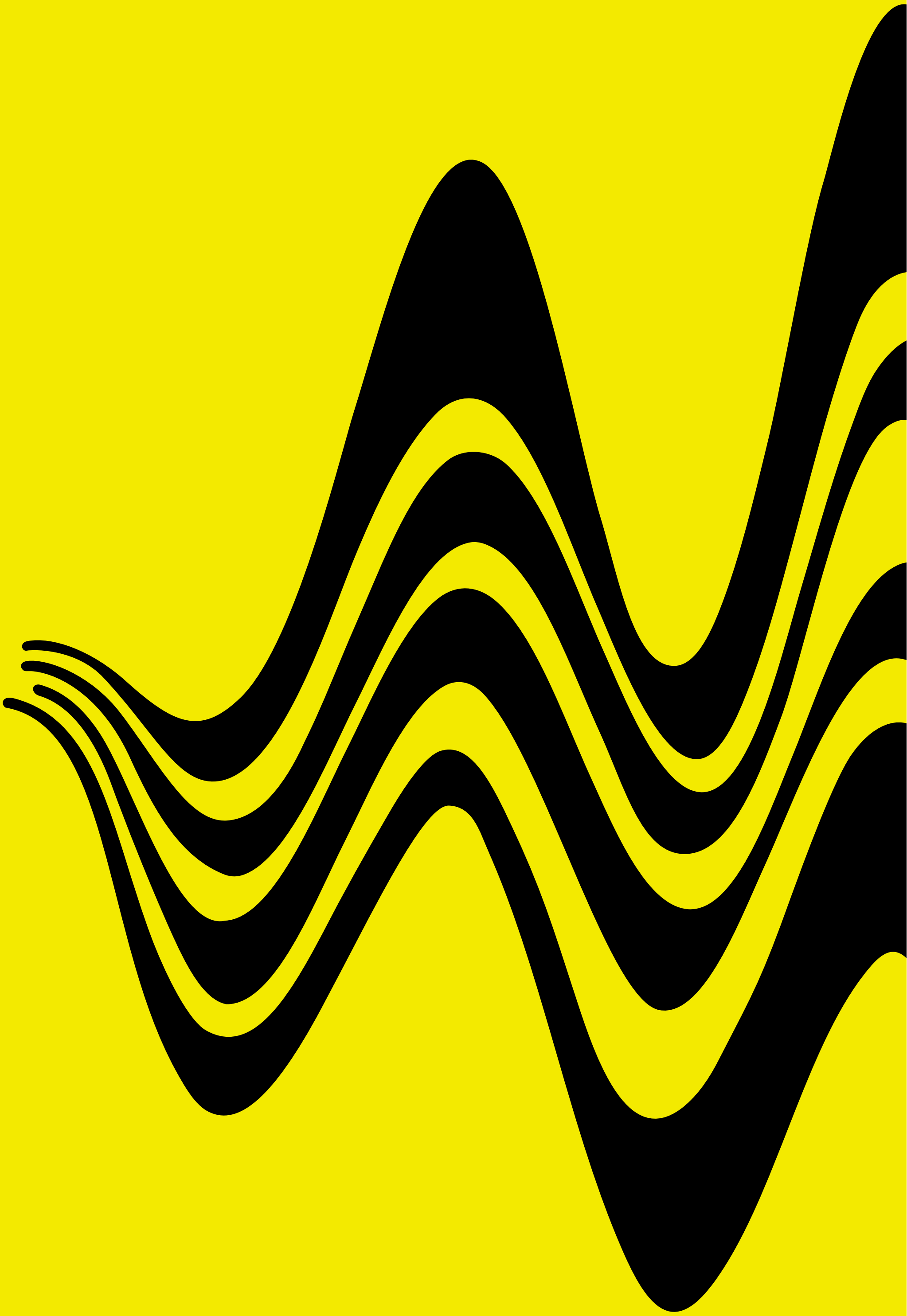
Another contentious proposal has been the potential use of some of the country's gold and foreign currency contingency reserves—amounting in total to around R500 billion—to help alleviate public debt. While tempting, it is important to remain cautious of this option as it is a short-term fix for deeper structural issues, which are of our own making. South Africa must create an investor-friendly climate to stimulate growth and rather reduce reliance on reserve funds—in this case, there is no such thing as an easy out.

Tax hikes also present a looming spectre, with the Minister announcing the need to extract an additional R15 billion of taxes in the medium-term budget. But doing so would risk further burdening an already strained populace, which the Minister may not want to do ahead of the polls. If he does go ahead with it, we are likely to see this additional tax being extracted through less than full inflationary relief from bracket creep.

Overall, the national budget, as always, will be a balancing act between short-term needs and long-term sustainability. The current trajectory of our public debt, especially given the high cost of interest, is a point of concern. It is important, then, that whatever measures the Minister proposes to fund current expenditure does not come at too great a risk to long-term sustainability—or the scales will be further tipped against us.

"South Africa must create an investor-friendly climate to stimulate growth and rather reduce reliance on reserve funds—in this case, there is no such thing as an easy out"

BIG IDEAS
BEGIN WITH
CHANGE.



45 minutes CPD

FORGET THE CROSSROADS: THE MINISTER IS AT A T-JUNCTION

PROF WALDO KRUGELL, Professor of Economics at North-West University

The Minister of Finance has repeatedly warned that the fiscus is in trouble and that the 2024/25 budget speech must present some hard choices. There is talk of austerity measures and tax increases. In this article, I will try to briefly explain how we reached this point, why the fiscal position presents a macroeconomic challenge and what needs to be done to dig ourselves out of this hole.

The first thing to realise is that we have been at this juncture before but were bailed out by a commodity price-based tax revenue windfall and now we are back in the precarious position where the budget deficit keeps growing, the stabilisation of the public debt burden seems further and further away and the economy is stagnating.

We had problems but then COVID-19 hit

In February 2020, the then Minister of Finance, Tito Mboweni, said in the Budget Speech that "*fiscal sustainability must be uppermost in our mind*". At the time, he budgeted for a deficit of 6.8% of Gross Domestic Product (GDP) and gross national debt stood at 65.6% of GDP. The Budget presented R261 billion baseline spending reductions of which R100 billion were to come from adjustments on programme spending and R160 billion from adjustments on the wage bill. Then the COVID-19 pandemic hit. The Minister presented a supplementary budget with a fiscal relief package that included R190 billion in additional main budget spending.

A part of this fiscal response was offset by downward adjustments in spending. These were cuts across all functions apart from Health. This removed funds underspent due to delays caused by the lockdown and suspended allocations for capital and other departmental projects that could be delayed or rescheduled. It also suspended allocations to programmes with a history of poor performance and/or slow spending. In addition, a significant tax revenue shortfall of R304 billion was predicted for 2020/21 and a revised budget deficit-to-GDP ratio of 14.2% was pencilled in. At this time of crisis, the Minister proposed spending reductions of R250 billion until 2024/25. This included a R160.2 billion reduction in the public sector wage bill.

The fiscus got bailed out

By the 2021 Budget Speech, things had taken a turn for the better. The economic outlook had improved and with it the projected tax revenue. Minister Mboweni proposed several ways in which the government could stay the course of its fiscal consolidation plans. The 2020/21 revenue overrun of almost R100bn would be used to reduce the borrowing requirement and debt issuance.

Both the budget deficit and debt-to-GDP ratios were projected to decline sharply over the following three years. This was based on slightly stronger growth forecasts that improved the ratios and boosted tax income. He also proposed plans to limit the growth of spending. For example, the government planned to achieve a primary surplus in 2024/25. Excluding compensation of employees, expenditure would grow by an annual average of only 0.4%. In Budget terms, there was a hard ceiling on wage growth. Public sector wages were to be cut by R303bn over the following four years from 2020/2021. Social grants were budgeted to increase by less than inflation with the grants budget being cut by 2,2% over the following three years even though the number of beneficiaries was expected to increase. There was very limited bailout funding allocated for the Land Bank, SAA and Eskom.

Minister Godongwana stays the course

The tax revenue overrun from the commodity price boom continued into 2022 and the economy was growing again. The maiden Budget Speech of the new Minister of Finance, Enoch Godongwana, was an easy one. Following what turned out to be a R176 billion revenue shortfall in the 2020/21 fiscal year, he expected a R182 billion windfall in 2021/22. This gave him leeway to use part of it to pay for extra spending and to use the rest to reduce the borrowing requirement. He could continue with the fiscal discipline but also give some tax relief. The budget deficit was expected to narrow to 5.7% of GDP (compared to the 7.8% expected in November 2021) and the debt-to-GDP ratio was to stabilise at 69.5% in 2021/22 with a maximum of 75.1% in 2024/25.

But trouble was brewing

During the course of 2022, commodity prices started to decline and load shedding dampened economic activity. By the 2023 Budget Speech, the Minister was able to continue with his balancing act. On paper, he found a balance between conservative spending, tax relief and plans that could promote growth. Ordinary people would be helped by the 5% increase in social grants and the R350 COVID Social Relief of Distress (SRD) grant would be paid for another year. There were also no personal tax rate increases and the tax brackets were adjusted upwards by 4.9%. The petrol price levy was unchanged and sin tax increased by just 4.9%. There were also additional resources for the police and justice system and for infrastructure maintenance. The Budget also presented details on the partial takeover of Eskom's debt. The important ratios, such as the budget deficit to GDP and government debt to GDP, showed that the process of getting the government finances on a sustainable footing is still ongoing. Yet, there were concerns about the building blocks of the budget numbers. At the time, he budgeted for a primary surplus but things could quickly look different if economic growth slowed. Commentators questioned whether it was realistic to budget nothing for the COVID SRD grant after 2024 or to budget for a 3.3% wage increase for civil servants. Events soon proved them right.

In April, the government and trade unions agreed on a 7.5% wage increase for 2023 and an inflation rate increase the next year. It was estimated that this would cost the state coffers approximately R37.4 billion extra. National Treasury maintained that there was no additional money for the increase and that the money had to be found within the existing budget. The plan was therefore to limit new recruitment in non-critical positions and not to fill vacant positions. Departments could also move money from other spending on projects and programmes to be able to afford the salary increases. At the same time, SARS announced their tax collection figures for the year to the end of March 2023. R123 billion more was collected than the Minister budgeted for in 2022, but this is R5 billion less than his updated estimate in the 2023 Budget.

"There is no money"

By the Medium Term Budget Policy Statement (MTBPS) in early November 2023, the Minister again faced the challenge to stabilise the debt-to-GDP ratio while the economy and its tax revenues stagnate and there were many demands for additional spending. He announced plans to cut spending by R213 billion over the next four years. In the short term, the most important measure was not to fill vacant positions. Yet there was a funding gap in the allocations made to the provinces for social development which would affect service delivery. The Minister did emphasise that they wanted to protect the budgets of important services such as education, health and police services. Transfer payments would also not be cut and provision was made for the continuation of the R350 per month COVID SRD grant. Additional money was also allocated to implement the wage agreement. The Minister did not announce specific tax measures but budgeted for a R15 billion increase in tax revenue in the next budget.

Now, weeks before the Budget Speech the projected deficit-to-GDP again stands at 6% and the Minister has to cut spending in an election year.

Can't we just muddle through?

A fair question to ask is whether the situation is quite as dire as the business press and mainstream economists make it out to be. The short answer is that our important fiscal ratios are much higher than the international rules of thumb. That conventional wisdom is that for developing economies a sustainable budget deficit-to-GDP ratio is 3% and the debt-to-GDP ratio is better around 60%. Better in the sense that a lower deficit and debt burden is associated with higher economic growth rates. The channels through which a sustainable or unsustainable fiscal position affects economic growth are numerous and some are likely to work with significant lags.

"Reforms are needed that will allow the private sector to fill the gap created by a failed government. We don't need new plans. There are good enough ideas in the National Development Plan (NDP) or the Economic Recovery and Reconstruction Plan but they need the government to get out of the way"

Our large deficit is financed at particularly high-interest rates compared to other emerging market economies. This pushes up the cost of servicing the debt. Debt service cost as a share of main budget revenue increased from 11.9% in 2024/25 to a projected 19.4% in 2024/25. That is almost 20 cent of every rand of tax revenue collected. It crowds out other spending. If one considers that compensation of government employees makes up 36% of current revenue and transfers to households another 35%, that does not leave a lot of income for other spending.

