SHARES AFTER THE BUDGET

HYDE PARK: The budget held two unpleasant surprises for equity investors and those who invest in businesses in South Africa. The real impact of these surprises will likely be felt long after our current crop of politicians have retired, but my feeling is that they are going to be detrimental to our country in the long term.

VALUATIONS OF EQUITIES HAVE REDUCED

The adjustment from Secondary Tax on Companies (STC) to Dividends Tax was supposed to bring us in line with international norms. The net effect of the change to investors was going to be minimal because STC was levied at 10% and the new tax was also going to be at 10%. Due to the way that the taxes are levied, the net effect of this change was going to be 1% worse for investors. The first unpleasant surprise was that the new tax is 50% higher than anticipated. This immedialy has the effect of reducing income for equity investors by 6.5% according to my high school maths. In my perception, this means the value of all companies that pay dividends have immediately and permanently been reduced.

The second unpleasant surprise was the increase in Capital Gains Tax (CGT). For individuals the rate was effectively increased by 33.3% for individuals with similar increases for others legal entities. This means that your potential profits when selling your shares have reduced by 3.33%. This might seem like a small change but the combination of the dividends tax and the CGT are going to punish the valuations of listed shares and private businesses.

INITIAL CONSEQUENCS – OUR EXPERIENCE

In the first few days after the budget was announced, more than 4% of our clients sold investments as a direct result of the budget. These were unplanned sales where investors decided to sell before the financial year end so that they did not have to pay the increased CGT or dividends tax. Our clients are not active traders and I imagine more active investors took greater steps after the budget. All of the investment companies that we work with were inundated by investment sales. I cannot begin to calculate what quantity of money is involved but it must be significant. After my initial discussions with those investors who have sold, it is clear that they are now going to be investing more capital overseas. The general sentiment is that they want to send their capital to more investor friendly destinations as they believe these changes are not the last that we will see from Government.

I predict that we will see a range of new products from local and international product providers that will specifically be aimed at avoiding dividends tax. Internationally, there is a class of unit trusts called “roll up” or “accumulation” funds that specifically capitalise all income from investments. I think they will become more popular with South African investors.

The drive by Government to move assets to retirement funds is also being viewed with deep scepticism by some people. I have received a reasonable number of emails from Moneyweb readers asking me whether we are going to see Apartheid-era regulations forcing retirement funds to invest in prescribed assets. An example of these prescribed assets would be Transnet bonds that are issued to fund infrastructure growth and Government forces retirement funds to allocate a portion of their capital to these instruments. The fear with this type of forced investment is that the returns to investors might not be competitive and other classes of investments will be compromised. I have no idea if prescribed assets will be forced on us in future but I also had no idea that dividends tax would be increased by 50% in the last budget.

WHAT SHOULD YOU DO?

The short answer to this question is that I have no idea. All investors hate sudden changes by Government and after all the recent upheaval caused by the nationalisation debate, I was hoping for some predictability and comfort for investors from Government and these changes did not achieve that objective. I would caution against rash action but I think we need to see if the changes are a start of a trend or the final touches to work that was started years ago.