SUBMISSION TO THE STANDING COMMITTEE AND SELECT COMMITTEE ON FINANCE WITH RESPECT TO THE PROPOSED 2018 NATIONAL BUDGET

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INTRODUCTION

This submission

- This submission is supported by 30 organisations - submitted by ten civil society organisations (CSOs) and endorsed by another 20 CSOs whose members are drawn from, or whose work supports advocacy in, working class communities.
- The submission concerns the proposed National Budget with specific attention to revenue raising, proposed tax measures, and the increase to VAT.

The South African context

- The South African context of extreme inequality is critical to consider:
  - Top 10% of full-time earners earn 82 times more than the bottom 10%
  - The top 10% of South Africans hold at least 90-95% of its wealth, much of which is inherited. The top 1% holds 50% or more of total wealth
  - The majority of people, including the more than 9 million unemployed, do not receive any social assistance transfers and social grants increases have barely kept pace with inflation in recent years
- Taxation must play a positive redistributive role.
- The context of low growth is also relevant and spending by government is vital to ensure that social needs are met and economic expenditure supports growth and development.
- The budget makes significant cuts to social expenditure on schools, housing, informal settlements, transport and various forms of infrastructure, despite government's constitutional obligations to fulfil socio-economic rights and promote economic growth.
- Progressive taxation should aim to sufficiently cover pressing social needs.

The main arguments

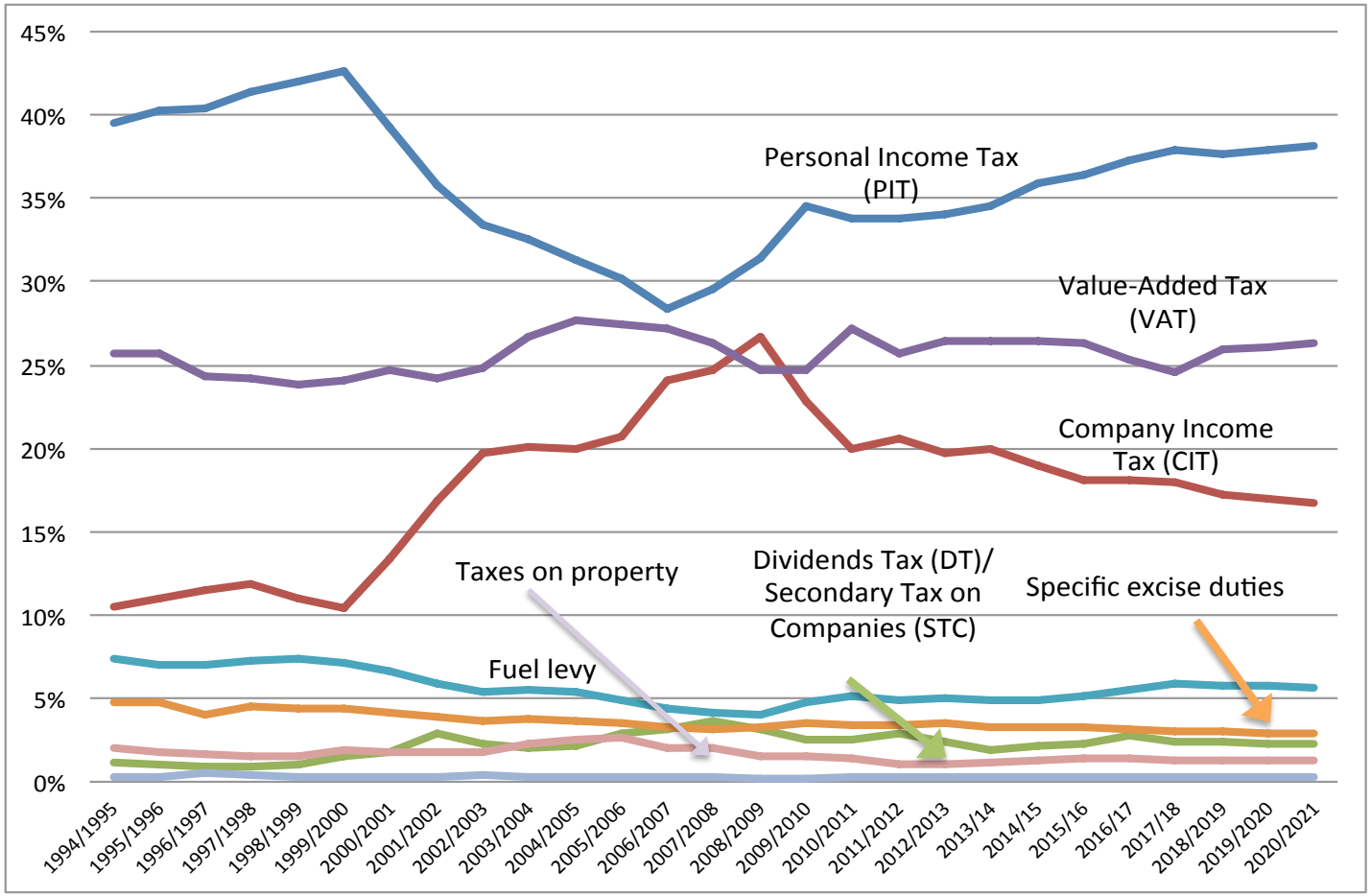
We make four main arguments:

1. The changes to the tax regime must be seen in the context of high inequality and an already imbalanced tax mix.
2. Increases to indirect taxation are the least progressive options available.
3. The increases to indirect taxation will negatively impact the disposable income of lower-income households and the most vulnerable.
4. Other viable, more progressive options are available.

THE TAX MIX

The tax mix at a glance

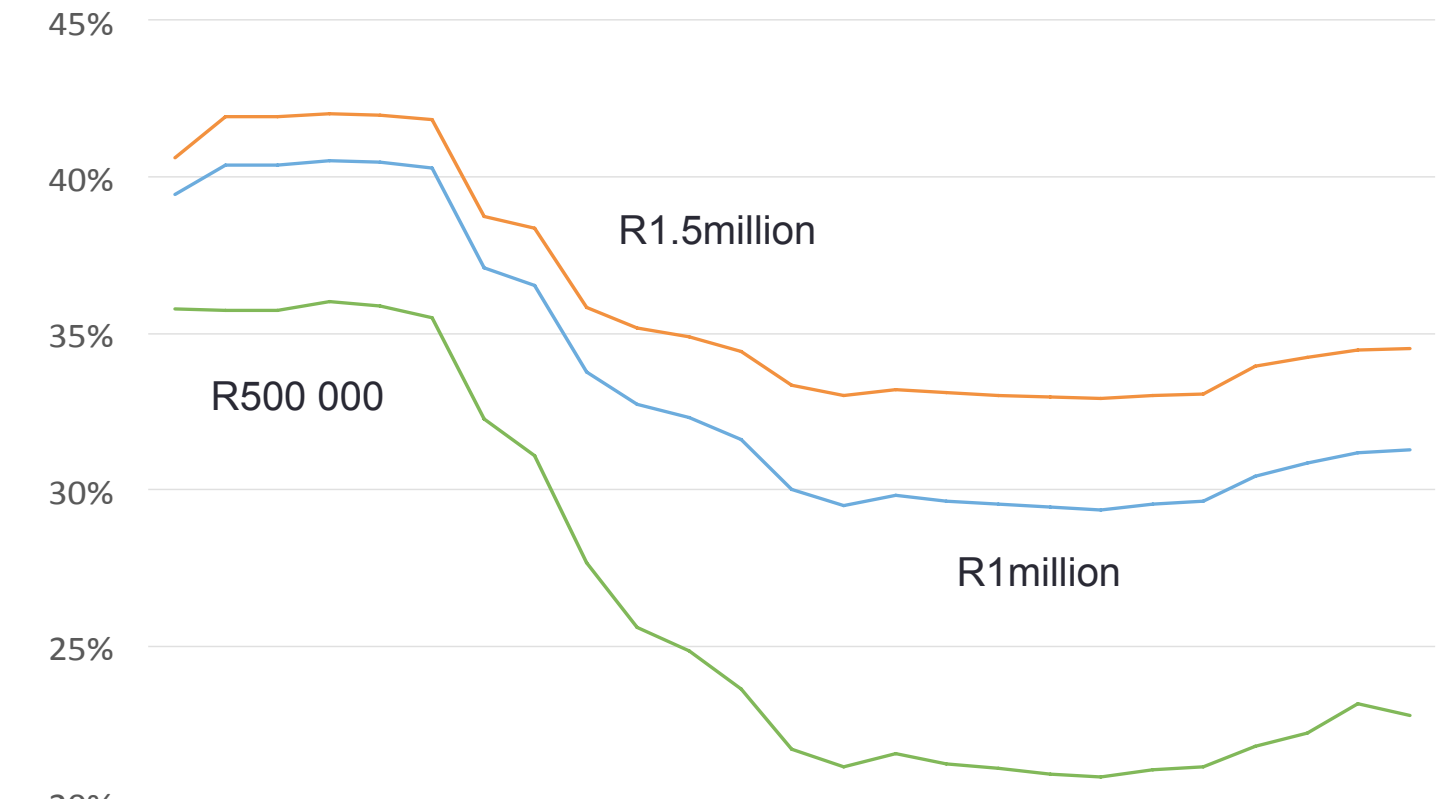
Figure 2: Different tax categories as share of total tax revenue (1994 – 2020)