But why can't we just keep on borrowing more? The debt-to-GDP ratio is still low compared to developed economies, but the issue is: 'Who will buy the bonds?' Over the past ten years, foreign investors have withdrawn from the bond market despite the relatively high-interest rates that we offer. South African financial institutions, particularly banks, have stepped in, but the Reserve Bank has warned that holding even more bonds may present a risk to the stability of the financial system.

In addition, offering very high-interest rates to attract investors makes capital expensive for other borrowers, such as corporates, who want to issue bonds. That limits investment.

All in all, it is not straightforward to determine at what level the debt burden becomes unsustainable but, at a high level, it does create uncertainty that has a negative impact on the exchange rate. That is bad for inflation, interest rates, the consumer, businesses and the economy.

So we need fiscal consolidation: What can we do?

The answer is easy, the government should find more income or cut spending. Doing it is not easy at all. Proposals for significant tax increases are limited to ideas like a wealth tax on individuals or a tax on the super-profits of a particular industry. Such proposals are typically for a once-off skimming of wealth and never explain the consequences. It seems to assume that the rich, or the mining industry, or whoever must pay will just continue to do business and make money simply to be asked to pay up again later. South Africa's tax base is simply too narrow to think that there would be no consequences. There are about 385 companies in South Africa that earn over R200 million in taxable income; they contribute to 65% of the total company tax take. In total,

"All in all, the geese that lay the golden eggs are relatively few and probably quite footloose. Any significant tax increases are likely to have negative consequences for investment and economic growth"

South Africa has approximately 5.5 million income taxpayers above the tax-free threshold (2020 data from the Codera blog). About 1.2 million taxpayers earn over R500 000 per year, representing about 65% of the total personal tax liability. There are more or less 275 000 taxpayers who earn over R1million. This group represents under 2% of taxpayers and has contributed over 35% of the total personal tax take. South Africa's tax system is highly progressive: roughly 110 000 people (around 0.7% of taxpayers) who earn over R1.5 million contributed over 23% of personal income tax.

All in all, the geese that lay the golden eggs are relatively few and probably quite footloose. Any significant tax increases are likely to have negative consequences for investment and economic growth.

Cutting spending is not easy either. The story above shows that the government has been doing it for some years without much success. It is also an election year and the President has hinted at some form of a basic income grant to replace the R350 COVID SRD grant while he is searching for his pen to sign the National Health Insurance (NHI) bill that has not been budgeted for before. Almost all state-owned enterprises require further bailouts. Eskom and Transnet are simply too big to fail. In addition, recent cuts have been facilitated by freezing vacant positions and reprioritising spending away from goods and services, maintenance and capital spending towards paying salaries. Michael Sachs and his research team at Wits University have repeatedly warned that further austerity measures can cause a service delivery crisis, some part of which we are seeing now, for example, provincial health departments that are unable to appoint more doctors. Sensible spending cuts will require an epic review of budgets and spending, actual closing of programmes and departments, and downsizing headcounts—for which no one has an appetite.

There is only one way out

The only way to get the budget and the broader fiscal position on a more sustainable footing is through faster economic growth. The problem is that taxes and spending are a very small part of what drives economic growth and there is little that the Minister of Finance can do via the Budget Speech. Reforms are needed that will allow the private sector to fill the gap created by a failed government. We don't need new plans. There are good enough ideas in the National Development Plan (NDP) or the Economic Recovery and Reconstruction Plan but they need the government to get out of the way.

FAILING STATE-OWNED ENTERPRISES: UNRAVELLING THE ECONOMIC TOLL

15 minutes CPD

DR PRIVILEDGE CHETENI, Researcher at the University of Cape Town

In the intricate web of a nation's economic landscape, the health of state-owned enterprises (SOEs) serves as a critical barometer. These entities, intended to be engines of economic growth and stability, can unfortunately become burdensome liabilities when they falter.

Owing to the increasing pressure they put on public funds and the continuous fall in operational and financial results, there is an urgent need to improve their performance while reducing their economic impact. Both things make it harder for productive private companies to grow and for the economy to be efficient and competitive. A comprehensive inventory of all current SOEs to decide whether to sell, liquidate or keep them after restructuring might be undertaken as a potential reform. With clear objectives, solid leadership and stringent checks and balances, retained SOEs can thrive independently in competitive markets.

The question at the forefront of economic discourse is straightforward: What is the actual cost of failing SOEs to a nation's economy?

The role of SOEs

State-owned enterprises, spanning industries from energy and transportation to telecommunications and finance, are designed to play a pivotal role in a country's economic development. The government's ownership implies a responsibility not only to generate profits but also to fulfil broader socio-economic objectives such as job creation, infrastructure development and public service provision.

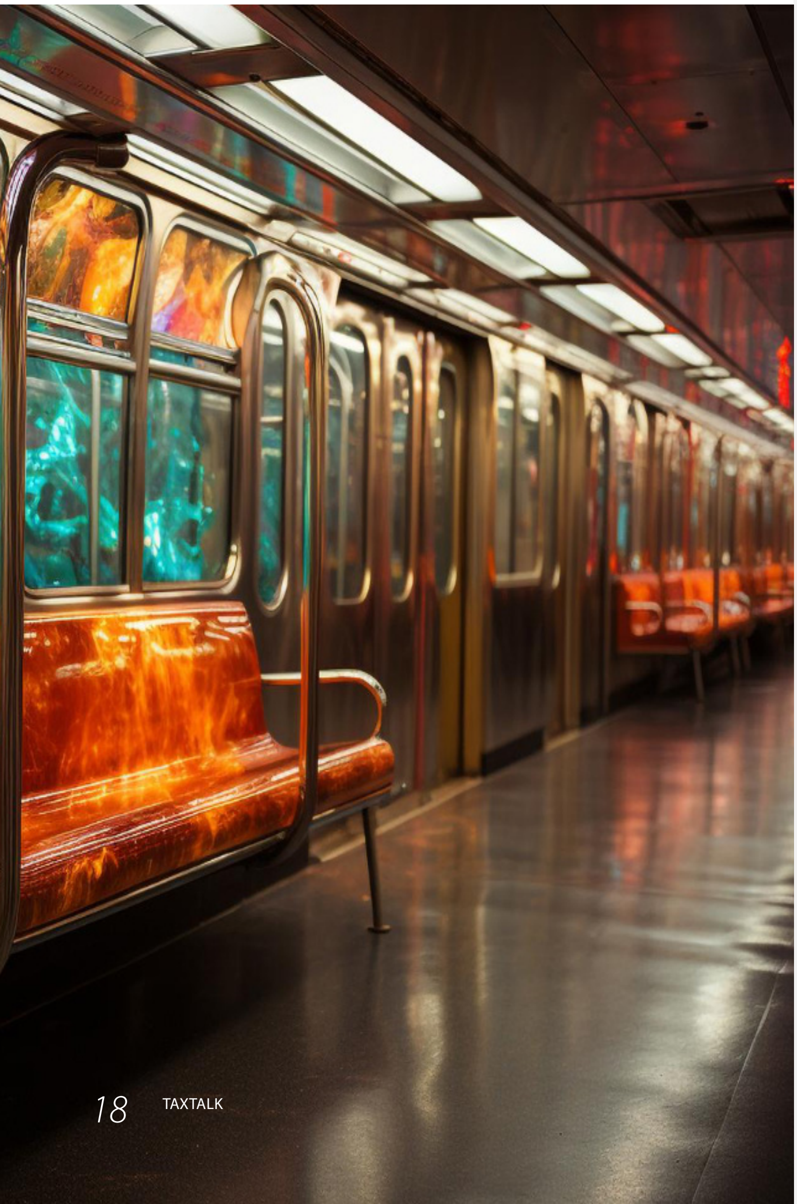
The debate about whether SOEs are cost-effectively fulfilling their mandates has grown in recent years. The increasing burden that SOEs are placing on the budget has been a primary concern as public finances have become increasingly constrained. Furthermore, deficiencies in the service delivery of SOEs, particularly in the provision

of electricity in conjunction with scandals involving corruption in procurement and administration, have been a source of discontent and have led to calls for structural reform. Direct transfers from the government to SOEs amounted to 1.6 per cent of Gross Domestic Product (GDP) in the fiscal year 2021/22, a significant increase from the already high average of 1 per cent of (GDP) in the five fiscal years before this one. Although a decrease in transfers to SOEs is planned for in the budget, there is a significant possibility that the projected transfers will not be sufficient if progress with restructuring plans, particularly in the electricity sector, is not rapid.

The unseen toll

However, the repercussions are far-reaching when these enterprises underperform or face systemic issues. The economic toll manifests in various forms:

1. **Financial drain:** Failing SOEs often require continuous financial injections to stay afloat. These financial lifelines come at the expense of public funds, diverting resources away from essential services and infrastructure projects.
2. **Diminished investor confidence:** Persistent underperformance erodes investor confidence. Foreign and domestic investors may become wary; this impacts the overall investment climate and potentially deters much-needed foreign direct investment.



3. **Inefficiencies and ineffectiveness:** In many cases, failing SOEs are plagued by inefficiencies, poor management and a lack of adaptability. This not only stifles economic growth but also stifles innovation and competition in the affected sectors.
4. **Social implications:** The economic burden is not solely financial. Failing SOEs can lead to job losses, reduced household incomes and exacerbated social inequalities. Moreover, disruptions in critical services that these entities provide can affect the general populace.
5. **Abuse of public office and the fraud triangle:** Government officials and lawmakers can exert political pressure on SOEs. Different government agencies may pressure SOEs directly when board members speak for their interests (Du et al., 2012). By giving their friends job promotions and subsidies, political leaders can take advantage of SOEs. State-owned enterprises can be used by politicians to advance their own agendas by disbursing funds, enhancing their public image or granting favours to supporters. A nation's corporate governance system suffers when politicians use their power over SOEs for private gain.

   Consequently, agency losses can appear in many forms including, but not limited to, corruption, self-dealing, shirking, moral hazard, adverse selection and moral hazard (Shapiro, 2005). Owing to the state's unique ownership position in SOEs, agency problems are likely to be more severe than in private companies. Politicians have two options for interfering with SOE decision-making: directly or indirectly (Qiang, 2003). Governments can foster political ties by appointing executives and board members who share their political beliefs and are, therefore, more likely to support the party or government's stated objectives. Public office abuse occurs when a politician or public official hires a relative, friend or political ally over a candidate who is more qualified (Gardiner, 2002; Kuzman et al., 2018). Simply put, board members or CEOs are fired and publicly humiliated if they refuse, disagree with or challenge government orders (Radon and Thaler, 2005). In SOEs, the board of directors is frequently just a formality and managers have limited decision-making power (Apriliyanti and Randy, 2019). Therefore, government employees are more likely to use their positions to further their own political ambitions and profit personally (Radon and Thaler, 2005).

Addressing the issue

The path to revitalising failing SOEs involves a multifaceted approach:

1. **Transparent governance:** Establishing transparent governance structures and mechanisms for accountability is paramount. Clear lines of responsibility and oversight can help curb mismanagement and corruption. What is referred to as the corporate governance of SOEs is influenced by the state's ownership role, the government's oversight role, the board of directors' oversight role and the agency implications of contracts between the government and its agents. The larger context informs integrating these structural components of regulatory reforms, national interests, public legitimacy, organisational culture and social impact. Agents' lack of incentives to increase their companies' profits due to the state's generous subsidies and lax budget constraints contributes to the state's role as a principal, leading to poor monitoring.

2. **Strategic restructuring:** Some failing SOEs may benefit from strategic restructuring, including privatisation or partnerships with the private sector. This can inject fresh capital, expertise and efficiency into these entities.
3. **Investment in human capital:** Equipping SOEs with skilled and competent leadership is vital. Investing in training programs and attracting top-tier talent can enhance organisational capabilities.
4. **Adaptive policies:** Governments must adopt adaptive policies that foster innovation, competition and resilience within SOEs. Encouraging a culture of continuous improvement and adaptability can mitigate future risks. Politicians and bureaucrats, who are more concerned with maximising political benefits than maximising economic efficiency, are typically given board and management positions in SOEs in emerging economies. The phrase 'politically embedded' describes how heavily politicians and government officials are involved in the management of SOEs. Consequently, strong politicians may develop strong relationships with particular SOEs, giving them preferential treatment in the form of low or no leverage requirements and high subsidy levels. Top executives, board members and government representatives rely on 'reciprocal opportunism' in an effort to impose their agenda on SOEs. It might be necessary to appoint new directors or managers when the political party or organisational structure of the government changes.

Conclusion and recommendations

In conclusion, the economic toll of failing SOEs is a multifaceted challenge that demands strategic and decisive action. By addressing issues at their core and adopting proactive measures, nations can transform failing SOEs into engines of sustainable economic growth, ensuring a brighter economic future for all.

