

# Briefing on request for VAT exemption on sanitary towels

*Joint Multi-Party Women's Caucus*

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**national treasury**

Department:  
National Treasury  
REPUBLIC OF SOUTH AFRICA

# Tax Policy welcomes invitation

- National Treasury – Budget Office and Public Finance presented yesterday on gender-responsive budgeting and funding issues
- Today NT's Tax Policy division presenting on gender-responsiveness of tax policy-we welcome invitation from Women's Roundtable
- One of the first tax reforms was to remove the distinctions based on gender and marital status
  - Married person, not a married person or a married woman
  - We did away with above concepts!
- Issue of making sanitary pads available to women critical for development, including for girls in school
- Key issue is how best to make sanitary pads available to all who need it
  - Is it through the tax system or the expenditure side of the budget?

# Key objectives of tax system

- Tax system objectives are to:
  - Fund government
  - Redistribute from the rich to the poor (progressivity)
  - Change behaviour (excise taxes on tobacco, alcohol, carbon, sugar)
- Our primary revenue-generating taxes are Personal Income Tax (PIT), Corporate Income Tax and VAT (raise over 80% of all tax revenue)
  - Other smaller taxes are customs, excise, fuel levy
- Each tax does not try and achieve all the above objectives
  - Some taxes (PIT) deals best with progressivity (redistribution),
  - Actual redistribution via spending from the TOTAL revenue pool
- Tax is a BLUNT tool for specific narrowly-targeted objectives – hence better dealt with via expenditure side of the Budget
  - Rich may also benefit more than poor when lowering a tax, undermining redistribution and revenue objectives

# Targeted expenditure programmes more effective

- Tax system is progressive in toto, but not all taxes are progressive
  - Lowering some taxes benefit may benefit the rich more than the poor
- More targeted expenditure programmes aimed at poorer communities are generally more effective than concessions through the VAT system in achieving socio-economic objectives.
- A good example is how government funds availability of condoms via making them available through spending side of the Budget, rather than tax side
- Treasury ready to support Departments of Health and / or Education in exploring the possibility of providing relief by making additional funding available for the purchase and distribution of feminine hygiene and sanitary products free of charge at schools and clinics.

# Overview of VAT in South Africa

- When VAT was introduced in 1991, the VAT Committee (VATCOM) recommended that a broad-based VAT with limited exclusions be implemented
- VAT, provided its base is kept as broad as possible, is an efficient means of raising tax revenue with very little distortion to an economy.
- When the VAT Act, No 89 of 1991, was promulgated on 12 June 1991 no provisions were made to exclude (zero-rate) any goods or services.
- On 17 July 1991 the zero-rating of brown bread and maize meal were included.
- On 29 September 1991 eight (8) additional basic food items were added to the zero-rated list.

# Zero-rating vs Exemption

- Lowering VAT can be done via lower rate, zero-rating or exemption
- Dual rates are administratively complicated, and introduce scope for abuse
- Zero Rating
  - Supplies that are subject to output VAT at 0% instead of the standard rate of 14%
  - If you make a zero rated supply, you can claim a VAT input tax deduction for VAT payable on goods and services purchased
- Exemption
  - No output VAT payable
  - However, If you make an exempt supply, you cannot claim a VAT input tax deduction for VAT payable on goods and services purchased

# VAT in South Africa

- The zero rating of an additional nine (9) basic food items was introduced with effect from 7 April 1993.
- The VAT rate was increased from 10 per cent to 14 per cent on the same day.
- The main policy objective of goods being zero-rated was to address the perceived regressivity of the VAT system
- Many analysts have demonstrated that in absolute monetary terms the middle and higher income earners benefit more from the zero-rating than the poor.
- However, public opinion is very strongly in favour of maintaining the zero rating of basic foodstuffs.

# VAT in South Africa

- An effective VAT system, not unduly compromised by well-intended but doubtful concessions, is essential in generating the necessary tax revenues to fund Government's expenditure programmes, including initiatives to help the poor.
- In 2013/14, the costs of the 19 foodstuffs was estimated at R20.1 billion in forgone VAT revenue
- The South African VAT system is a good example of a “modern” VAT that has relatively few exemptions, zero-ratings and exclusions.
- VAT is the second most important source of revenue for the fiscus, after PIT, and that it appears to be one of the better performing VAT systems

# Zero-rated and exempt supplies

The following goods and services are **zero-rated**:

- Exports
- 19 basic food items
- Illuminating paraffin
- Goods which are subject to the fuel levy (petrol and diesel)
- International transport services
- Farming inputs
- Sales of going concerns, and
- Certain grants by government.

