Tiger Brands

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The Honourable Members of the Standing Committee on Finance and the Portfolio Committee on Health
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Attention: Mr Allen Wicomb
Per e-mail: awicomb@parliament.gov.za

Topic addressed in this submission: **THE TAXATION OF SUGAR SWEETENED BEVERAGES**

Date of submission: **27 January 2017**

Date of Committee meetings/public hearings: **31 January 2017**

Dear Mr Wicomb

TIGER BRANDS LIMITED: SUBMISSION ON THE TAXATION OF SUGAR SWEETENED BEVERAGES: INEQUITY IN RELATION TO CONCENTRATED BEVERAGES AND CONSTITUTIONAL COMPLIANCE

We refer to the request for written submissions made by the Standing Committee on Finance and the Portfolio Committee on Health (the "**Committees**") on or about 15 December 2016 in relation to the Taxation of Sugar Sweetened Beverages (the "**Sugar Tax**") currently proposed by the Policy Paper published by the National Treasury on 8 July 2016 (the "**Policy Paper**").

Please kindly receive our submission and comments on the Sugar Tax, attached hereto as as **Annexure A** (the "**Submission**").

INEQUITY IN RELATION TO CONCENTRATED BEVERAGES:

The Submission focuses specifically on the inequitable application of the Sugar Tax to Concentrated Beverages ("**CBs**"), as compared to ready-to-drink beverages ("**RTDs**"), where the recommended tax of 20%, as extrapolated from RTDs, results in an effective tax rate of 50% for certain CBs. The Submission also focuses on the significantly adverse and disproportionate impacts that the Sugar Tax will have on Tiger Brands Beverages (a division of Tiger Brands Limited), which is a manufacturer of CBs, should the Sugar Tax be implemented in the manner currently contemplated in the Policy Paper.

CONSTITUTIONAL COMPLIANCE:

The Submission furthermore demonstrates the unconstitutionality of the Sugar Tax in light of its irrational and inequitable application to CBs and the disproportionate impacts which the Sugar Tax will have on Tiger Brands Beverages, as a manufacturer of CBs, should the tax be implemented in its current form.

Please note that the content included in the Submission may contain market sensitive information which is shared to highlight the tangible impact that the Sugar Tax will have on Tiger Brands' Beverage Division. We respectfully request that the information is treated as strictly confidential. We appreciate your understanding in this regard.

We request the opportunity to address the Committees in person to provide further context to the content of the Submission and to answer any questions that the Committees may have. We would also be grateful if you could provide us with details regarding the process of the public hearings and, should the opportunity be availed to us, the times at which oral representations may be made.

We thank you for the opportunity to make our written Submission to the Committees and we look forward to our further dialogue in this regard.

Please contact the undersigned (contact details below) should you require any clarity or further information regarding the Submission.

Sincerely,

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Annexure A : Tiger Brands' Submission : Inequity in relation to Concentrated Beverages and Constitutional Compliance

Tiger Brands Limited: Submission on the Taxation of Sugar Sweetened Beverages: Inequity in relation to Concentrated Beverages and Constitutional Compliance (the "Submission")

1. Introduction

1.1. This Submission is made by Tiger Brands Limited ("**Tiger Brands**") in respect of the Taxation of Sugar Sweetened Beverages (the "**Sugar Tax**") proposed by the Policy Paper published by National Treasury on 8 July 2016 ("**Policy Paper**").

1.2. The purpose of this Submission is to highlight what appears to be an unintended (but serious) oversight as regards the application of the Sugar Tax to concentrated beverages ("**CBs**"). The Policy Paper omits to take into consideration the impact of the proposed Sugar Tax on the large local CB industry which, for the reasons more fully set out herein, stands to be disproportionately affected by the Sugar Tax if implemented in its current form.

1.3. The Policy Paper currently proposes taxing two distinctly different sub-categories of Sugar Sweetened Beverages ("**SSBs**"), namely CBs and 'ready to drink' beverages ("**RTDs**"), on the same basis using a single taxation model.

1.4. This Submission will demonstrate that the application of the Sugar Tax to CBs (as compared to RTDs) is inequitable and will have a significantly adverse and disproportionate impact on Tiger Brands Beverages (a division of Tiger Brands), which is a manufacturer of CBs, should the Sugar Tax be implemented in the form contemplated by the Policy Paper.

