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Davis Tax Committee
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Chair, Members,

COMMENTARY ON THE FIRST INTERIM REPORT ON MACRO ANALYSIS

1. On behalf of the SA Institute of Chartered Accountants (SAICA), we express our appreciation for the opportunity to present submissions on the first interim report on macro analysis (the Report) of the Davis Tax Committee (DTC).

EXECUTIVE SUMMARY

2. The primary submissions of our Tax Policy Committee (a sub-committee of SAICA’s National Tax Committee) are summarised as follows:

(a) We commend the DTC on its reconfirmation of the importance of solid empirical evidence in establishing the context for policy design. In this respect, we submit that the DTC should delay finalising its position on specific aspects of the SA tax system until it has finalised its conclusions on the over-arching framework for our tax system.

(b) We consider that a significant omission from this “first interim” version of the Report is a list of recommendations and proposals. (However, we concede that it may be appropriate to formulate and refine the DTC’s conclusions after public submissions are received.) Thus, perhaps our most important submission is that the next issue of the Report should include clear and specific recommendations and proposals.

(c) We use this opportunity to present our own preliminary recommendations in relation to SA’s tax policy. In summary, we consider that:
(i) Our country’s tax burden must be seen as “high” in the circumstances, and should be reduced from the current level (>25% of GDP). At the very least, we express our opposition to increasing the nation’s tax burden.

(ii) As regards tax mix, we recommend that the State should consider increasing VAT revenue and reducing its reliance on CIT.

(d) Whilst we acknowledge that expenditure policy is outside the scope of the DTC’s mandate, we submit that the DTC should be making a far more emphatic recommendation that Government urgently review the expenditure side. We are concerned that tax policy and revenue collection are being given disproportionate relative importance in the achievement of the country’s economic objectives and, furthermore, that the State is disregarding the impact of expenditure on our tax system.

3. We set out our detailed submissions in the attached annexure.

Once again, we thank the DTC for the opportunity to comment on its work and, in so doing, play a positive role in the development of our country. We would welcome the opportunity to meet with the DTC to discuss further and clarify our submissions.

Yours sincerely

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Chair: SAICA National Tax Committee

Pieter Faber
Project Director: Tax
ANNEXURE

DETAILED SUBMISSIONS

Scope of the Report

1. We concur with the Report’s recognition that any review of the tax system must be substantially more evidenced-based, especially given that we have more than two decades of experience in designing and administering tax policy since democracy.

2. Naturally, therefore, we note with concern that the DTC has already delivered several recommendations and papers on SA’s tax policy and system. We submit that many of those recommendations may be labelled “premature” given that they precede the process of analysing empirical evidence and making recommendations on the fundamentals of SA’s tax policy. Even the Report itself is at risk of having its relevance questioned given that several DTC recommendations have preceded the Report.

3. Whilst we acknowledge the time and resource constraints that have resulted the current situation, these constraints must not be taken as justification for placing the proverbial horse before the cart.

4. Submission: We therefore submit that priority should be given to the process of analysing evidence and focussing on overall policy design fundamentals before finalising recommendations as to the more specific aspects of the SA tax system.

Tax policy framework

The role of the state

5. At the outset, we express our support for the Report’s position (p8) that “participation in, and transparency of, the tax policy development process is important”.

6. We agree that tax policy and a tax system is politically and ideologically driven, but would hasten to add that it remains subject to the constraints of fiscal and economic realities. Hence, the need to base it on empirical evidence.

7. Whilst we appreciate that issue of Government expenditure is outside the DTC’s mandate, we consider that the DTC should be more emphatic on the impact of State expenditure on the tax system. Our concerns around the relationship between tax policy, on the one hand, and wasteful and inefficient expenditure, on the other, are twofold:

(a) First, there is the concern that even though a State’s failure to achieve economic objectives may be attributable to expenditure-side shortcomings, there is an almost inevitable (and inappropriate) reaction to fix the problem by increasing tax revenue. The State’s positioning of itself as (say) a “welfare state” or a “democratic
development state” will (as is alluded to in the Report) directly influence the role of the tax system — but if the State is not realistic about the efficiency and effectiveness of its own expenditure, the State’s expectation of the role of the tax system will be misplaced.