Source: National Treasury, Budget Review 2018 and Budget Review 2008

Tax rates: Personal income tax

Figure 1: Effective personal income tax (PIT) rates (1994 – 2018)

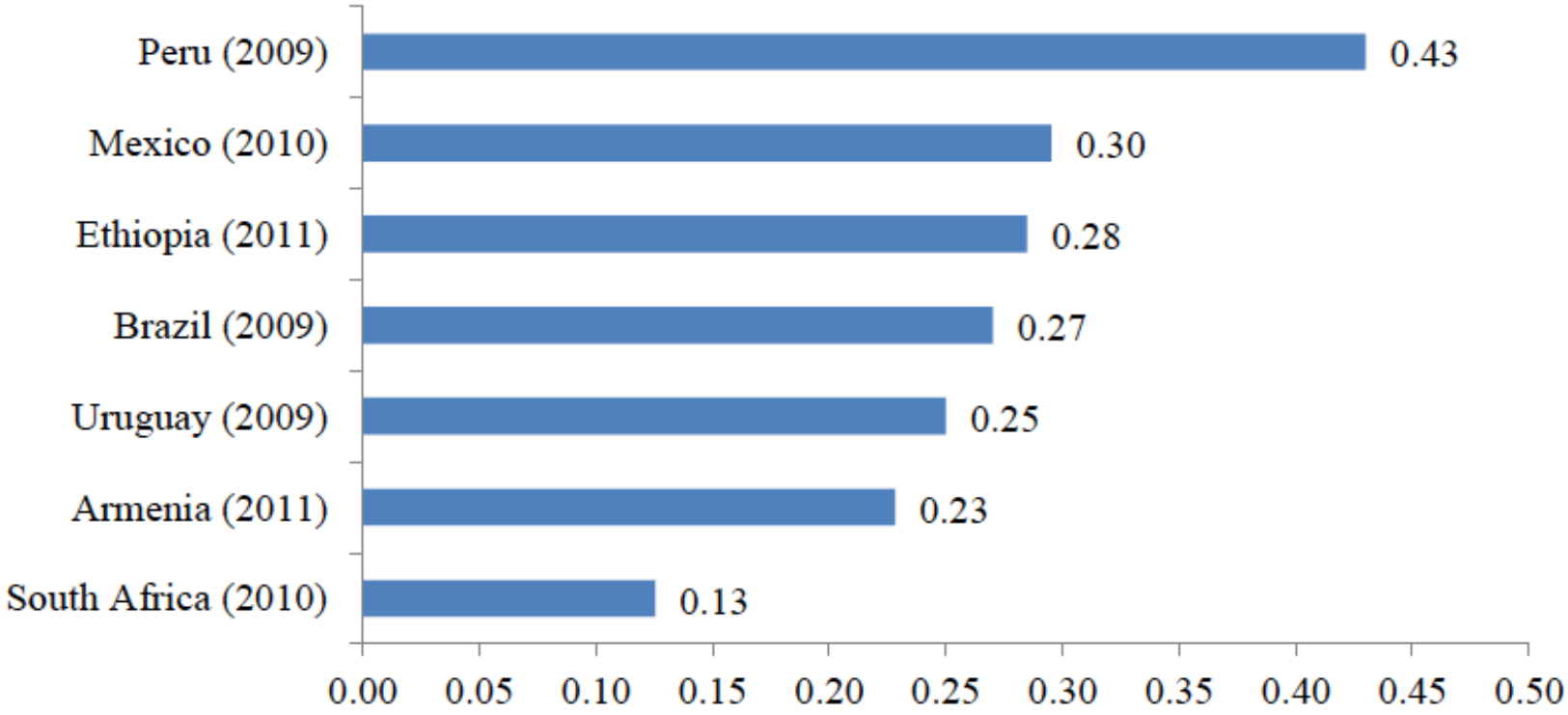


	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
R500 000	36%	36%	36%	36%	36%	35%	32%	31%	28%	26%	25%	24%	22%	21%	22%	21%	21%	21%	21%	21%	21%	22%	22%	23%	23%