1.5. This Submission furthermore demonstrates the unconstitutionality of the Sugar Tax, in light of its irrational and inequitable application to CBs and the disproportionate impacts which it will have on Tiger Brands Beverages, as a manufacturer of CBs, should the tax be implemented as contemplated in the Policy Paper.

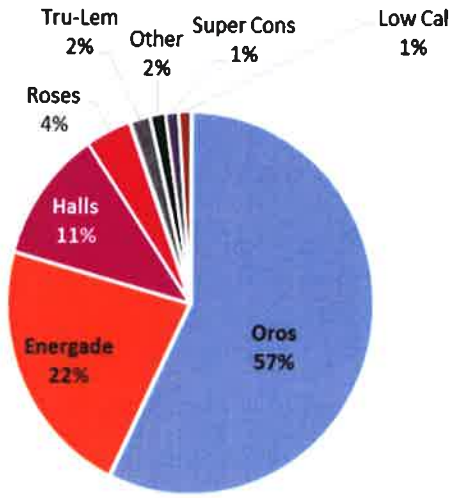
2. Inequity in relation to treatment of Concentrated Beverages

2.1. Background – Category of Concentrated Beverages:

2.1.1. CBs are non-carbonated, dilutable beverages which are typically consumed at home by families. CBs are sold in concentrated (undiluted) form in larger pack sizes than RTDs as they have a different consumption pattern when compared to RTDs. CBs are typically purchased for consumption over a period of time rather than for individual and generally immediate consumption as is the case with RTDs.

2.1.2. Tiger Brands Beverages manufactures both RTDs (such as Energade) and CBs (such as Oros, Halls and Roses). CBs constitute 74% of the volume contribution of Tiger Brands Beverages, with RTDs constituting 26% of the volume contribution of Tiger Brands Beverages.

Figure 1: Tiger Brands Beverages Brand Volume Contribution *(Nielsen, June 2016)*



Tiger Brands Beverages Brand volume contribution

2.2. Inequitable Application of the Sugar Tax to CBs

2.2.1. The stated objective of the Sugar Tax is to target obesity and to control and prevent non-communicable diseases by implementing fiscal measures aimed at reducing excessive sugar consumption from SSBs.

2.2.2. The Policy Paper states that a 10% to a 20% price increase of SSBs may be required for the Sugar Tax to have a significant impact on SSB production and consumption patterns and levels and ultimately on obesity and population health. The Policy Paper states that it therefore proposes applying a tax of R0.0229 per gram of sugar contained in a litre of a SSB, as this equates to an approximate 20% tax incidence for Coca Cola, being the most popular SSB.

2.2.3. The Policy Paper does not propose applying different rates of tax to RTDs and CBs; instead it applies the Sugar Tax to both RTDs and CBs on the same basis (i.e. it proposes applying the same tax and taxation model to both RTDs and to CBs) notwithstanding their fundamental differences in consumption.

2.2.4. The sugar content of CBs on a litre for litre or volume to volume basis cannot be compared to that of RTDs, as RTDs are manufactured and sold in a ready-to-drink form, whilst CBs are manufactured and sold as concentrates and are consumed only after being diluted at a minimum dilution ratio of 1:3.[1]

2.2.5. The Sugar Tax should be applied to CBs on the basis of the sugar content of CBs in their diluted form so as to avoid penalising them relative to RTDs, and not the concentrated form in which they are manufactured and sold to consumers.

2.3. Disproportionate Effects of the Sugar Tax on Concentrated Beverages

2.3.1. The application of the Sugar Tax to CBs, as currently proposed by the Policy Paper, produces results which are inconsistent with the philosophy of the Sugar Tax.

2.3.2. Typically, the consumption of a CB, once diluted, results in a lower intake of sugar than the consumption of an RTD. For example, a 100ml serving of Coca Cola contains 10.8 grams of sugar, whereas a 100ml serving of Oros contains 8.2 grams of sugar. Therefore CBs contribute less to obesity than RTDs.

2.3.3. Should the Sugar Tax be levied on CBs in their concentrated form then the threshold of an approximate 20% tax rate is far exceeded and in fact translates to an effective tax rate as high as 52% on CBs such as Oros, notwithstanding that CBs as consumed in diluted form generally contain less sugar than RTDs.