(b) Secondly, the oft-repeated impact on tax morality, e.g. the perception that abusive tax avoidance and even evasion is more justified if the State does not fulfil its obligation to appropriately use tax revenue to benefit all citizens. (We will refer to this point again later under the discussion of “Guiding principles.”)

8. We therefore note, with approval, the Report’s commentary on issues such as the social contract with citizenry, the perception of poor quality of expenditure outcomes (e.g. p12), and so forth.

9. Submission: We submit that the DTC should include a more express recommendation that our government should review and improve the effectiveness and efficiency of State expenditure.

Guiding principles to assessment of current tax system

10. We concur that principles of efficiency, equity, simplicity, transparency and certainty and tax buoyancy are appropriate principles with which to start the design of a tax policy and against which to measure it.

11. We hasten to add, however, that principles such as transparency and certainty should not only apply in respect of the specific rules and sub-systems within the overall tax system, but to the tax policy itself. We highlight, as a case in point, the Report’s statements (p19) on the lack of clarity on the State’s policy on tax burden (i.e. tax to GDP ratio).

12. Furthermore, on the principles of equity and simplicity, we return to our previous comment on tax morality with the following reminder. Any tax that is perceived as harsh or unfair or simply incongruent with the social compact would inevitably be too expensive — by creating the temptation (and perceived justification) for evasion and/or avoidance, thereby establishing a vicious cycle of (from the Revenue authority, on the one hand) harsher penalties, complex anti-avoidance rules and burdensome administration, and (from taxpayers, on the other hand) increasingly sophisticated avoidance and evasion techniques.

13. As a general overarching note we would also stress the importance of observing as far as possible all the above-mentioned principles of a good tax system. We cannot deny the reality of the need for trade-offs, compromises and sacrifices and, indeed, we acknowledge the appropriateness of this “pragmatism”.

14. However, we remain concerned that the mere acknowledgement of this pragmatism has come to be seen as a licence to adopt a default point-of-departure that places buoyancy
and revenue collection as primary principles in preference to all of the other principles. The current state of the world economy appears to have exacerbated this problem.

Current tax system performance

Tax burden – Tax to GDP ratio

15. As an initial point, we disagree with the suggestion that net tax is a more appropriate basis for measuring SA’s tax burden. Greater importance should be given to the amount of tax actually extracted from taxpayers to start with, as opposed to how much is retained to be used by the State. As we see it, SACU payments should be viewed as expenditure (and assessed accordingly), rather than as exclusions from revenue.

16. Furthermore, the Tax to GDP ratio should be measured and discussed in conjunction with the country’s “taxable capacity”, as noted in the Report (p19). (This also re-emphasises the relevance of disregarding the SACU payments.)

17. Critically, however, we consider that the Report comes across as too accepting of the current status quo, i.e. seemingly unprepared to challenge the ratio of 25% as essentially the de facto standard for SA. With respect, we submit that the DTC should not be seeking “specific guidance from the Minister on this issue” (p19), but rather that the DTC should be making recommendations to the Minister. We see it as unfortunate and unsatisfactory that the “policy stance of the current government on this issue has not been clearly articulated”, but the DTC (with respect) should be informing the debate rather than waiting to be told.

18. Naturally, this re-raises the question of empirical evidence and we repeat our previous support of the Report in its recognition of the importance of the requisite research and analysis. In this respect, we note that the data used in the Report will require further refinement (e.g. in relation to SACU payments and some of the other points mentioned further below).

19. Submission: It is our submission that a tax burden in the region of 25% (approximately) is not low —and is arguably even too high. Our recommendation is that we should be aiming to reduce our tax burden rather that experimenting with a scope for increases.

20. In this respect, we note the following:

- In comparing SA’s tax burden against world averages, regard should be had for the fact that, at present, SA does not have any social security tax system.