Agency conflicts must be resolved to create a situation where agents' incentives align with state goals and public interest. The government must choose between three complex options: commercialising the organisation while maintaining state control, privatising it entirely or in part, or keeping public funds flowing into the SOE's budget despite losses or inefficiencies. The first option, namely commercialising the organisation under state control, is the most difficult to implement because it calls for changes to corporate governance that might conflict with political objectives. Finally, the ability of the state apparatus to put an effective monitoring system in place determines whether SOEs can be commercialised.

"By addressing issues at their core and adopting proactive measures, nations can transform failing SOEs into engines of sustainable economic growth, ensuring a brighter economic future for all"

THREADING THE NEEDLE

15 minutes CPD

▶ **CHRIS HATTINGH,** Executive Director at the Centre for Risk Analysis

National Treasury data released during the week of 29 January indicated South Africa's budget deficit has increased from 5.7% in November on a 12-month sum basis to 6% in December 2023. The largest deficit in two years presents Finance Minister Enoch Godongwana and National Treasury as a whole with a yet greater headache heading into Budget 2024.

In the medium-term budget policy statement tabled at the beginning of November 2023, minister Godongwana indicated the main budget deficit had risen R54.7 billion compared with the 2023 budget estimates. At that time, Treasury was projecting a deficit of 4.9% of GDP, compared with its previous estimate of 4%. In an election year, the forces of fiscal credibility on the one hand versus additional spending on the other, make the challenge before the minister and his colleagues all the greater.

It is one thing to want a capable state that rolls out large-scale infrastructure projects, runs many state-owned companies, capacitates high levels of growth and provides quality housing, healthcare and welfare programs for citizens. It is entirely another matter to try and provide this kind of state when economic growth hardly ever breaches 2%, unemployment remains at record-high levels and taxpayers experience more pressure, which is partly due to stubborn inflation driven by administered prices and supply-side problems (in South Africa's case inconsistent electricity supply and constrained rail- and ports-operations). It is simply not possible to fund a capable state. Of course, this presumes that more tax revenues will solve the administrative, management and policy problems afflicting the South African state—another matter that deserves its own examination and resolution.

According to SARS, the entity collected for the 2022/23 fiscal year "*R2.07 trillion in gross tax revenue (R183 billion more than in the prior year), refunded taxes worth R381 billion (R60 billion more than in the prior year) and netted tax revenue amounting to R1.69 trillion (R123 billion more than in the preceding year).*"

A tax base under immense pressure has performed well—but it cannot be presumed that this will always be the case. SARS highlights the "*prolonged effects of geo-political tensions, energy supply risks, constrained logistics networks, labour and social unrest, as well as weaker global and domestic economic growth and heightened inflation risks*" that could all contribute to lower tax revenues over the short-to-medium term. A possible cut in interest rates (possibly only in the second or third quarter of this year) will provide a small measure of relief. But, the added uncertainty of the elections will add to South Africa's heightened risk premium and should be factored into tax revenue projections.

With these many pressure points in mind, South Africa has a ruling party under immense pressure heading into the elections during which it may deliver below 50% for the first time in a national election. To drum up support before the elections, along with wanting to maintain its vision for how the state should be run, the pressures for increased spending are immense—with negative consequences for taxpayers.

The proposed National Health Insurance (NHI) scheme and a Basic Income Grant (BIG) are foremost of the more radical proposals that could increase taxes and increase the general tax burden. The current healthcare budget is R233 billion. The estimated cost of prescribed minimum benefits under the NHI is R859 billion. Minister in the Presidency, Khumbudzo Ntshavheni, recently indicated it is a 'priority' that the NHI Bill be signed into law before the elections.

In our October 2023 *Macro Review, 'On the Dole: SA's Welfare Woes', we found that in "2022, grants were the main source of income for a quarter (23.5%) of all households in the country, while half (49.5%) of households received at least one grant. As a percentage of individuals, over a third of the population (37%) received at least one social grant." Additionally, "the number of social grants being paid out has been rising steadily over time. It increased from 2.4 million in 1996/97 to 18.8 million in 2022/23. These grants are currently received by 11.7 million beneficiaries. Not included in those numbers is the Social Relief of Distress (SRD) grant. . . . Between April 2022 and March 2023, the number of approved applications for the SRD grant rose from 6.5 million to 8.5 million. With the SRD grant included, the total number of grants being paid out stands at 27.3 million."* Given the country's colonial and apartheid history in addition to ongoing economic difficulties, grants play a vital role in providing poorer citizens with some measure of assistance. However, such programs need funding and this inevitably comes via tax revenues. Therefore, it is imperative that higher levels of economic growth be achieved because increasing the tax burden on the current base will not necessarily produce yet higher tax revenue collections.

Higher wage bill costs and higher debt service costs will make the post-election government's work more difficult. Whether that government is ANC-led (the most likely outcome) or composed of opposition parties in a form of coalition (unlikely, but not to be ruled out by any means), difficult decisions around spending priorities will need to be made.

At present, South Africans are burdened with additional forms of 'taxation'. Along with paying taxes, those who are able to (and even in many cases where people are simply forced to) pay more 'taxes' in the form of private schooling, security, healthcare, electricity, and water provision. There is no definitive point at which the majority of the current taxpaying base will drop off but the longer the various pressures unpacked here continue, the more this tax base will be at risk. In an election year, it will be untenable for the government to pursue increased revenue through, for example, increasing VAT. However, an increase in the fuel levy, along with slight increases in personal and corporate income taxes, could be on the table.

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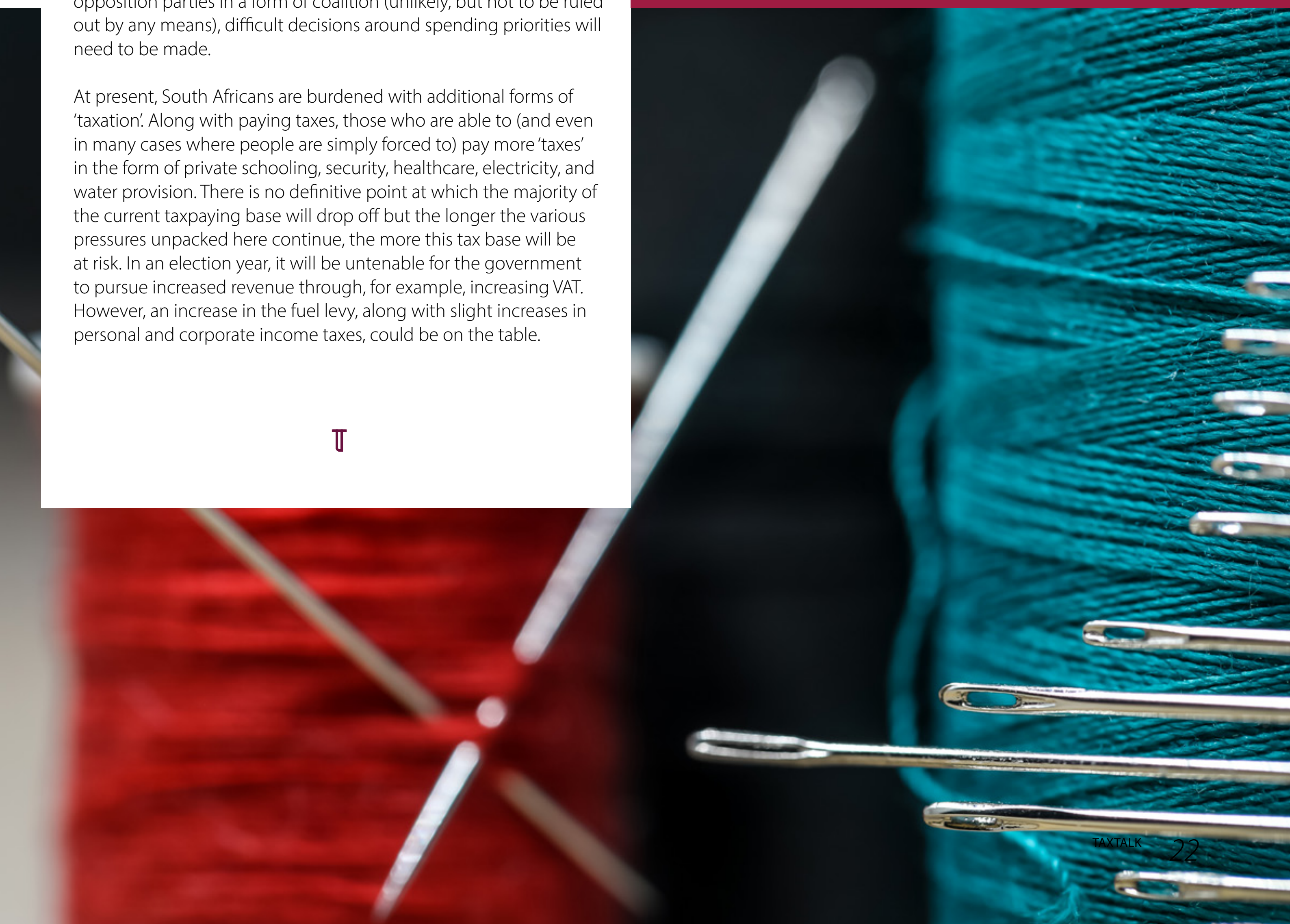

INCREASED PRESSURE ON HOUSEHOLD SPENDING: IMPLICATIONS FOR SOUTH AFRICA'S ECONOMIC GROWTH

15 minutes CPD

PROF DANIEL MEYER, Professor in the College of Business and Economics at the University of Johannesburg

Over the past decade, the South African economy has achieved relatively low economic growth rates and various factors contributed to this situation. A prominent factor behind the subdued growth is the imperative for expansion in the consumer market and expenditure.

Within macroeconomic frameworks, consumer spending constitutes a vital aspect of aggregate demand-side models. According to the Keynesian paradigm, alongside consumer spending, aggregate demand comprises government expenditure, domestic investment and net exports. Collectively, these components encapsulate the nation's total Gross Domestic Product (GDP). Among these elements, consumer spending notably stands out as the most substantial contributor to GDP, typically representing between 55% and 70% in most countries.

If consumer spending experiences a decline, it will lead to a reduction in economic growth. A pertinent international case illustrating this phenomenon is China, where consumer spending has stagnated. China's growth strategy has predominantly focused on expanding international trade through exports, neglecting domestic consumption development. In 2023, consumer spending contributed only 37% to aggregate demand. For over two decades, China enjoyed remarkably high economic growth rates but the onset of the COVID-19 pandemic disrupted its economic environment. Reduced global demand and supply chain disruptions have placed pressure on Chinese exports. While China's growth heavily relied on international trade, the decline in exports and relatively weak domestic demand and consumer spending indicate a significant slowdown in economic growth (Bloomberg, 2024). This underscores the importance of fostering a resilient domestic consumer base.

Table 2 presents an overview of consumer spending trends in South Africa over the past two decades (SARB, 2024). Initially, the contribution of consumer spending to the country's GDP gradually increased from 1995 to 2023. Starting from a relatively modest level below 60%, this contribution has steadily climbed to 66.6% during the analysis period from 2019 to 2023. Similar to the United States, South Africa has a consumer-oriented economy, where consumer spending contributes 67.5% to GDP. Internationally, notable comparisons include Qatar with the lowest contribution at 19.45%, China at 37%, India at 60.6%, Brazil at 63.1% and Lesotho with the highest at 90.7% (World bank, 2024). The escalation in consumer spending implies a diminishing role of other components of aggregate demand, such as domestic investment and net exports, in GDP. However, this increase does not signify robust growth solely in consumer spending; rather, it indicates sluggish growth in both spending and GDP.

This could positively impact growth if government expenditure decreases, particularly within a disorganised government and amidst declining governance, such as in South Africa. Conversely, if the government demonstrates trustworthiness and adopts practical, executable plans and strategies, increased government spending, particularly in infrastructure investments, could significantly stimulate growth. However, a less interventionist approach is preferred concerning the government in South Africa. According to the SARB (2024), in 2023, government spending contributed approximately 19.9%, whereas domestic investment, a key driver of economic growth, stood at only 14.8%. The proportion of domestic investment needs to rise to at least 25% to 30% of GDP as outlined in the National Development Plan of 2012, with government spending hovering closer to 15% of GDP. An optimal distribution among the components of aggregate demand is suggested as follows (refer to Table 1):

Table 1: Components of contributions to aggregate demand

Total GDP	Household consumer spending	Government spending	Domestic Investment	Net Exports
100%	60% to 65%	10% to 15%	25% to 30%	3% to 5%

Source: Author's compilation.