2.3.4. There is no rational basis for taxing CBs at an effective tax rate which is significantly higher than that applied to RTDs given the stated objective of the Sugar Tax.

2.3.5. In the event that the proposed tax rate of R0.0229 (2.29 cents) per gram of sugar is applied to CBs (in concentrated form), it is estimated to increase on-shelf prices of CBs by up to 52% of the selling price.

2.3.6. By way of example, if the proposed tax rate of R0.0229 (2.29 cents) per gram of sugar is applied to Oros Squash 2L, it equates to an increase of an estimated R15.20. This equates to a 49% tax on the price of Oros 2L (See Figure 2 below) compared to the Treasury's proposal of a 20% tax for SSBs.

2.3.7. The increase in price is likely to result in significant volume reductions as per Figure 2 below.

[1] The minimum dilution ratio specified by the Agricultural Product Standards Act, 1990 (Act 119 of 1990).

Figure 2: Application of proposed Sugar Tax to CBs and impact on volume (Source: Nielsen Pricing Study for Tiger Brands Beverages, July 2016)

Brand	Pack size	Grams of sugar per sales unit	Illustrative retail price incl. VAT	Sugar Tax per unit of sale @ R0.0229 per gram	Revised illustrative retail price incl. VAT	% PI due to sugar tax	Est. volume impact
Oros	2L	664	30.95	15.20	46.15	49%	-79%
	5L	1660	72.80	38.00	110.80	52%	-57%
Halls Nectars	1L	280	32.30	6.41	38.71	20%	-25%
	5L	1400	136.45	32.05	168.50	23%	-62%
Halls Fruit Drink	1.25L	200	19.80	4.58	24.38	23%	-11%
Roses Cordial	750ml	452	33.60	10.34	43.94	31%	-40%
Coca Cola	1L	106	11.45	2.29	13.74	20%	

2.3.8. Tiger Brands has obtained independent analyses on the Price Elasticity of Demand and the subsequent impact on volume declines on its CBs if the tax is applied without considering the dilution of the product. [2]

2.3.9. Based on modelling data and analyses from Nielsen[3], Tiger Brands anticipates that the current model will lead to volume reduction of up to 79% for Oros 2L squash (Figure 2), its largest CB by volume. The overall Tiger Brands volume is expected to decline by 40% with a total net sales decline of 35% due to the high price elasticity of demand (up to -3.28) in respect of these products. The repercussions of this decline are as follows:

2.3.9.1. The viability of Tiger Brands Beverages will be impacted by the significant reduction in volumes, which places 500 direct Tiger Brands jobs at risk. This will have immediate and significant implications on the Tiger Brands Group as a whole.

2.3.9.2. The effect on Tiger Brands Beverages and other manufacturers of CBs will lead to less choice for consumers in South Africa, particularly for lower income consumers.

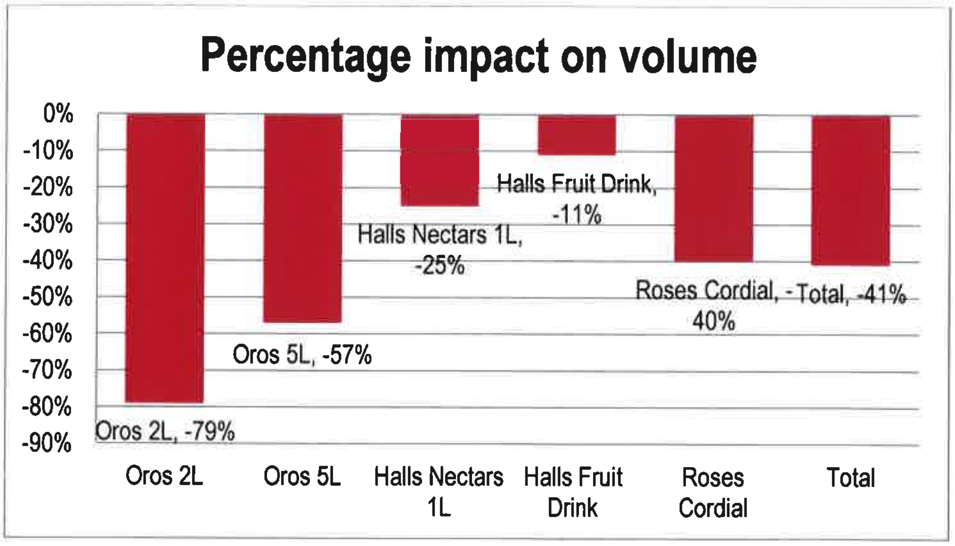
2.3.9.3. Holistically, every supplier providing input to Tiger Brands Beverages (which includes paper, plastic, agricultural commodities, manufacturing equipment, wholesale, utilities, retail, transport and communications etc.), will be directly and adversely affected by the