- After adjusting for social security taxes, SA’s current tax burden is higher than world and OECD averages.

- In World Bank and other data, SA is consistently ranked in the top 15 (even as high as 9th or 10th highest) in terms of tax to GDP ratio.
Certainly, in relation to developing nations, SA has one of the highest tax burdens.

Returning to our earlier point on the effectiveness and efficiency of State expenditure, we emphasise the issue of the impact of expenditure on job creation and economic growth. Given that the tax burden is also a measure of the transfer of spending capacity from the private sector to Government, the current state of government expenditure arguably supports the case for reducing the tax burden to increase the private sector’s capacity to grow the economy and create jobs.

21. **Recommendation:** We acknowledge that further empirical research and analysis is required. We agree especially that the DTC should commission economic modelling on tax capacity.

**Tax mix**

22. Discussions of tax mix must, in our view, have due regard for impacts such as progressivity, distortion and susceptibility to volatility.

23. We concur with the insights of the Mirrlees Review (p21 of the Report), that one should focus primarily on whether the tax system as a whole is progressive, not necessarily each individual tax.

24. In our view, having a society where everyone contributes within the tax mix, though measured by individual ability to contribute, creates a sense of participation in the social pact rather than being just a beneficiary and outsider to it.

25. It also creates a sense of fairness to the tax system that all are participants in it for the common good and welfare of the country. As a related initial comment, it is arguable that the data from the pre-democracy period would have bearing on discussions around tax mix as these taxes were imposed in the context of a distorted, closed and isolated economy.

26. We would add that the “overall” view of the tax system should apply not only to the question of progressivity but also to the other critical measures (such as distortive impact and susceptibility to volatility).

27. That said, in addressing the profile of the tax system as a whole, it remains critical to have regard for the individual tax handles and the interplay between them. For example, CIT’s susceptibility to volatility means that overreliance exposes overall revenue collection in times of significant economic swings. SA is a case in point where its heavy reliance on CIT reaped the “upside” benefits in our initial post-democracy period, but has precipitated the slump in revenue since the downturn in the last part of the previous decade.
28. Submission: Our primary submission on the question of tax mix is, again, the need for further and more comprehensive empirical research and analysis.

29. However, based on the preliminary evidence to date, we submit that SA should aim for a greater reliance on indirect taxes and aim to reduce its reliance on direct tax, especially CIT. In this respect, we note that:

- CIT is shown to be the more volatile tax handle, whereas VAT has proven to be far more stable and buoyant.
- As regards distortive effective, i.e. adversely impacting the private sector’s ability to grow the economy, CIT and PIT are again far greater offenders as compared to VAT.
- Whilst VAT is more regressive than CIT, the question of overall progressivity can be addressed either within the VAT system itself or within the fiscal system as a whole (or some combination). However, given that progressivity in SA is most directly and beneficially impacted by expenditure (e.g. social grants) rather than by the tax system and specific tax handle itself, we concede that a significant improvement in the success of the State’s expenditure-outcomes would be required.

30. Submission: With regard to the number of taxes in the mix, we are of the view that (especially in relation to payroll taxes) a consolidation needs to occur and that some of the specific taxes should could be subject to national appropriations. For example PAYE, UIF, SDL and COIDA are four separate taxes of which three are administered by SARS. However, the basis on which each is levied, and benefits conferred, differs, which creates administrative inefficiency and often results in budgetary mismatches.

Effective and marginal rates

31. As to the comparison of marginal rates within the global economy, it is our view that the actual benefits received from the amounts expended by government to the benefit of all the various levels of society should be duly considered. For example using the UK, the PIT 45% rate as comparison does not really make for a comparison of equity as the access to health care and tertiary education from this money is accessible and available to all, whereas this is not the case in SA.