Examining the relationship between the expansion of consumer spending and GDP growth yields intriguing findings. Upon analysis, it becomes evident that the growth in consumer spending consistently outpaced that of GDP in every period studied. However, a noteworthy issue concerning both variables is their rapid growth rate decline over time. From 2019 to 2023, both consumption and GDP growth rates fell below 1%. The country must achieve growth rates surpassing at least the 3% threshold. Such elevated growth rates are essential for job creation and poverty alleviation.

Table 2: Consumer spending growth and contribution to GDP

Consumer spending: Selected periods	Average annual growth in consumption	Average GDP growth	Contribution of consumer spending to GDP
1995 to 2000	3.26%	2.84%	59.5%
2000 to 2005	4.76%	3.84%	59.9%
2005 to 2010	4.15%	3.13%	61.9%
2010 to 2015	2.45%	2.05%	63.9%
2015 to 2019	2.32%	0.97%	64.8%
2019 to 2023	0.94%	0.21%	66.4%
2015 to 2023	1.19%	0.64%	65.4%

Source: SARB (2024).

Increased consumer spending is pivotal in fostering economic growth as expenditure stimulates demand for goods and services, thereby spurring increased production. Heightened production levels, in turn, create avenues for business expansion, investment and job creation. Consequently, a larger workforce expands the domestic market, generating further opportunities. It is imperative to nurture this cycle of prosperity to achieve robust economic growth. Enhanced spending and production, coupled with elevated growth levels, result in higher tax revenues for the government, facilitating infrastructure development and debt repayment. A robust private household spending component is indispensable for maintaining a thriving economy.

Diminished growth in consumer spending results in a downward spiral, leading to sluggish overall growth and a detrimental cycle of unemployment and various social issues, including poverty. The primary challenge with household consumption in South Africa is that about half of the households live in poverty, with constrained income levels. With unemployment standing at 41.2% according to the expanded definition (StatsSA, 2024), it is evident that the consumer market is only slightly more than half the size it should ideally be.

The middle-income bracket (comprising households earning between R 5 000 and R 20 000) is also relatively small and diminishing, yet it holds significant importance from an economic demand perspective. According to BankservAfrica (2024), the mean take-home salary for formal wage earners stood at R15 535 in October 2023 compared to R15 265 in October 2022, marking a meagre year-on-year increase of only 1.8%. When considering the inflation rate, which is nearing 6%, it becomes evident that the average salary failed to keep pace with inflation. Consequently, salary earners have experienced a 4.2% reduction in disposable income and diminished spending power since 2022, leading to decreased expenditure. Approximately 60% of the incomes of these approximately four million households are allocated to debt servicing and repayments.

As per data released by StatsSA (2024) regarding civil litigation and summonses issued against individuals and businesses, a noticeable trend indicates a deteriorating situation concerning debt and bankruptcy since 2020. From 2020 to 2023, there has been an annual increase of 6.8% in civil cases. Specifically, business-related civil cases have experienced a substantial surge of 29.2% over the same period, reaching approximately 88 000 cases in 2023. In terms of individuals, approximately 450 000 summonses were issued for debt, marking a 4.2% increase during the specified timeframe. These statistics underscore a worsening financial scenario for both consumers and private enterprises.

What measures could be implemented to boost consumer spending, thereby fostering sustainable and well-balanced economic growth?

"A comprehensive development strategy is essential to foster economic growth and development. Concentrating solely on a specific segment or sector of the economy will not yield favourable outcomes. Additionally, the government has acknowledged its inability to generate employment, emphasising the necessity for the private sector to be empowered to create jobs within a conducive environment"

- Fiscal policy: The fundamental approach of injecting more funds into consumers' hands remains relevant. However, the government's ability to employ tools like tax cuts is limited due to financial constraints on both income and expenditure. Moreover, the sustainability of cash transfers to the roughly 18 million social welfare beneficiaries under SASSA is already questioned.
- Monetary policy: Presently, South Africa finds itself at the zenith of the interest rate hike cycle, suggesting that the subsequent move by the SARB should involve reducing interest rates to encourage greater consumer spending. Over the past decade, economic growth has lingered within the 3% to 6% inflation target range. This prompts the query of whether the midpoint of 4.5% might be too conservative for fostering economic expansion. During the current interest rate hike cycle, the SARB even raised interest rates despite low or negative consumer spending and GDP growth rates.
- Support for diversification and increased exports, bolstered by enhanced supply chain systems.
- Assistance for business development: Implementing policies to foster small business development could encompass tax incentives, lower interest rate loans and training programs for aspiring entrepreneurs.
- Encouragement of private sector domestic investment: This could be achieved through providing policy certainty. Many sectors of the economy suffer from the adverse effects of policy ambiguity, such as the agricultural sector, which has been impacted by uncertainties surrounding the land reform process. Streamlining and implementing national economic development plans are imperative.
- Infrastructure development: The maintenance and expansion of infrastructure have been neglected for three decades, necessitating urgent action to spur economic growth and job creation.
- Provide opportunities for youth to acquire practical skills and enter the labour market.

A comprehensive development strategy is essential to foster economic growth and development. Concentrating solely on a specific segment or sector of the economy will not yield favourable outcomes. Additionally, the government has acknowledged its inability to generate employment, emphasising the necessity for the private sector to be empowered to create jobs within a conducive environment. The plethora of labour legislation types, for instance, imposes constraints on job creation, thereby influencing the vitality of consumer spending.

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45 minutes CPD

STRATEGIC TRANSFORMATION IN **SOUTH AFRICAN STATE-OWNED ENTERPRISES:** THE INCEPTION AND IMPACT OF STATE ASSET MANAGEMENT SOC LTD

CHRISTIAAN HERBST, Director at The Southern African Advisory Company

In the quest for economic stewardship, the creation of institutions designed to manage state assets stands at the crossroads of potential and challenge. The launch of The State Asset Management SOC Ltd (SAM) marks a significant moment in this complex journey of economic governance.

SAM, born in a challenging economic context, represents more than a mere administrative adjustment. It is a strategic shift aimed at redefining the control and oversight of State-Owned Enterprises (SOEs). These enterprises have historically struggled with inefficiency and political interference. This move is seen as an answer to the systemic issues affecting these entities with the ambitious goal of instilling efficiency, accountability and financial discipline.

At its core is the question: "Does SAM signify a true transformation in SOE governance or is it just a superficial change that fails to address fundamental issues?"

Background and context

To fully grasp the significance of SAM, it is essential to delve into the historical and economic backdrop of South Africa. The nation's economic journey has been tumultuous, characterised by phases of growth, stagnation and regression. At the heart of this narrative lie the State-Owned Enterprises (SOEs), entities that have been pivotal yet also troubled by deep-rooted challenges.

SOEs like Eskom, Transnet and South African Airways have been key in delivering essential services and infrastructure in South Africa. Nonetheless, these entities have faced significant challenges, including financial distress, operational inefficiencies and corruption allegations. These problems extend beyond mere operational issues, reflecting the complex economic and political dynamics of the country. The struggles of SOEs are symptomatic of the national quest for economic stability and growth amidst formidable challenges.

The introduction of SAM is a strategic response to these persistent issues. This initiative represents a critical step towards reform, acknowledging that the existing management of SOEs must evolve for the country to achieve economic revitalisation. The establishment of this entity is a component of a larger government strategy aimed at addressing systemic weaknesses within SOEs and aligning them with the objectives of economic efficiency and public accountability.

This move also signifies a paradigm shift in economic management, adopting a more strategic and structured approach to handling state assets. Inspired by global trends and successful international examples, this initiative aims to enhance SOE performance and accountability. However, it also brings to the fore the debate on the appropriate balance between state intervention and market autonomy, particularly pertinent in the context of emerging economies such as South Africa.

The introduction of SAM, therefore, occurs against a backdrop of economic necessity, political resolve and an aspiration to align South Africa's SOEs with international best practices. It represents a critical effort to redefine the management of vital economic assets in a country where economic rejuvenation and stability are of paramount importance.

Vision of SAM

The vision underpinning SAM is a commitment to fundamentally reforming the efficiency, accountability, and strategic focus of SOEs. This vision is not just an idealistic goal but a practical response to the urgent need for a comprehensive overhaul in the management and governance of these entities.

The creation of SAM embodies an initiative for economic rationalisation. Its aim is to introduce a corporate-like ethos in the management of SOEs, incorporating modern principles of corporate governance and financial management. The objective is to transform these organisations from their current state of bureaucratic inefficiency into entities that are leaner, more agile and responsive to market demands. This transformation hinges on the idea that a centralised, professional management structure will be more effective in guiding these enterprises towards financial health and operational effectiveness.

A key aspect of this vision is to shield the SOEs from political meddling. By establishing a clear distinction between state ownership and operational management, SAM intends to protect these enterprises from political volatility that has historically affected their performance. This separation is crucial to depoliticising the SOEs, enabling them to operate based on business principles rather than political directives. This approach draws inspiration from successful models in countries such as Singapore and Malaysia, where centralised management of state assets has significantly improved performance through a focus on professionalism, accountability and market orientation. These international examples offer valuable insights into how strategic state asset management can bolster economic growth and stability.

Nonetheless, realising this vision presents considerable challenges. It requires not only legal and structural changes but also a shift in organisational culture within the SOEs, transitioning from a bureaucratic approach to a corporate, performance-driven mindset. This change is intricate and requires serious skills.

Political Implications

The launch of SAM is deeply intertwined with the political environment in which it operates. In South Africa, where the fusion of politics and state enterprises has often led to contention and inefficiency, the political ramifications of this new entity are significant.

A key aspect of the political debate surrounding SAM is its objective to diminish political interference in the operations of SOEs. This marks a pivotal change, addressing a historical problem where political motives have frequently overshadowed commercial and operational effectiveness. The aspiration of this new entity is to foster a decision-making environment governed by sound business principles rather than political convenience.

However, the challenge lies in actualising this demarcation of politics from business in a context traditionally influenced by political patronage. Although SAM theoretically supports operational independence, the practical implementation of this distinction is complex. The entity's capacity to withstand political pressures, ensure transparent decision-making and adhere to good corporate governance principles will critically test its effectiveness and integrity.
The government's role in appointing the board of directors adds another layer of complexity. The ability of either the President or a Cabinet member to make these appointments has raised concerns. Critics suggest that this could continue the cycle of political influence in state enterprises. It is vital that these appointments are merit-based, focusing on expertise rather than political allegiance to maintain the legitimacy and functionality of SAM.

In a broader sense, the creation of this entity reflects a sophisticated view of the state's role in economic development, moving away from a purely laissez-faire stance. It acknowledges the importance of state involvement in guiding critical economic sectors while also incorporating market efficiency and corporate governance principles.

Therefore, the political implications of SAM reach beyond the management of SOEs. They delve into essential questions about the interplay between the state and the market within South Africa's economic framework. The success of this entity in managing these intricate political dynamics will not only shape the future of South Africa's SOEs but also signify the nation's commitment to a new model of economic governance that is more efficient, transparent and accountable.

Challenges and criticisms

The establishment of SAM, while buoyed by a vision of transformation, is met with significant challenges and criticisms. These concerns are substantial, questioning the entity's effectiveness and the practicality of its ambitious objectives.

A principal critique of SAM is the risk of continuing political benefaction, contradicting its goal to reduce such influence. Historical instances of political interference in South African SOEs, which often lead to mismanagement and corruption, fuel this scepticism. The process of political figures appointing the board is particularly contentious as it might allow for ongoing political sway, negating the entity's foundational purpose.

Transitioning from a bureaucratic framework to a corporate governance model is another formidable challenge. This shift is not merely structural; it demands a deep-seated cultural change within SOEs. The move towards a performance-oriented approach may face resistance from employees and managers accustomed to previous practices. Additionally, unifying the varied interests and operations of different SOEs under one management umbrella is a strategic and logistical hurdle.

Moreover, SAM must carefully balance state oversight with market autonomy. Excessive state intervention could hamper innovation and efficiency, whereas insufficient oversight might lead to poor accountability and strategic misdirection. Achieving this balance is vital for the entity's success.

