INSTITUTE FOR ECONOMIC JUSTICE
RESEARCH POLICY ADVOCACY

JOBS SUMMIT POLICY BRIEF SERIES

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STREAM 2, POLICY BRIEF 3

TAX

Policy brief prepared for the Labour Caucus in the Jobs Summit Inclusive Growth working group by the Institute for Economic Justice (IEJ).

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1. NATURE OF THE PROBLEM

Tax management in South Africa suffers from four main interrelated problems. First, recent years have seen significant under collection of tax revenue. In the 2018 National Budget, an approximate R50bn shortfall was identified.

Second, the administrative capacity of the South African Revenue Service (SARS) has been undermined due to the involvement of senior officials in supporting corruption and state capture.

Third, the tax mix is insufficiently progressive. While personal income tax (PIT) is progressive (the poor and low-income households pay none and middle-income households less than high-income households), corporate income tax rates are moderate and wealth is under taxed.

Fourth, South Africa suffers from high levels of illicit financial flows, tax avoidance and evasion, profit shift and base erosion. This undermines revenue collection.

Insufficient taxation has a direct impact on job creation through limiting funds available to the state. This limits the opportunity for state employment, both in formal state-sector jobs and through public works schemes. It also reduces funds available for social and economic expenditure (e.g. the building of hospitals and roads respectively), which would generate jobs in the private sector.

2. PREVIOUS AGREEMENTS BY SOCIAL PARTNERS TO ADDRESS THE ISSUE, AND THE SHORTCOMINGS AND GAINS IN THIS REGARD

These problems have been raised in a range of forums: Parliament, the Davis Tax Commission (DTC), SARS enquiries, the media and by activists and academics. However, tmmhere does not appear to be any one social partner agreement on restructuring the tax system and addressing these challenges. This should be considered as a process to follow the jobs summit.

3. PROPOSALS

1. The National Treasury (NT) must **publicly recognise that taxation is an instrument to achieve economic transformation and resource redistributio**n and that sufficient funds, from appropriate sources, must be raised in order to achieve this.
2. Levels of **PIT, CIT and wealth taxation should be increased** in order to generate sufficient resources. Submissions to Parliament made by the Budget Justice Coalition (drafted by the IEJ) include various estimates of revenue that could be raised from increasing tax rates. These are shown in Table 1, Table 2, Table 3 in the Appendix.

2.1. **Regarding PIT,** two scenarios are offered in Table 1. In Scenario 1, the lower three effective tax rates are left as is and the effective tax rate for those earning between R500,000 and R1mn is raised from 26% to 28% and the effective rate for those earning over R1mn is raised from

37% to 40%. In this Scenario 2, the top three rates are raised from 16.7% to 18%, 26% to 29%, and 37% to 41%. Scenario 1 raises an additional R27.2bn and Scenario 2 an additional R47.4bn. These are then adjusted downwards to take account of an assumed elasticity of taxable income (ETI) of 35% – essentially an adjustment based on the assumption that those taxed more might adjust their income sources or evade tax by this margin. With this adjustment the two scenarios still raise an additional R17.7bn and R30.8bn.

2.2. **Regarding CIT,** Table 2 shows four alternative scenarios with effective rates ranging from 30% to 35%. As shown, even a 2 percentage point increase can raise an additional R16.5bn. The table also shows how much extra revenue could be raised if we assume the taxable income falls by 5% due to the increased CIT rate (i.e. if a degree of offsetting occurs). Even with this potential fall in profits, additional revenue of between R4.1bn and R43.4 can be raised.

2.3. Possible approaches to increase **wealth taxation** shown in include:

- **Institute a permanent net wealth tax** in the international range of 0.5%-2.5%.
- **Raise the CGT inclusion rate** to 100% (so all capital gains are taxed) and the tax rate to comparative rates to PIT.
- **Raise the STT rate and broaden applicability** to include bond markets. Investigate the best modalities of a universal financial transactions tax (FTT).
- **Institute a land property tax**, particularly on vacant land, and a property rate or transfer duty surcharge for second and foreign owned homes.
- Significantly **raise the estate duty tax** and close loopholes.