32. However, within the CIT environment it is undeniable that marginal rates are a measure of competitiveness. Whilst a lower tax rate is not necessarily (by itself) an incentive for foreign direct investment in a global economy, higher tax rates are certainly a disincentive. In this sense the global average corporate tax rate has continued to fall over the last decade. Without falling into the race-to-the-bottom trap, tax policy should be cognisant of global trends, with the requisite recognition of our own specific context.
33. As already mentioned earlier, VAT is seen as a regressive tax. However, as acknowledged by the DTC, it would be the most efficient manner to increase tax collection. Furthermore, it is also seen as the most effective measure against tax evasion (p36).

34. Submission: Most importantly we acknowledge and agree (again) that further empirical research and analysis is required — including also our country’s “taxable capacity”. Our submissions here must be viewed together with our earlier comments on tax mix.

35. In terms of economic impact and social impact as done by the Treasury modelling (p43), we would argue that the proposed model is flawed in that it allocates the recoveries on the same basis as the pre-existing budget. Against that, our expectation was that the object of increased taxes was to finance social security and NHI. The beneficiaries of the latter would be primarily the poor, thus more likely to have an overall positive effect on the GINI coefficient.

Tax Administration

36. Whereas the DTC refers to an efficient tax administration especially after the introduction of the Tax Administration Act and SARS e-Filing, our experience is not as unreserved. Whilst it certainly is the case that the process for initially rendering a return has become substantially more efficient, all the other processes from registration, producing supporting documents, assessment, verification, audit and dispute resolution have increased considerably.

37. On balance, there is little doubt that the overall compliance burden has increased substantially in recent years. As we see it, the improvement in systems and effective application of technology have paved the way for the State to demand more from taxpayers rather than reduce taxpayers’ time to comply.

38. Furthermore, there has been a substantial increase in reporting. For example, the introduction in 2008 of the new IRP501 employers return resulted in employers having to collect and collate substantially more data than before, including a substantial increase in electronic AA88 agency appointments. We have also seen a substantial increase in third party reporting and other returns such as the IT14SD. The replacement of STC with the Dividends Tax has also seen a significant increase in reporting.

39. The introduction of global reporting, such as FACTA, and the future common reporting standard will place another substantial burden on many taxpayers.

40. Recommendation: In this regard, it is again imperative that the DTC conduct further research. Whilst the PwC report relied upon represents a useful comparative starting point, it may not be sufficiently comprehensive. That report itself clarifies that, for example, on the question of “Time to comply”, its methodology would consider only the time taken to “prepare, file and pay”.
41. We would also draw your attention to the proposed migration to self-assessment in the draft 2015 Tax Administration Laws Amendment Bill which, in our view, will compound taxpayers’ administrative burden.

| 42. **Recommendation:** | In our view, tax administration should be measured against the same principles of tax system design, as failure to do so will result in the administration of the tax system being an impediment in government achieving its goals. |

**Tax expenditure**

43. Tax expenditure is in our view a secondary consideration in the tax system and policy and in our view should only be considered once a policy on the primary purpose of securing adequate and equitable financing has been ascertained.

44. We would note, however, and we would as a general matter warn against the over-emphasis of tax incentives in general. To be clear, we are not necessarily suggesting the elimination of tax expenditure. Rather, we question its importance-ranking within the bigger question of attracting and supporting investment by business. It is our experience, however, that the non-tax factors in the ease of doing business generally (e.g. workforce issues, perceptions on corruption, etc.), are far more important. Whilst an attractive tax regime can certainly represent an additional sweetener within an environment that is already conducive for business, we would be naïve to believe that tax expenditure can compensate for a bad-for-business environment.

| 45. **Submission:** | The relationship between tax expenditure and anti-competitive behaviour —whether at the State level in the form of so-called harmful tax practices, or whether in the creation of unfairly protected industries — must also be considered. |

| 46. **Recommendation:** | Again the DTC may want to do more research on tax expenditure efficiency especially as to tax expenditure that seeks to promote industry and tax incentive that make them dependent. |

**Tax and the informal economy**

47. As an introductory comment, the concept of what constitutes the informal economy should be more clearly defined.

48. Furthermore, it is also our view that this part of the economy should not be defined as equating to small and subsistence businesses, as it includes multi-million Rand businesses and multi-billion Rand industries, including the taxi industry and the food and beverage industries. The Report itself notes that around 2.2 million people work in this economy.
49. **Recommendation**: We question the presumption that the majority of informal sector firms would be below the tax threshold, and we therefore agree with the Report that further research is required. Work needs to be done on how to formalise the informal economy and on the impact (on the tax system and our taxable capacity) of the inclusion of the informal sector.