“These problems extend beyond mere operational issues, reflecting the complex economic and political dynamics of the country. The struggles of SOEs are symptomatic of the national quest for economic stability and growth amidst formidable challenges”

The broader economic landscape of South Africa also presents challenges. Characterised by significant inequality, unemployment and instability, the economy sets a complex backdrop for SAM. The SOEs under its guidance are not only commercial enterprises but also vehicles for public policy, responsible for delivering essential services and aiding economic development. Reconciling commercial objectives with socio-economic responsibilities adds to the complexity of the entity's mandate.

Addressing these challenges and criticisms requires stewardship; it involves implementing transparent processes, establishing robust checks and balances and maintaining a commitment to continuous evaluation and adaptation.

Opportunities and upsides

The inception of SAM, despite facing challenges and criticisms, presents a host of significant opportunities and potential benefits for South Africa's economy. These positive aspects serve as a counterweight to prevailing scepticism, underscoring the transformative promise of this initiative.

1. Enhanced efficiency and professionalism: A key advantage of SAM lies in its potential to elevate efficiency and professionalism in SOE management. The centralisation of oversight coupled with a corporate governance approach, promises more coherent decision-making, reduced bureaucracy and a robust focus on performance and accountability. This paradigm shift could see SOEs emerging as competitive and agile entities, poised to effectively meet market demands and make substantial contributions to the national economy.
2. Financial stability and sustainability: By adopting a centralised management structure, the potential for improved financial oversight and control is significant. This approach aims to mitigate the risks of mismanagement and corruption that have historically affected many SOEs. Enhanced financial stability could reduce dependence on government bailouts, contributing to the fiscal health of the nation, lightening the taxpayers' burden and allowing government funds to be allocated to other vital areas.
3. Attracting investment: A more professional, transparent approach to managing SOEs is likely to bolster investor confidence, potentially drawing both domestic and foreign investment. This influx of capital could be pivotal in upgrading infrastructure, fostering innovation and stimulating growth. Increased investment also promises job creation and skills development, contributing to wider socio-economic objectives.
4. Global best practices and innovation: SAM offers a platform to embrace global best practices in state asset management, extending beyond financial and operational aspects to include innovation and technological advancements. Learning and adapting successful international models to the South African context can propel local SOEs to industry leadership.
5. Balanced approach to economic development: The establishment of this entity allows for a balanced approach to economic development, integrating state-led initiatives with market-driven dynamics. This approach ensures that SOEs fulfil public mandates while maintaining operational efficiency and competitiveness, resonating with contemporary perspectives on the state's role in a mixed economy.

- SAM harbours the potential to redefine governance in South Africa's SOEs. Effective implementation could catalyse a substantial transformation in the operational ethos of these entities, contributing to economic stability, growth and development. The opportunities presented by this initiative, if leveraged appropriately, could significantly alter the course of South Africa's economic future.

Case study analysis: Eskom

To understand the potential effectiveness of SAM it is instructive to examine Eskom, South Africa's main electricity provider. Eskom is grappling with an immense debt, estimated to exceed R400 billion, representing a significant risk to South Africa's fiscal health. This is exacerbated by outdated infrastructure, frequent breakdowns and reliance on costly emergency power solutions. These issues create a vicious cycle of operational disruptions, tariff hikes and financial bailouts, impacting the entire economy.

Potential impact of SAM:

1. Improved governance and oversight: Under the aegis of SAM, Eskom could see a revamp in governance, driving operational efficiency and financial prudence. This may include stringent performance monitoring, cost reduction initiatives and focused infrastructure investment strategies.
2. Strategic financial management: A centralised financial oversight approach could help optimise Eskom's debt management and capital acquisition strategies. Possibilities include debt restructuring, exploring novel funding avenues and forming private sector alliances to mitigate financial pressures.
3. Operational efficiency: Adopting best practices in utility management and technological innovation could significantly enhance Eskom's operational efficiency. Potential measures include investing in renewable energy, upgrading grid infrastructure and implementing cutting-edge energy solutions.
4. Reduced political interference: A primary goal of SAM is to limit political influence on operational decisions. For Eskom, this could result in greater strategic and decision-making autonomy, devoid of short-term political agendas.

Broader economic implications:

1. Stabilising the power sector: An efficient, financially sound Eskom is vital for South Africa's economic stability. Consistent and affordable electricity is foundational for industrial activities, business confidence and general economic growth.
2. Job creation and skills development: As Eskom stabilises and adopts modern technologies, new employment opportunities, especially in renewable energy sectors, could arise. This also opens doors for skills enhancement and technological progress.
3. Attracting investment: A reformed Eskom could boost investor confidence in South Africa's economic landscape, signalling a serious commitment to addressing one of the nation's most critical economic challenges.

The situation of Eskom exemplifies the extensive influence SAM could have on individual SOEs and the wider economic scene. Despite the existing challenges, the prospects for substantial positive change are considerable, hinting at a more stable and prosperous economic future for South Africa.

Conclusion

SAM stands as a pivotal and transformative initiative in South Africa's economic narrative, embodying aspirations for a renewed approach to managing state enterprises and caution due to past challenges. Its success hinges on the precise execution of its mandate, robust governance and navigating South Africa's socio-economic and political complexities. This entity signifies a significant shift towards transitioning them from fiscal burdens to drivers of growth and development, contingent upon fostering a culture of professionalism, responsibility and operational efficacy. More than a structural change, it is a test of South Africa's commitment to economic reform, challenging entrenched political interference and bureaucratic inertia and integrating market-driven principles with corporate governance.

Balancing state involvement with market dynamics, SAM seeks to align SOEs' commercial goals with broader socio-economic mandates, contributing positively to the national interest without compromising efficiency. As South Africa faces economic challenges, this entity's success or failure will profoundly influence not only the SOEs under its ambit but also the country's entire economic framework. This venture, laden with challenges and opportunities, reflects South Africa's broader economic journey towards greater transformation under the watchful eyes of both national and international observers, hopeful yet cautious, as the country moves towards a more prosperous and stable future.Tax Talk 2024

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DEPARTMENT OF TRADE, INDUSTRY AND COMPETITION

15 minutes CPD

IMPORT REGULATORY TRENDS CONTINUE

▶ **ANNEKE JANSEN VAN VUUREN,** Trade Analyst in Economics at XA Global Trade Advisors

For the past few years, South Africa has had a very specific focus when it comes to our economic, industrial and trade policies; we need to stop importing so many products, produce more products locally and grow our exports. On paper, this seems easy enough; however, in reality, it is far from easy.

The government has been focusing on localisation such as the master plans and the 42 product areas of localisation champions, yet it has yielded little economic benefit. In South Africa, localisation largely aims to replace imported products with locally produced products (import replacement). This does not work if the country has an electricity and infrastructure problem. For example, businesses use their revenue to cover their basic needs such as installing solar or even running water. Electricity needs to be freely available in order to manufacture more, which will result in relying less on imports. However, the very opposite is happening; South Africa is manufacturing less and importing more.

The United Nations publishes the Classification by Broad Economic Categories (BEC), which allows us to classify and aggregate our trade data in specific groupings, for example, the end use dimension of the imported product. In other words, the imported product is classified as:

1. Final consumption: Products that do not need any further processing (think of things you can buy in a shop);
2. Intermediate consumption: These are raw materials or components; or
3. Gross fixed capital formation: Capital goods such as manufacturing equipment.

The value of South Africa's imports over the last 13 years (from 2010 to 2023) was analysed and a very clear pattern is emerging. The combination of products in our import basket is moving in the wrong direction. South Africa imports more final consumption products and less intermediate and gross fixed capital formation products. Instead of importing everything, we need to produce the product locally; we are skipping right to the finished goods. This is not a successful implementation of localisation. More final products are imported because similar products are not being produced locally.

If the localisation strategy had been working, the import pattern would have been the opposite; there would have been a decrease in final consumption products and an increase in the less intermediate and gross fixed capital formation products. Just that simple change in pattern would have confirmed if the strategy had been successful.

In a small, open economy such as South Africa, imports play an important role in manufacturing by supplying necessary input materials at competitive prices and helping our domestic manufacturers become more competitive in the market. Without competition in the market, we would simply end up with higher prices and no economic growth. The people who would be affected most are the consumers of the products because the businesses would simply increase their prices.

If you want to force the import replacement strategy and limit competition in the market, import duties are the easiest way to do so. Customs duties only amount to about 5% of the total taxes collected by the government; they are not used to generate income but are a very effective method of discouraging import behaviour. Depending on what type of products (final or intermediate) the duties are levied on, the impact of the duties will differ.

If duties are increased on the final consumption products, their effect on the market will be limited as the tax burden sits with the final consumer of the product. However, the further upstream the duties are imposed in the production process, the greater their effect will be on the entire market. For example, if duties on primary steel are increased, they will have a ripple effect in the market on all products that use steel as a raw material to produce something.

"The value of South Africa's imports over the last 13 years (from 2010 to 2023) was analysed and a very clear pattern is emerging. The combination of products in our import basket is moving in the wrong direction"

- If a product is not being produced locally, but there is a demand for the product (meaning someone is importing it), there should not be duties imposed on the product. All imports, which attract a duty when imported, were analysed from July 2022 to June 2023. We compared that list of products with a list of tariff codes that have been reviewed in the last 20 years since 2003. The further back a duty was imposed, the more the market would have changed since then. When duties remain in place for very long periods, the duty simply becomes part of the business model (economists call this a rent). Duties should be reviewed every three to five years, but this does not happen. More than 90% of the products which attracted and paid duties in the last year have not had their duty levels considered in the last 20 years. After two decades, it is not even clear if all the companies benefitting from the protection still exist.

Highly protected markets swiftly create a low innovation, low competitiveness environment, which is what we have. If the intention is to grow exports, then South Africa needs to change its approach to duty protection dramatically and review the existing duties in place. We cannot expect to grow our exports without increasing imports. No country has ever grown more by trading less.

TAXTALK 34

30 minutes CPD

BEIT BRIDGE: The Zimbabwean versus South African side of the border – getting to grips with the issues

▶ **MARK GOODGER,** Managing Director at GMLS

When considering the challenges of crossing borders in Africa, particularly land borders, an immediate picture forms of long queues of trucks, agitated drivers, frustrated traders and layer upon layer of border authorities governing various compliances. Numerous such authorities conduct their respective regulatory mandates in an uncoordinated, heavy-handed manner and, only on rare occasions, in cooperation with one another.

These problems and challenges are not only found on the African continent, but also on many other continents with lesser developed nations.

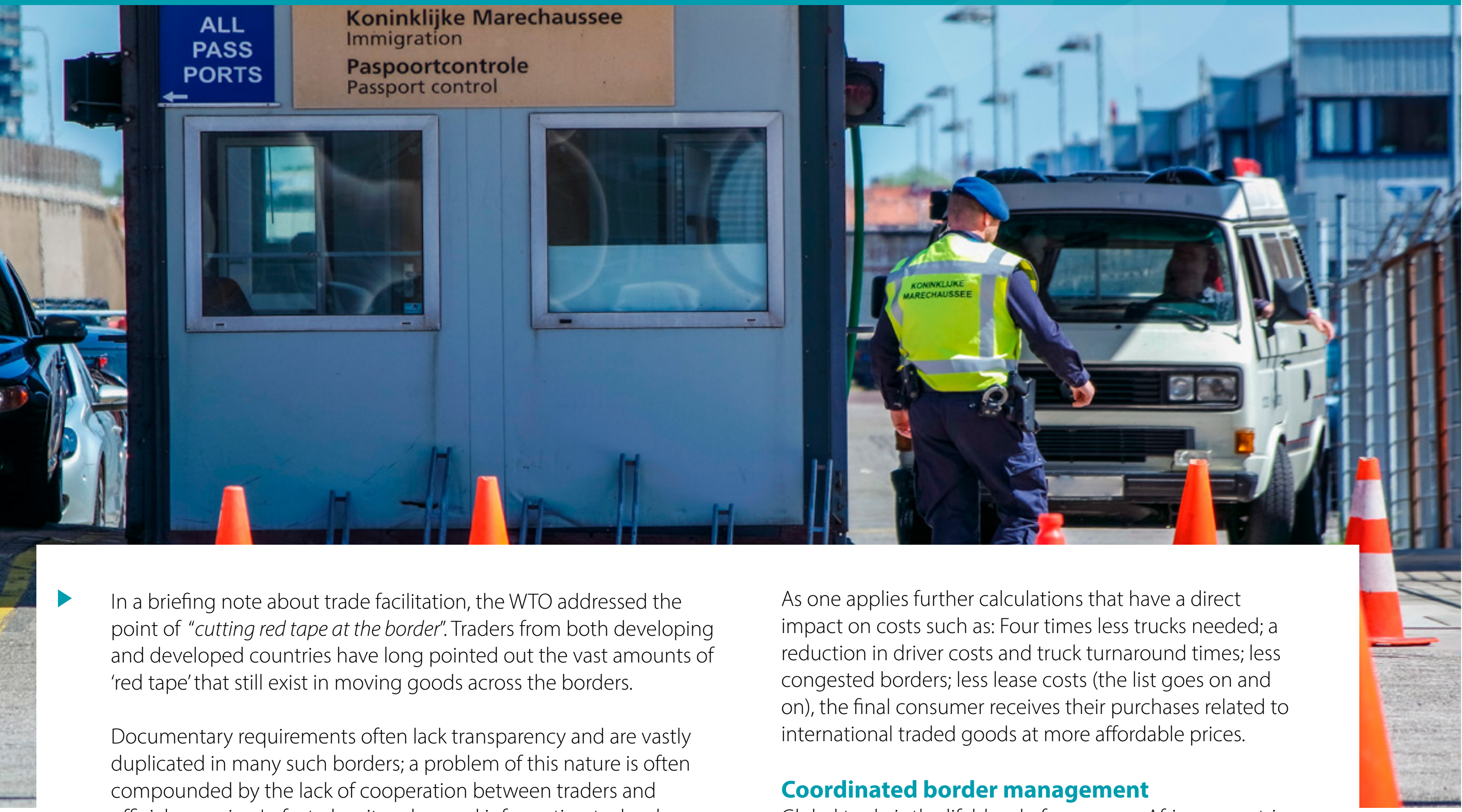
Such is the extent of concerns that attention to the problems and the need for resolution standards to resolve them were driven by the World Trade Organization (WTO), which concluded the landmark WTO Agreement on Trade Facilitation (ATF) through negotiation at the 2013 Bali Ministerial Conference. The agreement entered into force on 22 February 2017, following its ratification by two-thirds of the WTO membership.