Goods and services **exempted** from VAT are:

- Non-fee related financial services
- Educational services provided by an approved educational institution
- Residential rental accommodation, and
- Public road and rail transport.

# Basic foodstuffs zero-rated in South Africa

- Brown bread.
- Maize meal.
- Samp.
- Mealie rice.
- Dried mealies.
- Dried beans.
- Lentils.
- Pilchards/sardinella in tins.
- Milk powder.
- Dairy powder blend.
- Rice.
- Vegetables.
- Fruit.
- Vegetable oil.
- Milk.
- Cultured milk.
- Brown wheaten meal.
- Eggs.
- Edible legumes and pulses of leguminous plants.

# Request for VAT concessions

Over the years, especially immediately following the zero-rating of illuminating paraffin in 2001, the Minister of Finance has received several requests from the public, certain interest groups and by way of questions in Parliament to abolish VAT on the following goods and services:

- 450 gram household candles. The South African Candle Manufacturers argued that the zero-rating of illuminating paraffin has impacted negatively on the sales of household candles.
- medicines; medical services;
- books;
- electricity; water;
- red meat;
- mageu (a maize based soft drink, largely consumed by the poor);
- security related expenses by private individuals;
- canned vegetables;
- toll fees; and
- **Now sanitary towels.**
- What Next ??

# VAT in South Africa: What Kind of Rate Structure? Cnossen, VAT Monitor, 2004 (Katz Commission, 1994)

- “providing relief to the poor through exemptions and VAT zero-rating is likely to be both unsound tax policy and ineffective social policy”
- “the disadvantages of multiple VAT rates outweigh the possible redistributive gains available from this option”
- “VAT impact studies in other countries also confirm specific conclusions of the Katz Commission. In Ireland, for example, it was found that the poor spend relatively more of their income on food than the rich, (however) in absolute amounts the rich spend twice as much (on food) as the poor. Consequently, Ireland’s zero-rating of food gives twice as much tax relief to high-income groups than to low-income groups - an odd way of alleviating the plight of the poor”.

# Consumption Taxes: the Way of the Future? OECD, Policy Brief, October 2007

- “... many countries apply a reduced rate of VAT to certain “necessities” in order to reduce the tax burden on the poor. However, this is a relatively ineffective way of dealing with the problem as the rich typically consume more of the “necessities” than the poor”.
- “An argument can also be made in the case of using VAT to reduce employers social security contributions, thus reducing the cost of exporting and importing-competing firms”.
- “Germany increased its VAT rate at the beginning of 2007, partly to finance a cut in social security contributions”.

# Summary from VAT study

- 2007 study of VAT on merit goods conducted by Treasury
- A VAT system with the smallest number of exemptions, zero-ratings and lower rates is desirable. Efficiency and simplicity considerations should dominate and equity and other objectives should be pursued through the expenditure side of fiscal policy.
- In principle, the adoption, or perpetuation, of VAT concessions aimed at addressing regressivity should not occur unless ways can be found to target such benefits only to lower income households.
- The VAT has been seen as a key instrument for securing macroeconomic stability and growth by placing domestic revenue mobilization on a sounder basis.

# Why more VAT concessions are not deemed to be effective

- Providing VAT concessions is both an unsound tax policy and ineffective social policy, as concessions:-
  - Erode the tax base, thereby reducing the ability of the VAT system to be optimal in generating the necessary tax revenues;
  - Create a precedent for interest groups to lobby for preferential treatment of goods and services on the grounds that differentiation may be merited (i.e. so-called merit goods);
  - Accomplish little in the way of redistribution;
  - Increase the scope for abuse, and also results in increased administration and compliances costs; and
  - Zero-rating may not significantly reduce prices and in some instances, producers may not even pass on the lower prices to the consumers.

**THANK YOU**