**Subnational revenue sources**

50. We acknowledge that the constitutional design of the tax system must result in a system that caters for all three tiers of government. However the factors for the design of the tax system as a whole should ensure that its takes cognisance of this tiered approach and its effect on tax capacity and the guiding principles.

51. Local government revenue collection has migrated from rates and taxes to an overreliance on surcharges.

52. However, decades of under spending on maintenance (i.e. loss of water and electricity paid for) and large incidence of theft and non-payment for water and electricity theft have result in a continual spiral of above inflationary increases by local government on surcharges and services to finance the lost revenue. Bad financial management at local government level has, as noted in the Report, resulted in an increased reliance on national appropriations as a percentage of income.

53. **Submission**: In our view, a financing model for local government will remain a challenge until structural and governance matters are addressed. The proposal of a local business tax will only be viable if local government has the ability to properly manage and enforce such tax, since inefficient implementation will only result in further taxpayer dissatisfaction.

**Earmarked taxes**

54. By definition, in the Report, earmarked taxes are taxes of which the proceeds are designated for a particular purpose.

55. However, we submit that in the SA context many so-called earmarked taxes have become taxes merely charged on a particular group but then aggregated into the National Revenue Fund. A good example is the general fuel levy which was originally earmarked for road maintenance and upgrade. However, since it was included into national revenue from 2008, the effectiveness of the tax to achieve its purposes was substantially reduced with government merely allocating it for other purposes, including for general subsidisation of local government.

56. Without the funds recovered being earmarked for spending of a particular purpose, we agree that these taxes are in effect just surcharges.
57. **Submission**: As a general matter, we would advocate the concept of earmarked taxes in only exceptional cases, e.g. specified short-to-medium term projects. In the main, however, in the same way that relatively permanent obligations of the State should be funded from the aggregate revenue pool, relatively permanent sources of tax revenue should flow into that aggregate revenue pool. Apart from cases where we should simply dispel the façade of fake earmarked taxes (i.e. where the taxes collected are in any event simply mixed into aggregate national revenue) we are also concerned that actual earmarked taxes end up constraining government expenditure. That is, where earmarked taxes remain separated and end up generating significant surpluses of deficits, the mechanisms to correct or take advantage of these situations are either complex or non-existent.

58. **Recommendation**: In this regard, we recommend that the DTC should undertake further research as to the effectiveness of and, indeed, the necessity for, ring fenced earmarked taxes.

*International Tax Trends*

59. In our view, SA is ahead of the global curve in relation to concerns such as base erosion, hybrid instruments and to some degree even tax on e-commerce.

60. However, we would warn against hastening blindly to comply with calls for global conformity (in the context of tax avoidance hype and rhetoric) without due recognition of SA’s profile as a hybrid developed-developing economy, its role in Africa and its domestic economic objectives in relation to its citizens. We would do well to recognise that what is often portrayed as a unified economic trend is sometimes nothing more than the manifestation of the economic self-interests of the most influential economies.

61. That said, it is equally critical to recognise to extremist sovereignty and unilateralism will inevitably discourage global business, both for foreign businesses coming to SA or SA-based businesses expanding abroad.

62. Furthermore, as noted earlier, we cannot ignore the issue of the competitiveness of our tax system in relation to the rest of the world.

63. **Submission**: Our submission on this issue is to call for the DTC to formalise its recommendations. In our view, the recommendations that we have made earlier in this paper —especially in relation to tax burden and tax mix— remain equally in point here.