This agreement was thus directed at trade facilitation which, clearly, is not being achieved at all African borders and, without doubt, the Beit Bridge/Zimbabwe Border came under the spotlight for not consistently meeting all the objectives of trade facilitation. According to the WTO, trade facilitation contains, in conformance with the ATF, provisions for expediting the movement, release and clearance of goods, including goods in transit. It also sets out measures for effective cooperation between customs and other appropriate authorities on trade facilitation and customs compliance issues.

Benefits of the WTO ATF

An alarming statement cited by the WTO under its 'Benefits of the ATF', continues to state that "*full implementation of the ATF could reduce Trade Costs by an average of 14,3%, and boost Global Trade by up to 1 trillion per year, with the biggest gains in the poorest countries*". In essence, through its provisions, the ATF has been created to assist and ensure least developed countries to obtain the assistance needed to reap the full benefits of the ATF.

“Documentary requirements often lack transparency and are vastly duplicated in many such borders and a problem of this nature is often compounded by the lack of cooperation between traders and official agencies”



In a briefing note about trade facilitation, the WTO addressed the point of *"cutting red tape at the border"*. Traders from both developing and developed countries have long pointed out the vast amounts of 'red tape' that still exist in moving goods across the borders.

Documentary requirements often lack transparency and are vastly duplicated in many such borders; a problem of this nature is often compounded by the lack of cooperation between traders and official agencies. In fact, despite advanced information technology, automatic data submission is still not common-place and not structured with cooperation on information through the layers of controls at borders.

What stands out in the WTO statements, is the 14,3% reduction in trade costs, which could be achieved when the Standards of Trade Facilitation are adopted and achieved. In respective communications with customs officials, trade associations and traders, one generally finds blame directed at authorities and, vice versa, from authorities citing the lack of capacity and compliance by traders and their logistics service providers. Unfortunately, the negative conclusion is that the costs are borne by all in their respective daily livelihoods.

Example of costs and related impacts

This brings to mind an example of costs and related impacts that was addressed for solution purposes in the Mexico to Panama Canal Route some years ago. It had been concluded that goods carried along this route by road were required to clear up to seven borders before reaching their destination.

This research concluded that, in fact, the average speed of the trucks from departure to arrival was 15 kilometres per hour. Drastic measures were taken to address coordinated border management and the end result was that the improvements realised determined that the speed of such trucks had increased from 15 to 60 kilometres per hour.

As one applies further calculations that have a direct impact on costs such as: Four times less trucks needed; a reduction in driver costs and truck turnaround times; less congested borders; less lease costs (the list goes on and on), the final consumer receives their purchases related to international traded goods at more affordable prices.

Coordinated border management

Global trade is the lifeblood of numerous African countries, inclusive of South Africa and Zimbabwe.

Mr Erich Kieck, former Director of SARS and then Capacity Building Director of the WCO, stated the following in an article titled 'Coordinated border management: unlocking trade opportunities through one stop border posts':

"With the progress made in liberalising international trade through the reduction in tariff barriers, the focus is shifting increasingly to the removal of non-tariff barriers and the facilitation of legitimate trade. At the same time, border management is becoming more complex and this is compounded by the multiplicity of state agencies involved in that management.... From an international coordinated border management perspective, one stop border posts have been introduced or are being considered as a mechanism to improve the movement of goods across shared borders."

The objective of a 'one stop border post' can be realised through simplification and harmonisation of all procedures.

Statistical information – February 2024

A snapshot of recent crossings and time consumed at the Beit Bridge/Zimbabwe Border is reflected in the table below, as secured from the Federation of South African Road Transport Associates (FESARTA).

Border	Direction	Fastest 5% Crossing Time	Medium Crossing Time	Slowest Crossing Time	Average Crossing Time	Standard Deviation
Beitbridge Border	SA - Zimbabwe	9 hrs 56 min	1 day 7 hrs	4 day 13 hrs	1 day 16 hrs	1 day 12 hrs
Beitbridge Border	Zimbabwe - SA	3 hrs 16 min	12 hrs 7 min	1 day 21 hrs	18 hrs 3 min	15 hrs 4 min
Total		4 hrs 2min	1 day 0hr	3 day 1 hr	1 day 8 hrs	1 day 8 hrs

As mentioned before, the complexity and delays in border crossings are attributed to both the public and private sector, each with their respective perspectives. Looking at recent developments from reliable sources, Limpopo Police caused a number of issues at the Weighbridge, impacting traffic in both directions during the first week of February 2024.

It appears that vehicles arriving at the border without fully and duly completed documentation is an issue in addition to slow processing times. In this first week of February 2024, queue times for Beit Bridge stood at 31 hours for northbound and 12,07 hours for southbound traffic.

Northbound crossing times for that week stood at 9,56 hours minimum, 32 hours median and 109 hours maximum, while Southbound crossing times stood at 3,16 hours minimum, 12,07 median and 45 hours maximum.

As noted by FESARTA, there is quite a large variance between the crossing times of both sides of the border.

The Beit Bridge Border Post, situated on the border between South Africa and Zimbabwe is the busiest regional transit link in Southern and Eastern Africa, connecting RSA, Zimbabwe, Botswana, Zambia, the Democratic Republic of the Congo (DRC), Malawi, Tanzania and Northern Mozambique.

Looking at the volumes in perspective, it is estimated that over 400 trucks cross this border every day. In prior estimates, trucks experienced average delays of approximately three days, some of which could extend to one week. Each delay is estimated to cost USD 400 per truck per day, which provide a rough estimate of the impact of these delays, especially increasing the price of significant consumer goods, such as fuel and sugar. Many reports reflect that power shortages also significantly contribute to delays. One such example is that generators utilised by the Zimbabwe Revenue Authority (ZIMRA) officials cannot generate enough power to supply electricity to its offices and truck scanners at the same time. Customs entries are conducted electronically and when the power is off, no entries can be processed.

Taking into account that the global WTO ATF, the UN ALMAY ACCORD (facilitation of trade to landlocked countries), the Southern African Development Community (SADC) Trade Agreement and the recent African Continental Free Trade Area Agreement all focus on trade facilitation initiatives, the current state at the Beit Bridge/Zimbabwe Border must be considered unsatisfactory and negative to the citizens of countries relevant to trade facilitation through this border post.

With specific review of the African Continental Free Trade Area (AfCFTA) and its annexes to the Protocol on Trade, specifically those related to transit, trade facilitation and the elimination of non-tariff barriers, including the fact that such agreements are binding on nations via their constitutional provisions, it is clear that we require political will and application to meet the objectives and requirements of such agreements.

Mr Erich Kieck stated the following in his concluding remarks:

"The establishment of one stop border posts provides states with the opportunity to reduce the costs of doing business and improve enforcement at shared borders. Moving successfully from conceptualisation to implementation requires that these initiatives be carefully planned and the emphasis placed on the involvement and buy in of stakeholders. It also needs to be recognised, that the shift from two stops to one stop arrangements has a significant impact on officers of both states. Investments in change management and retraining are essential to ensure that the participating states reap the envisaged benefits."

Conclusion

In conclusion, there is an observed awareness of various areas of improvement and upgrading by authorities and trade, yet the current situation is far from satisfactory. In fact, it would be a pleasure to finally see politicians hanging their credentials on the drastic improvement of these concerning border issues towards the benefit of their citizens, which are of high importance and impact to many, rather than other insignificant matters.

Continued research conclusions as observed on the topic of these orders by organisations such as the *Deutsche Gesellschaft für Internationale Zusammenarbeit* (GIZ), the South African Institute of International Affairs and the like, reflect that bringing such issues to the attention of the media and using research to feed into parliamentary debates, will greatly assist in finding political will towards the required solutions and meeting international obligations for trade facilitation.

Improvements by border authorities and some concerns to note

The following improvements noted deserve some mention.

Almost all clearances via Beit Bridge are automated via electronic data interchange (EDI) and the SARS risk profiling system is in operation to target high-rik consignments. This has led to improved automated pre-clearance of cargo; gate controls and scanners for cargo and luggage are also in utilisation. There is a focus on Customs-to-Customs cooperation, including Customs-to-Business and Customs-to-OGAs (other governmental organisations), to enhance trade facilitation and compliances.

Zimbabwe has also made incredible investments into physical infrastructure to improve port management for travellers, cargo trucks and pedestrians; notably, both presidents of RSA and Zimbabwe met at the border to inspect infrastructure on both sides.

Whereas the abovementioned improvements are positive, there are still rumours of truckers that have diverted their trucks from this border to Botswana due to exorbitant toll fees in Zimbabwe.

The following links will be of interest to readers:

1. https://constructionreviewonline.com/biggest-projects/beitbridge-border-post-modernisation-project-update/
2. https://www.youtube.com/watch?v=5hslhryld38
3. https://www.herald.co.zw/zimborders-reviews-vehicle-toll-fees-to-speed-up-automation/

45 minutes CPD

NAVIGATING THE SHIFTS:

A deep dive into changes in 2023 for South Africa's tax landscape

GODFREY WILLIAMS, Tax Advisor at Goliath Williams Financial Services

In this article, we turn our focus to the significant operational changes that have occurred in South Africa's tax landscape during the year 2023.

The year 2023 was a landmark year for South Africa's tax environment with the introduction of new tax legislation, the launch of digital platforms and shifts in enforcement strategies. These changes have not only reshaped the way in which businesses and individuals comply with their tax obligations but also the role of tax professionals in guiding them through this complex landscape.

Join us as we delve into the intricacies of these operational changes, providing you with the insights and analyses you need to better serve your clients and stay ahead in this dynamic field. Together, we will chart the course through the complexities of South Africa's 2023 tax landscape, arming you with the knowledge to confidently guide your clients through these changes. Let's embark on this journey together.

Resilience amid challenges in the budget speech

In the ever-evolving realm of South Africa's fiscal policies, Budget 2023 unfolds a narrative that tax professionals cannot afford to overlook. The Minister's endeavor to present 'the facts as they are' unveils stark realities and challenges in stabilising public finances, shaping the trajectory for tax-related matters in the nation.

A noteworthy surge in total tax collections, reaching approximately R1.69 trillion for the year, marks a significant stride. The tax-to-GDP ratio is poised to climb to 25.4% in 2022/23, followed by a progressive increase to 25.7% over the next three years. Despite economic headwinds, tax revenue collections are set to outperform earlier estimates. Elevated commodity prices, increased profitability in the services sector and a buoyant personal income tax collection driven by economic recovery and employment improvements, contribute to this fiscal resilience. Notably, growth in import prices, resilient corporate income and enhanced tax administration underscore the sectoral dynamics influencing tax outcomes.

