

South Africa | How is National Treasury going to fund the COVID-19 stimulus package?

With the emergency budget tomorrow (24 June 2020), the question on everyone's minds is, how will our Minister of Finance fund the cost of the government's COVID-19 stimulus package? There is little room to move as we are seeing a decrease in tax revenue collections which is anticipated to be further exacerbated by the pandemic – a drop of between 27% - 32.5% in tax collections has been forecast as a result of the pandemic¹. National Treasury (**NT**) and the South African Revenue Service (**SARS**) may have to consider new avenues in order to fund this package as well as support the economy going forward.

Currently there is a debate amongst academics and tax professionals regarding whether a wealth tax can provide some of the much needed tax revenue, but it is evident that the views are leaning against the introduction of a wealth tax, due to the limited additional revenues in light of the cost to implement. The Davis Tax Committee (**DTC**) also supported this view in 2018².

So what is another alternative? Although not as much in the limelight as the wealth tax debate, there have been some references to re-looking at how trusts are taxed. In the DTC's 2015 report **3**, the following amendments to the existing trust legislation were recommended to possibly increase SARS's tax revenue collections:

- Trusts should be taxed as separate taxpayers, by repealing the deeming provisions of section 7 and 25B, only insofar as they apply to South African trust arrangements.
- The deeming provisions of section 7 and 25B should be retained, insofar as they apply to non-resident trust arrangements, as this will retain the ability for tax to be collected in South Africa.
- The flat rate of tax for trusts should be maintained at its existing level, of 45%.
- The only relief to the rule should be for "special trusts".

Applying the above and effectively taxing a trust as a separate entity, instead of taxing the beneficiary or donor of the trust, may provide a two-fold benefit for SARS and NT:

- The trust will be taxed on the income at 45%, instead of the beneficiaries/donor which generally could be taxed at a lower effective tax rate.
- The trust may be taxed earlier, at least in the form of provisional tax collections.

Despite the above recommendation, in light of strategic tax planning implemented using trusts, the DTC does acknowledge that taxpayers should be allowed to make use of trusts where there is a sound commercial benefit to have a trust. Generally, the commercial reasons considered for setting up a trust are:

- Wealth preservation or asset protection – since the assets in the trust are not owned by beneficiaries or trustees, the creditors of said beneficiaries and trustees have no claim over the assets.
- Separation for benefit and control – the trust manages assets and controls distributions on behalf of beneficiaries who cannot manage assets themselves.
- Continuity and flexibility - a trust can cater for multiple generations, and ensure compound growth across the generations.

As the Minister of Finance has said “We are in this together. South Africa is resilient, and we have the ability to get through tough times together.” Only time will tell how the Minister of Finance proposes to fill the COVID-19 stimulus relief gap. These are very uncertain times and an additional form of tax, that is not thought through thoroughly may have severe repercussions for the income streams of all South Africans in the longer term. We will continue to keep you informed as to any tax proposals.

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Footnotes

¹ Briefing by the National Treasury on the Financial Implications of COVID-19 on the both the Economy and Budget, dated 30 April 2020 to the Joint Standing Committee and Select Committee on Finance and Appropriations.

² The Davis Tax Committee, March 2018, Report on Feasibility of a Wealth Tax in South Africa.

³ The Davis Tax Committee, January 2015, First Interim Report on Estate Duty.

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