R1 000 000	39%	40%	40%	41%	40%	40%	37%	37%	34%	33%	32%	32%	30%	29%	30%	30%	30%	29%	29%	30%	30%	30%	31%	31%	31%
R1 500 000	41%	42%	42%	42%	42%	42%	39%	38%	36%	35%	35%	34%	33%	33%	33%	33%	33%	33%	33%	33%	33%	34%	34%	34%	35%

Source: SARB, Tax Chronology of South Africa 1979-2016

PIT in context

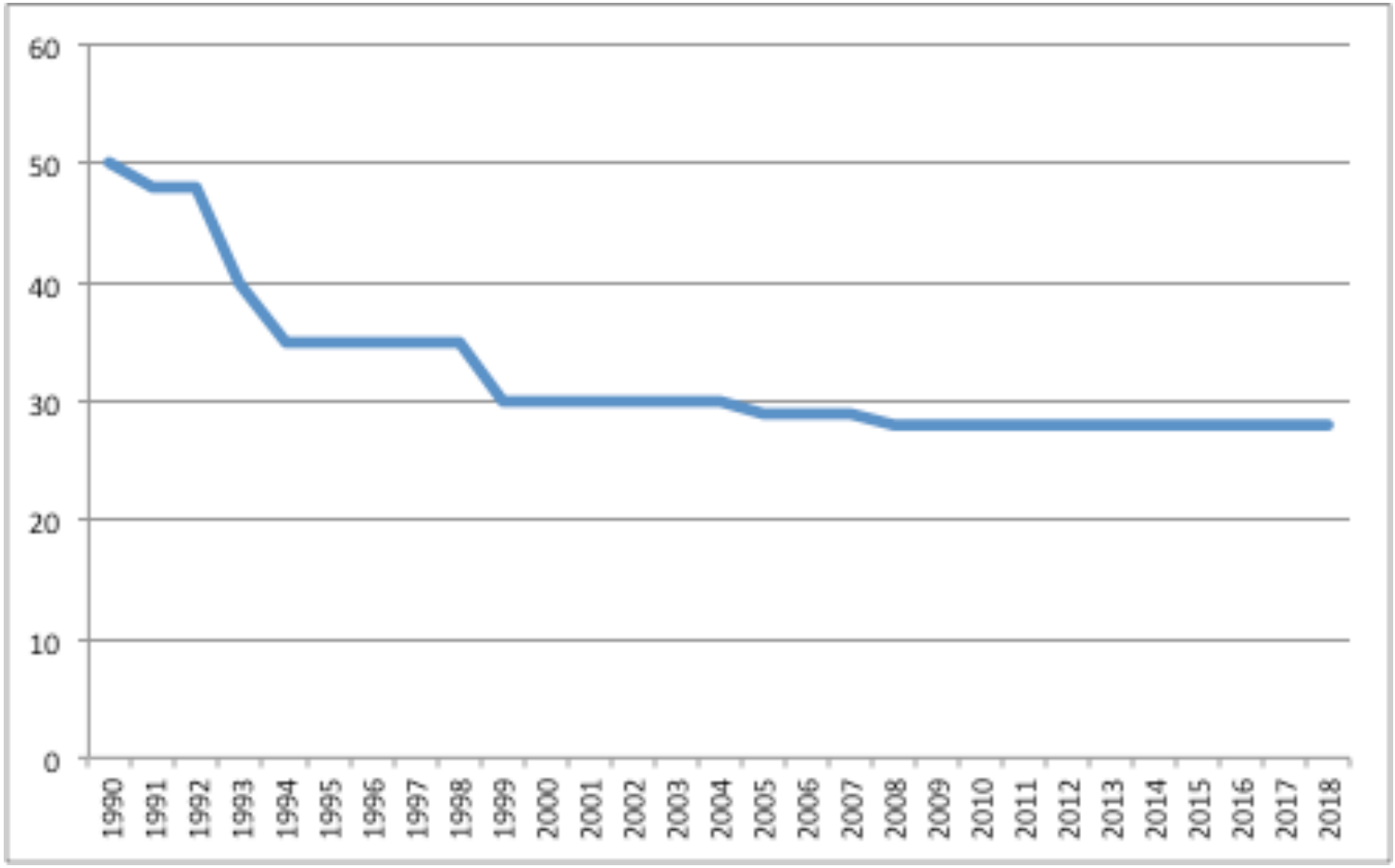
Figure 3: The progressivity of South Africa's direct taxation systems: the Kakwani coefficient