The role of SARS in augmenting revenue collections is acknowledged but concerns linger over governance failures. The call for a structural review of SARS governance promised after the 2018 Nugent Commission remains unanswered. Tax professionals urge a re-evaluation to enhance service delivery and taxpayer experience.

A cautious approach to tax rate increases is evident; it aligns with research indicating potential impediments to economic activity during low-growth periods. While inflationary adjustments are made, critics argue that they fall short of addressing the actual inflation rate. The focus remains steadfast on protecting the tax base, implementing reforms and aligning with the recommendations of the Davis Tax Committee.

Therefore, Budget 2023 paints a nuanced picture for tax professionals in South Africa. The intricacies of revenue dynamics, fiscal risks, governance concerns at SARS and strategic tax policies collectively shape the landscape. Navigating this terrain demands astuteness, adaptability and a keen understanding of the economic forces at play.

Overview of key tax changes affecting individuals in South Africa

The recent adjustments to individual tax policies have significant implications for taxpayers.

Personal income tax

Personal income tax (PIT) continues to be a substantial contributor to the total estimated tax collections in South Africa. The latest figures indicate that PIT accounted for R601.6 billion of the total estimated tax collections of R1.69 trillion, constituting 36% of the total tax revenue.

An inflationary increase in personal income tax brackets and rebates has resulted in a noteworthy relief of R15.7 billion. Notably, the change in the primary rebate has increased the tax-free threshold from R91 250 to R95 750 for taxpayers under 65 years old.

Exemption for interest and dividend income

The annual exemption on interest earned by individuals, both younger and older than 65 years, remains unchanged at R23 800 and R34 500, respectively. Additionally, the annual contribution limit to tax-free investments remains at R36 000.

Rooftop solar incentive

In a bid to boost electricity generation, a proposed rooftop solar incentive aims to encourage individuals to invest in solar photovoltaics (PV). Eligible individuals can benefit from a tax rebate of 25% of the cost of new and unused solar PV panels with a maximum rebate capped at R15 000 per individual. The South African Institute of Chartered Accountants (SAICA) has expressed concerns about limiting the allowance to solar PV panels only and the one-year availability, considering likely legislation in January 2024.

Two-Pot retirement system

Following extensive public consultation, the first phase of legislative amendments to the retirement system is set to take effect on 1 March 2024. The changes allow pre-retirement access to a portion of retirement assets while preserving the rest for retirement. Contributions remain deductible with permissible withdrawals taxed according to specific rules. The forthcoming draft legislation will clarify further details on seed capital, defined benefit funds, legacy retirement annuity funds and withdrawals.

Proposed changes include apportioning the tax-free investment contribution limitation and limiting the deduction of retirement fund contributions to align with provisions for individuals ceasing to be tax residents.

Clarifying anti-avoidance rules for low-interest or interest-free loans to trusts

Proposed amendments aim to clarify exclusions and foreign-denominated loans, ensuring a comprehensive understanding of what constitutes a primary residence in the Eighth Schedule of the Act.

The brackets for transfer duties, retirement fund lump sum benefits and retirement fund lump sum withdrawal benefits will all be adjusted upwards by 10% to compensate for inflation, whereas tax rates remain unchanged.

These changes have a significant impact on individuals.

General corporate tax proposals

Recent developments indicate a review of Practice Note 31 of 1994 (PN 31) and Practice Note 37 of 1995 (PN 37). SARS announced its intention to withdraw these practice notes, effective from years of assessment, starting on/after 1 March 2023. The decision is prompted by the increasing abuse of the tax deduction concession per PN 31 and the failure of PN 37 to incorporate the requirements of the term 'registered tax practitioner' as stipulated in the Tax Administration Act, 2011 (TAA). SARS is currently considering public comments and aims to delay and align the withdrawal with the effective date of any related legislative changes.

Clarification of anti-avoidance rules

The Act includes anti-avoidance rules targeting debt-like equity instruments such

> ***"As we navigate these shifts, tax professionals must remain vigilant by adapting to legislative changes and by demonstrating astuteness in guiding clients through this intricate tax terrain. The journey through South Africa's 2023 tax landscape demands technical expertise and a keen understanding of the economic forces at play"***

as third-party backed shares. Currently, any dividend or foreign dividend received in respect of a third-party backed share is deemed as income. Exceptions apply if funds from the shares are used to acquire equity shares of an operating company. However, the rules do not cover situations where the person no longer holds shares in the operating company. The government proposes a legislative amendment to provide clarity on this matter.

Changes for Companies

South Africa is witnessing several notable changes in the dynamic business realm that will influence how companies operate and strategise. This summary provides insights into key developments in the corporate landscape.

Refining the Research and Development (R&D) tax incentive

In response to public consultation on the R&D incentive, the government proposes significant refinements:

1. Extension of the incentive for 10 years from 1 January 2024 with a six-month grace period for project commencement before application submission.
2. Simplification of the definition of R&D for an easier application process.
3. Adopting the Organisation for Economic Cooperation and Development (OECD) Frascati Manual principles in defining R&D, emphasising novelty, uncertainty, systematic approach and transferability/reproducibility.
4. Removal of the exclusion for internal business processes, broadening the scope of qualifying activities.
5. Empowering the Commissioner of SARS to disclose information to the Minister of Higher Education, Science and Innovation for better monitoring and evaluation.

Extending the Urban Development Zone (UDZ) incentive

Due to ongoing public consultation and delayed review processes, the UDZ tax incentive is extended for two years until 31 March 2025. The extension allows for a thorough assessment of the incentive's impact, requiring additional engagement and evaluation of municipal data on uptake and compliance.

Adjusting minimum royalty rate for oil and gas companies

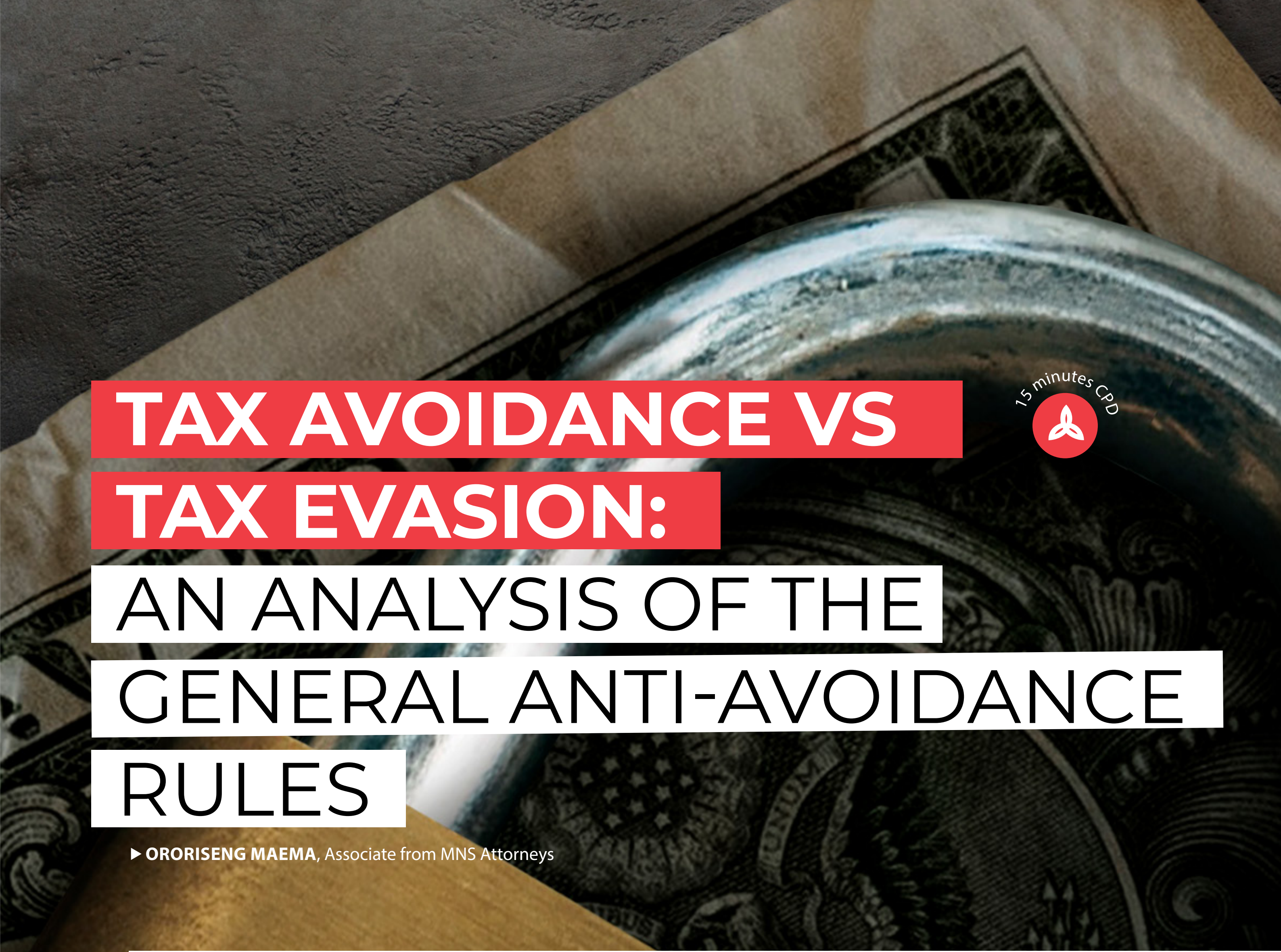
After consultations, the government proposes maintaining flexibility in royalty rates based on profitability for oil and gas companies. The minimum royalty rate is set to increase from 0.5% to 2% with the maximum remaining at 5% to ensure fair compensation for the country's finite resources. This approach acknowledges the varying costs and profit levels faced by companies operating in different environments such as deep or shallow waters.

In conclusion, the year 2023 has marked a pivotal moment for South Africa's tax landscape, witnessing substantial changes that demand the attention and strategic foresight of tax professionals. The Budget Speech, with its nuanced depiction of fiscal challenges, sets the stage for a resilient yet cautious approach to taxation. The SARS plays a vital role but lingering governance concerns necessitate a thorough review for enhanced service delivery.

The adjustments to individual tax policies bring relief and incentives, notably in personal income tax, exemption for interest and dividend income, rooftop solar incentives and the two-pot retirement system. These changes, coupled with proposed amendments to anti-avoidance rules, significantly impact individuals, requiring a comprehensive understanding by tax professionals.

Corporate tax proposals reflect a dynamic business environment with refinements to the Research and Development (R&D) Tax Incentive and the Urban Development Zone (UDZ) Incentive extension. The oil and gas sector witnesses adjustments in royalty rates, acknowledging the diverse operational landscapes faced by companies.

As we navigate these shifts, tax professionals must remain vigilant by adapting to legislative changes and by demonstrating astuteness in guiding clients through this intricate tax terrain. The journey through South Africa's 2023 tax landscape demands technical expertise and a keen understanding of the economic forces at play. Let this be a collective endeavour to stay informed, resilient and proactive in the ever-evolving realm of taxation.



15 minutes CPD

TAX AVOIDANCE VS TAX EVASION: AN ANALYSIS OF THE GENERAL ANTI-AVOIDANCE RULES

▶ **ORORISENG MAEMA**, Associate from MNS Attorneys

Want to structure your affairs in such a way that you pay the least amount of tax possible? Be sure not to accidentally find yourself guilty of tax evasion!

Tax avoidance vs tax evasion

So what is tax avoidance and tax evasion anyway?

On the one hand, tax avoidance involves the use of legitimate means, i.e. employing provisions of tax legislation in order to pay less tax. [1]On the other hand, tax evasion involves the use of illegal means by taxpayers to free themselves from a tax burden. [2]

The court in *Commissioner for South African Revenue Service v NWK Ltd*[3] held that the taxpayer may organise their financial affairs in such a way as to pay the least tax permissible. The court did provide, in addition, that there is, however, something wrong with dressing up or disguising a transaction to make it appear to be something that it is not, especially if this has the purpose of tax evasion, amongst other things.