2.4. Raise taxation on luxury consumption via:

- **Setting excise duties** in a manner that achieves social objectives but does not unduly tax the poor.
- **Increase ad valorem excise duties** on luxury goods further than already proposed and expand the list of goods covered by these taxes.
- **Institute a higher VAT on luxury goods** making the expanded zero-rating tax neutral.

3. Additional essential basic food and non-food items should be VAT exempt.

A new report by the Institute for Economic Justice (IEJ), entitled Mitigating the impact of the VAT increase: can zero-rating help? highlights that zero-rating the following products would disproportionately benefit poor and low-income households as well as advance the rights to health care, education, dignity and gender equality. 23 categories of goods and services are identified and listed in the Appendix.

4. Reduce VAT back to 14% within the next three years.

5. Reduce tax breaks that predominately benefit higher-income households (such as on pensions and medical aid). These are shown in Table 5 and could raise close to R60bn in 2018/19.

6. Reduce the rate of increase for the fuel levy.

7. Regarding tax administration:

7.1. **Suspend all SARS officials implicated in corruption** and pursue criminal charges against them.

7.2. **Appointing a Presidential Commission** to oversee the revitalisation of SARS.

8. Regarding tax avoidance and evasion:

8.1. **Reintroduce a special priority crime unit within SARS** staffed by credible and skilled investigators.

8.2. **Expand capacity within SARS** to enforce the general anti-avoidance rule (GAAR), controlled foreign company (CFC) legislation and other levers available to reduce tax evasion and avoidance.

8.3. **Introduce a special SARS unit to tackle transferring pricing.**

8.4. **Increase continental and international efforts to curb offshore tax avoidance and evasion.** Efforts at the African Union and United Nations levels should be accelerated.

8.5. **Immediately institute a special investigation into illicit cigarette smuggling cartels.**

8.6. **Increase transparency measures** regarding the holding of individual wealth and corporate structures, e.g. a more sophisticated public registry of trusts and companies including those offshore.

8.7. **Require SARS and NT to publish a report stating how they will implement the recommendations of the DTC** in their Report on Base Erosion and Profit Shifting (BEPS) or why they plan not to implement certain recommendations.

9. A social partner driven social compacting process should be instituted in order to make important decisions regarding the above. This could take the form of a process to evaluate which recommendations from the DTC should be implemented. Tax policy should not be a "no go area" for those outside of NT.

10. Certain tax income could be ring-fenced for job creating policies, e.g. a work-seekers' grant or public employment guarantee scheme, as proposed in Policy Brief 4.2.

4. FINANCING

An investigation must take place into whether any of the above measures to revitalise SARS and tackle tax evasion and avoidance require additional resources for the Service.

5. IMPACT ON JOBS

As stated above, insufficient taxation has a direct impact on job creation through limiting funds available to the state. This limits the opportunity for state employment, both in formal state-sector jobs and through public works schemes. It also reduces funds available for social and economic expenditure (e.g. the building of hospitals and roads respectively), which would generate jobs in the private sector.

Increasing tax revenue can thus be used to support a fiscal stimulus, jobs guarantee programme, capitalisation of industrial financing funds and expanding social services. All of these have job-enhancing outcomes as argued in other briefs.

Reducing inequality has been shown to be growth enhancing and tax policy, e.g. through high taxation on wealth and high-income households, can play a redistributive role. Increasing economic growth can be job creating given supporting policies.

A well functioning tax service, as well as a sense that the rich are paying their fair share, is important for social solidarity and stability, this can improve investment outcomes.

Certain tax income could be ring-fenced for job creating policies, e.g. a work-seekers' grant or public employment guarantee scheme, as proposed in Policy Brief 4.2.

6. THE ROLE OF STATE INSTITUTIONS AND SOCIAL PARTNERS

SARS and National Treasury will play the leading role in implementing tax policy. However, a social partner driven social compacting process should be instituted in order to make important decisions in this regard. This could take the form of a process to evaluate which recommendations from the DTC should be implemented.

7. SEQUENCING AND TIMEFRAMES

- The recommendations regarding changes to the tax mix should be phased in over a three-year period beginning with the 2019/20 National Budget with a clear intention to do so stated in the October 2018 MTBPS.
- The measures to improve governance within SARS and begin to tackle tax evasion and avoidance should be implemented within the next eighteen months.