Source: Inchaste et al. (2015), p. 17

Tax rates: Corporate income tax

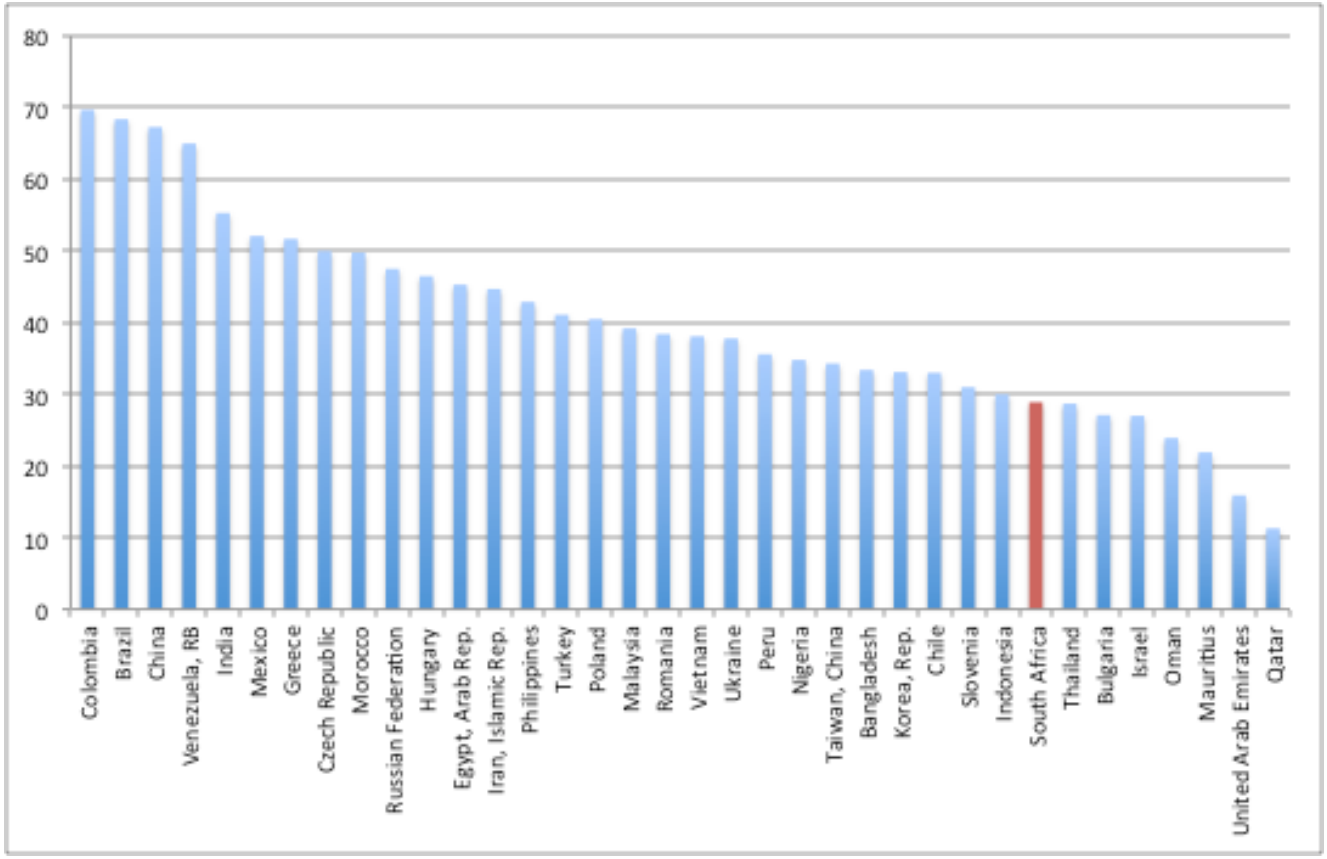
Figure 4: Corporate income tax (CIT) rate (1990 – 2018)