So technically, there is nothing wrong with taxpayers arranging their affairs to pay the least amount of tax possible. A legitimate tax avoidance scheme is one where taxpayers have arranged their affairs to minimise their tax liability in a manner that does not involve fraud, dishonesty, misrepresentation or other actions designed to mislead the Commissioner.[4]

On the contrary, tax evasion involves the non-payment of a tax that would properly be chargeable if the taxpayer had made a full and true disclosure of income and allowable deductions.[5]

[1]M Stiglingh (editor), AD Koekemoer & L Van Heerden et al SILKE: South African Income Tax 2022 (2021) 1135
[2]M Stiglingh (editor), AD Koekemoer & L Van Heerden et al SILKE: South African Income Tax 2022 (2021) 1136
[3](27/10) [2010] ZASCA 168; 2011 (2) SA 67 (SCA) ; [2011] 2 All SA 347 (SCA) (1 December 2010)
[4]SARS Practice Note 5 stamp duty, income tax, secondary tax on companies, tax on retirement funds, value added tax and uncertificated securities tax implications of lending arrangements in respect of marketable securities (14 APRIL 1999)
[5]M Stiglingh (editor), AD Koekemoer & L Van Heerden et al SILKE: South African Income Tax 2022 (2021) 1136

- Tax evasion can include, but is not limited to, the creation of false financial statements or deliberately presenting false information on a tax return. Non-compliance with Tax Acts,[6] as well as the evasion of tax with intent, are criminal offences and are subject to severe penalties.[7]

So far, we have learned that tax evasion is bad in that it is not permitted by the law; but tax avoidance? The courts seem to understand.

Notwithstanding the legality of tax avoidance arrangements, the implications are that such schemes often result in significant loss of tax revenue to the fiscus.[8] This, then, necessitates the development and imposition of general anti-avoidance rules, otherwise known as 'GAAR' to identify and prevent impermissible tax avoidance arrangements.

Impermissible tax avoidance arrangements

Section 80A of the Income Tax Act defines an impermissible avoidance arrangement as an arrangement where:

- the '*sole or main purpose*' (of such an arrangement);
- is to obtain '*a tax benefit*';
- with one of the '*tainting*' elements[9];
- depending on whether the arrangement is "*in the context of 'business,' or 'in a context other than business'* ".[10]

('the Test')

It is important to note that the elements of the Test must be considered in conjunction when determining whether a transaction is an impermissible tax arrangement. The determining factor is whether the manner in which the transaction was entered into or carried out, is a manner that would *normally* be used for business purposes other than to obtain a tax benefit.[11]

In general, SARS will assume that an avoidance arrangement is entered into or carried out for the sole or main purpose of obtaining a tax benefit, unless it is the responsibility of the taxpayer to prove obtaining a tax benefit was not the sole or main purpose of the avoidance arrangement.[12]

Beyond the (objective) test provided for in section 80A, the Income Tax Act provides for tainting elements which will be indicators of impermissible tax avoidance arrangements, which include:

- **lack of commercial substance:** including where a transaction would result in a significant tax benefit for a party but does not have a significant effect upon either the business risks or net cash flows of that party apart from any effect attributable to the tax benefit that would be obtained;[13]
- **round trip financing:** including any avoidance arrangement in which funds are transferred between or among the parties (round-tripped amounts) and the transfer of the funds would result, directly or indirectly, in a tax benefit and significantly reduce, offset or eliminate any business risk incurred by any party in connection with the avoidance arrangement.[14]; and
- **accommodating or tax indifferent parties:** including any avoidance arrangement in which funds are transferred between or among the parties (round-tripped amounts) and the transfer of the funds would result, directly or indirectly, in a tax benefit and significantly reduce, offset or eliminate any business risk incurred by any party in connection with the avoidance arrangement.[15]

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[6]Such as the Income Tax Act 58 of 1962, the Value Added Tax Act 89 of 1991 and the Tax Administration Act 28 of 2011
[7]Section 234 and 235 of the Tax Administration Act 28 of 2011
[8]M Stiglingh (editor), AD Koekemoer & L Van Heerden et al SILKE: South African Income Tax 2022 (2021) 1135
[9]The tainting elelments are discussed from paragraph 18 below
[10]M Stiglingh (editor), AD Koekemoer & L Van Heerden et al SILKE: South African Income Tax 2022 (2021) 1135
[11]Section 80A of the Income Tax Act 58 of 1962
[12]Section 80G of the Income Tax Act 58 of 1962
[13]Section 80C (1) of the Income Tax Act 58 of 1962
[14]Section 80D (1) of the Income Tax Act 58 of 1962
[15]Section 80D (1) of the Income Tax Act 58 of 1962

"Taxpayers are permitted to structure their affairs in such a way that they avoid or minimise tax payable. Provided that in structuring their affairs, taxpayers do not breach of any tax Act—this would amount to tax evasion, which is illegal"

- An example would be where the ownership of a vehicle belonging to an individual who is both a shareholder and an employee of a trading company is changed to a dormant company in the same group of companies on a loan account equal to the value of the vehicle at the time of the transaction. The vehicle is subsequently leased to the trading company for the exact amount required to service the loan on a monthly basis. The trading company would be able to claim the rental amount as an allowable deduction and the creditor of the loan (the individual) would not be required to pay income tax on the money received from the dormant company as it would be the repayment of a loan. Objectively, it is evident that the sole purpose of the net effect of the entire transaction is to minimise tax liability for the trading company and the creditor of the loan.

In addition to the above, the Commissioner may treat parties who are connected persons in relation to each other as one and the same person or disregard any accommodating or tax-indifferent party or treat any accommodating or tax-indifferent party and any other party as one and the same person.[16]

How can a taxpayer rebut SARS' presumption of an anti-avoidance agreement?

As stated above, a presumption is made that an anti-avoidance agreement has been concluded where the above indicators are present and the obligation is on the taxpayer to rebut the presumption.

The substantive trigger for the exercise of GAAR, as provided by the Tax Court[17], arises where SARS forms an opinion that there is an impermissible avoidance arrangement.

Tax consequences of impermissible tax avoidance arrangements

In essence, the Commissioner has the power to restructure or ignore transactions that amount to impermissible tax avoidance agreements.

Conclusion

Taxpayers are permitted to structure their affairs in such a way that they avoid or minimise tax payable. Provided that in structuring their affairs, taxpayers do not breach of any tax Act—this would amount to tax evasion, which is illegal.

The legislature does, however, place restrictions on taxpayers' rights to structure their affairs in the most tax-efficient manner. Taxpayers are not allowed to enter into transactions for the sole or main purpose of obtaining a tax benefit.

Where SARS is of the opinion that a taxpayer has concluded an impermissible tax avoidance arrangement, the onus is on the taxpayer to rebut the presumption on a balance of probabilities.

Should the taxpayer fail to rebut SARS' presumption, SARS may, inter alia, disregard, combine or recharacterise any steps in or parts of the impermissible avoidance arrangement.

Make sure to always check with your tax professional to avoid unknowingly breaching the GAAR!

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[16] Section 80F of the Income Tax Act 58 of 1962

[17] Mr X v The Commissioner for the South African Revenue Service (Case No IT24502) and Mr Y v The Commissioner for the South African Revenue Service (Case No IT24503) (as yet unreported).

THE LAUNCH OF THE JSE VENTURES CARBON MARKET IN SOUTH AFRICA

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The JSE Ventures Carbon Market, powered by Xpansiv was launched on 9 November 2023 by the Johannesburg Stock Exchange (JSE) in collaboration with Xpansiv. This trading platform allows local participants to buy or sell carbon credits and renewable energy certificates (RECs) held in local or global registries; it adds another tool to mitigate climate change.

What is a carbon credit?

A carbon credit is a tradable certificate representing a one-metric tonne reduction in carbon dioxide emissions. Carbon credits are generated through projects that avoid emissions, such as renewable energy initiatives or projects that reduce emissions which are referred to as 'nature-based solutions' such as reforestation. Carbon credits can be sold to entities wishing to offset their emissions, but who are unable to do so through reducing the carbon emitted from their operations.

What is a voluntary carbon market?

Voluntary carbon markets (VCMs), in contrast to mandatory compliance markets (MCMs), enable individuals and organisations to voluntarily purchase credits to reduce their carbon emissions. A transparent and regulated VCM allows a proactive approach to climate change, supports emission reduction projects and is driven by demand from corporates seeking environmental sustainability.

Unlike VCMs, MCMs are regulated systems with finite allowances for emissions. Participants can trade surplus credits to meet targets and gain financial incentives.

RECs versus carbon credits

RECs differ from carbon credits in the following ways:

- The units in which they are measured (megawatt hours versus CO2 equivalent emissions);
- The sources from which they originate (renewable energy sources versus projects that reduce or avoid emissions);
- Their purpose (conveying usage of renewable energy versus representing emissions reductions);
- Their uses; and
- The environmental claims that they support.

South African carbon taxpayers may reduce their direct carbon tax liabilities by acquiring eligible carbon credits and offsetting those carbon credits against their taxable greenhouse emissions. The carbon tax rate will increase from R190 per ton of CO2 equivalent emissions in the 2024 tax period to R462 in the 2030 tax period. The higher rates of carbon tax will no doubt increase the demand for carbon credits which carbon taxpayers will offset against a maximum of 10% of their taxable emissions. In contrast, RECs can lower an organisation's scope 2 emissions relating to purchased electricity.

Concerns surrounding Voluntary Carbon Markets

Increasingly, companies are under pressure to make climate commitments or to back up the claims or commitments which they have made. The VCM offers an opportunity for corporates to achieve their decarbonisation strategies through trading in carbon credits where they cannot achieve reduction through a change in operations.

Given that the market is voluntary, participants need to be able to trust that they are entering into credible carbon transactions if the market is to succeed in driving decarbonisation in the real world. If the credits purchased through the market do not, in fact, reference a reduction of carbon, or such reduction cannot be reliably verified, or there is a risk of double-counting or lack of additionality, then the market, in fact, hinders decarbonisation efforts, providing a way for corporates to avoid having to decarbonise their operations while still being able to make claims on decarbonisation. Globally, VCMs have faced this criticism.

Besides the need for credible market infrastructure, clarity is also required on the claims that corporates can make once they have acquired carbon credits. This is important to avoid the risk of greenwashing, where corporates rely on the VCM as part of their decarbonisation strategy.

On 28 June 2023, the Voluntary Carbon Market Integrity Initiative (VCMI) published its Claims Code of Practice. The Code is supported by international organisations, governments, companies, NGOs and civil society and provides a rulebook for corporates to follow, ensuring that they make credible climate claims. The Code, for example, requires corporates to meet key threshold requirements before making a valid VCMI Claim. The adoption of this Code by corporates engaged in the VCM will help build market confidence in the use of credits acquired on VCMs.

A supply of credits is, of course, critical for the functioning of the VCM, but to date the African experience has been more demand than supply. While Africa is well positioned for carbon projects, developers face regulatory and cost uncertainty. For example, it is important that the holder of the rights to a land-based carbon credit project has proper security of tenure and secure rights to the land on which the project will take place. The holder must either be the registered owner of the land or the holder of a registered long term lease or other registered real right over the land. The rights must have preference over any mortgage bond or onerous title conditions or registered real rights in favour of any third-party that is registered over the land. Ministerial consent is required before it is possible to register any real rights over land for any project to be undertaken over a portion of farmland that is not registered as a portion in the deeds registry. The land must also be properly zoned for its intended use and, of course, appropriate regulatory approvals, including environmental approvals, need to be obtained.

Engagement with local communities is required as part of the verification process and may become a critical consideration, depending on where the project is undertaken. Often, in an African context, land on which projects are to be developed is owned by communities or tribal authorities, bringing complexity to contracting, which should not be overlooked and which require substantive engagement. It is important that all relevant land rights holders, communities and other key stakeholders are identified to ensure that their rights, practices and customs are respected and that open and transparent communication is maintained to address any concerns that may be raised.

"Besides the need for credible market infrastructure, clarity is also required on the claims that corporates can make once they have acquired carbon credits. This is important to avoid the risk of greenwashing, where corporates rely on the VCM as part of their decarbonisation strategy"

In addition to these project-related considerations, developers will need to ensure that they raise sufficient finance to fund the project development, its verification and possibly on-going costs relating to management of the credit scheme. These costs can be a barrier to entry for smaller projects.

The launch of the JSE's trading platform follows the announcement by CYNK, a Kenya-based carbon offsets trading platform, that it had handled a carbon futures trade of more than 2 million credits.

The VCM in Kenya has been active for many years. Key beneficiaries of the VCM include farmers, ranchers and government entities. At a VCM auction organised by Kenya in June 2023 in which various African countries participated, 15 Saudi companies purchased 2.2 million credits. The VCM is, however, facing challenges, particularly around greenwashing. Kenya as a signatory to the Paris Agreement, has committed to a Nationally Determined Contribution, which is in the process of establishing an MCM that will address some of the challenges facing its VCM. Once an MCM is established in Kenya with a national carbon registry, the VCM may not continue to be as robust.

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