[2] Nielsen: www.nielsen.com; Nielsen Pricing Study for Tiger Brands Beverages, July 2016.
[3] Nielsen: www.nielsen.com; Nielsen Pricing Study for Tiger Brands Beverages, July 2016.

reduction in volumes. The reduction in procurement on an upstream, downstream and production basis has been projected to be in the region of R 500 million.

2.3.9.4. There will be no return on historic Capital Expenditure investments of R 203.3 million (2012-2016) and therefore the 2017 Capital Expenditure investment programme of approximately R 178 million will be non-viable and abandoned.

Figure 3: Graphic representation of the impact to Volume of Tiger Brands' Beverages with the proposed tax of R0.0229 (2.29 cents) per gram of sugar (*Tiger Brands Sales 2016, Nielsen Pricing Study for Tiger Brands Beverages, July 2016*)



2.3.10. If the inequitable application of the Sugar Tax is implemented it will have catastrophic consequences for Tiger Brands Beverages, as is demonstrated by the data provided above. The proposed tax model will have the effect of contracting the CB industry and other local industries, which, it goes without saying would have a devastating impact on jobs and employment in the sector.

2.4. Conclusion

In conclusion and as shown above, the outcome of the application of the Sugar Tax on CBs as currently proposed is clearly inequitable and has a disproportionate result on CBs as compared to RTDs. **Accordingly the proposed Sugar Tax is an unfair, inconsistent and prejudicial taxation model for CBs.**

3. Constitutional Compliance

3.1. By proposing that the Sugar Tax be applied in an identical manner to CBs and RTDs, the government, although probably unintentionally, risks acting inconsistently with the rule of law and/or breaching the constitutional right of equal protection and benefit of the law. Subjecting the manufacturers of these dissimilar SSBs to the same treatment results in inequality, because there is no rational reason to disproportionately impact the manufacturers of CBs, having regard to the stated purpose of the Sugar Tax.

3.2. Constitutional framework for the right to equality

3.2.1. One of the founding values of the Constitution of the Republic of South Africa, 1996 (the "**Constitution**") is supremacy of the Constitution and the rule of law.[4] In addition, section 9(1) of the Constitution provides that "*[e]veryone is equal before the law and has the right to equal protection and benefit of the law*".

3.2.2. The right to equality, as provided for in the South African Constitution, includes substantive equality, which means that while similarly situated persons should generally be treated similarly, dissimilarly situated persons, in appropriate circumstances, may need to be treated differently in proportion to their dissimilarity.[5] Accordingly, equality can be "advanced through similar or differential treatment, depending on the context".[6]

3.2.3. Section 9(1) of the Constitution provides constitutional protection against any irrational or arbitrary classifications (on any basis) made by the State. This aspect of the right to equality renders irrational or arbitrary classifications unconstitutional. A violation of section 9(1) cannot be saved by the so-called limitations clause (section 36 of the Constitution).

3.2.4. Rationality is an incident of the rule of law.[7] When enacting laws, the legislature is constrained to act rationally and not capriciously or arbitrarily.[8] A statutory measure is irrational and inconsistent with section 9(1) of the Constitution if the differentiation it makes is arbitrary or manifests "naked preferences" that serve no legitimate government purpose.[9]

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[4] Section 1(c).
[5] Titia Loenen 'The Equality Clause in the South African Constitution: Some Remarks from a comparative perspective' (1997) 13 *SAJHR* 401 at 405.
[6] Catherine Albertyn and Beth Goldblatt 'Equality' in Stuart Woolman et al *Constitutional Law of South Africa* Vol 3 (2nd edition, Original Service: 03-07), at 35-7.
[7] *AB and another v Minister of Social Development (Centre for Child Law as Amicus Curiae)* 2016 (2) SA 27 (GP) at para 283.
[8] Ibid.
[9] Ibid.