APPENDICES: TAX POLICY BRIEF

TABLE 1 POTENTIAL EXTRA PIT REVENUE RAISING

(R bn)	Proposed 2018/2019			Scenario 1		Scenario 2	
	Taxable income	Effective tax rate	Tax accessed	Effective tax rate	Tax accessed	Effective tax rate	Tax accessed
0 – 150 000	432.2	2.4%	10.2	2.4%	10.2	2.4%	10.2
150 001 – 250 000	351.8	9.4%	33.2	9.4%	33.2	9.4%	33.2
250 001 – 500 000	736.7	16.7%	123.2	16.7%	123.2	18.0%	132.6
500 001 – 1 000 000	549.0	26.0%	142.5	28.0%	153.7	29.0%	159.2
1 000 000 +	531.7	37.0%	196.7	40.0%	212.7	41.0%	218.0
Total:	2601.5		505.8		533.1		553.3
Additional revenue					27.2		47.4
Additional revenue adjusted for ETI of 35%:					17.7		30.8

Source: National Treasury, Budget Review 2018

TABLE 2 CIT 2018/2019 BUDGET PROPOSAL VS ALTERNATE SCENARIOS

	Taxable income	Effective tax rate	CIT raised	Difference between budget proposal and scenario	CIT raised with 5% profit loss	Difference between budget proposal and scenario with 5% profit loss
Budget proposal	825.8	28%	231.2			
Scenario 1	825.8	30%	247.7	16.5	235.3476043	4.1
Scenario 2	825.8	32%	264.2	33.0	251.0374446	19.8
Scenario 3	825.8	35%	289.0	57.8	274.5722051	43.4

Source: National Treasury, Budget Review 2018

TABLE 3 POSSIBLE TAX REVENUE FROM WEALTH TAXES

Rbn	2017/2018		Scenario 1		Difference
	Rate	Tax revenue	Rate	Tax revenue	
Capital gains tax	Ind 16% / Comp 22%	17.06	Ind 18% / Comp 24% + full inclusion	22.35	5.29
Estate duty	20%	2.41	30%	3.61	1.2
STT	2.50%	5.45	3%	6.54	1.09
Property tax (residential > R1mn)*			0.50%	11.94	11.94
Property tax (commer–cial > R5mn)*			0.50%	3.98	3.98
Property tax (unused urban land)*			0.10%	0.64	0.64
Property tax (farm)**			0.10%	1.57	1.57
Net wealth tax***			2%	130.212	130.21
Net wealth tax***			1%	65.106	65.11
Net wealth tax***			0.50%	32.553	32.55

*Property Sector Charter Council (2014/5): Res: R3900bn Com: R1300bn / unused: R580bn

**Agri Land Group (2015): R5.58bn

***Momentum/Unisa study HH wealth (2017Q3): R7.2bn

TABLE 4 POTENTIAL ITEMS FOR VAT ZERO–RATING

Cake and bread flour	Infants and children's clothing and footwear (include school uniforms)
Sorghum meal/powder and mabella	Candles and matches
Poultry (incl heads and feet)	Coal and other household fuel
Mopane worms	Hotplates
Other canned fish	Soap
Whiteners (Cremora; Ellis Brown)	Medicine and medical services in public institutions
Amageu	Calls (including airtime for cellular phones)
Baby food	Textbooks and stationery
Powder soup	Disposable nappies
Instant yeast	Sanitary towels and tampons
Soya product (excluding soy milk)	Agricultural own production
Tea	

Source: IEJ (2018), Mitigating the impact of the VAT increase: can zero-rating help?

TABLE 5 TAX EXPENDITURE ESTIMATES PIT AND VAT

R million	2012/13	2013/14	2014/15	2015/16
Personal income tax				
Pension and retirement annuity contributions	26 314	28 467	30 485	**31 772**
Medical	20 272	21 883	19 750	20 442
Interest exemptions	2 067	2 191	2 418	2 592
Secondary rebate (65 years and older)	1 533	1 711	2 087	2 186
Tertiary rebate (75 years and older)	119	132	177	185
Donations	620	826	963	633
Capital gains tax (annual exclusion)	309	393	458	446
Total personal income tax	**51 233**	**55 603**	**56 338**	**58 256**
19 basic food items	**18 628**	**20 107**	**21 503**	**22 793**

Source: National Treasury, Budget Review 2018