3.2.5. In *Prinsloo v Van der Linde,*[10] Ackermann J explained the point as follows:

> *"[T]he constitutional state is expected to act in a rational manner. It should not regulate in an arbitrary manner or manifest naked preferences that serve no legitimate governmental purpose, for that would be inconsistent with the rule of law and the fundamental premises of the constitutional state. The purpose of this aspect of equality is, therefore, to ensure that the state is bound to function in a rational manner. This has been said to promote the need for governmental action to relate to a defensible vision of the public good, as well as to enhance the coherence and integrity of legislation."*[11]

3.2.6. Irrationality that is not based on differentiation is also unconstitutional, for violation of the rule of law. Rationality is part of accountability and justification in a democratic state. Moseneke DCJ in *Law Society of South Africa v Minister of Transport*[12] stated the following about the jurisprudential test for rationality: "*[i]t remains to be said that the requirement of rationality is not directed at testing whether legislation is fair or reasonable or appropriate. Nor is it aimed at deciding whether there are other or even better means that could have been used. Its use is restricted to the threshold question whether the measure the lawgiver has chosen is properly related to the public good it seeks to realise. If the measure fails on this account, that is indeed the end of the enquiry. The measure falls to be struck down as constitutionally bad*".

3.2.7. Whether inequality of outcomes is a breach of the right to equality (section 9(1)) or the rule of law (section 1) of the Constitution is neither here nor there. The fact is that a court may be called upon to consider whether an impugned provision or conduct (the Sugar Tax in this case) irrationally differentiates between similarly situated persons, or fails to differentiate between dissimilarly situated people or categories of people.

3.3. Impact of Sugar Tax policy on CBs

3.3.1. The application of Coca Cola, an RTD, as a reference point for the proposed rate of Sugar Tax on CBs, is flawed because it fails to take account of the principal difference between RTDs and CBs, namely that CBs must be diluted before consumption. The sugar content of an undiluted CB is not comparable to the sugar content of an RTD, as regards its effect on the health of consumers of those beverages. Therefore it is not rational to treat them as being identical in effect.

[10] 1997 (3) SA 1012 (CC) at para 23.
[11] At para 25 (footnotes omitted).
[12] 2011 (1) SA 400 (CC) at paras 32-3.

3.3.2. The Policy Paper does not articulate any reason for imposing this adverse differential outcome on manufacturers of CBs, and it thus appears to be an unintended and arbitrary consequence of the proposed flat rate.

3.3.3. As noted above, in general the consumption of a diluted CB, such as Oros, results in a lower sugar intake than the consumption of an RTD beverage, such as Coca Cola. Therefore CBs contribute less to obesity than RTD beverages. This fact further undermines the rationality of a disproportionately high tax impact on CBs.

3.4. Conclusion:

In light of the above, the application of the Sugar Tax to CBs on the basis of a model formulated using an RTD, such as Coca Cola, as the point of reference, fails to afford the manufacturers of CBs equal protection and benefit of the law, and is irrational and inequitable having regard to the stated purpose of the Sugar Tax and the intended target taxation rate in order to achieve such purpose. The Sugar Tax as currently proposed is accordingly constitutionally unsound.

4. Recommendations

4.1. In light of the data and the supporting information provided, Tiger Brands recommends that, should Parliament proceed to implement the Sugar Tax, that it apply a fair and consistent, non-prejudicial taxation model for CBs which equates to the taxation of the product once diluted on a 1:3 basis or as directed for consumption. In other words, the tax rate should take the dilution ratio of CBs into account.

4.2. By way of example, for a CB product such as a 2L bottle of Oros, which contains 664 g of sugar but is diluted on a 1:3 basis, the tax of R0.0229 per gram of sugar should effectively be divided by the dilution ratio of 4 before being applied to the sugar content. In this example, the tax rate for the 2L bottle of Oros would be calculated as R0.0229 ÷ 4 = R0.0058.