Source: SARB, Tax Chronology of South Africa 1979-2016

CIT in comparison

Figure 5: Total tax and contribution rate (% of profit) of companies in emerging markets



South Africa ranks:

- 172 out of 213 countries, where 1 has the highest company tax and 213 the lowest.
- Fifth lowest in Africa

Note: Shows taxes and mandatory contributions that a medium-size company must pay or withhold in a given year.
Source: World Bank, Doing Business 2017 index

CIT in comparison

Table 1: Corporate tax rates of G20 from the US's Congressional Budget Office

Corporate Tax Rates in G20 Countries, From Highest to Lowest, 2012

Top Statutory Corporate Tax Rate[a]		Average Corporate Tax Rate[b]		Effective Corporate Tax Rate[c]	
United States	**39.1**	Argentina	37.3	Argentina	22.6
Japan	37.0	Indonesia	36.4 [d]	Japan	21.7
Argentina	35.0	**United States[e]**	**29.0**	United Kingdom	18.7
South Africa	34.6	Japan	27.9	**United States**	**18.6**
France	34.4	Italy	26.8	Brazil	17.0
Brazil	34.0	India	25.6	Germany	15.5
India	32.5	South Africa	23.5 [d]	India	13.6
Italy	31.4	Brazil	22.3	Mexico	11.9
Germany	30.2	Russia	21.3	Indonesia	11.8
Australia	30.0	South Korea	20.4	France	11.2
Mexico	30.0	Mexico	20.3	Australia	10.4
Canada	26.1	France	20.0	China	10.0
China	25.0	Turkey	19.5	South Africa	9.0
Indonesia	25.0	China	19.1	Canada	8.5
South Korea	24.2	Australia	17.0	Saudi Arabia	8.4
United Kingdom	24.0	Canada	16.2	Turkey	5.1
Russia	20.0	Germany	14.5	Russia	4.4
Saudi Arabia	20.0	United Kingdom	10.1	South Korea	4.1
Turkey	20.0			Italy	-23.5

Source: Congressional Budget Office, using data from KPMG International, the Organisation for Economic Co-operation and Development, the Internal Revenue Service, and the Oxford University Centre for Business Taxation.

Source: CBO (2017), International comparisons of corporate income tax rates

Tax rates: Property taxes

Table 2: Current property taxation

	Rate / Effective rate	Share of tax revenue	Exclusion / inclusion	Comparsion
Capital gains tax	Individuals: 16% / Companies: 22%	1.5%	Only 80% is taxed, first R40k of tax excluded (up from R10k in 2006)	OECD rate - 40%
Estate duties	20% (except over R30mn)	0.02%	Primary abatement: R3.5mn	Around middle of OECD rates
Securities transaction tax	2.5%	0.4%		Raises only 1/3 of OECD ave but market 3x larger
Immovable property	Taxed via municipal rates and transfer duty	0.6%		
Land taxation	Can be taxed municipally			
Net wealth tax	None in place			

INCREASES TO INDIRECT TAXATION IS LEAST PROGRESSIVE OPTION

Analysing tax choices

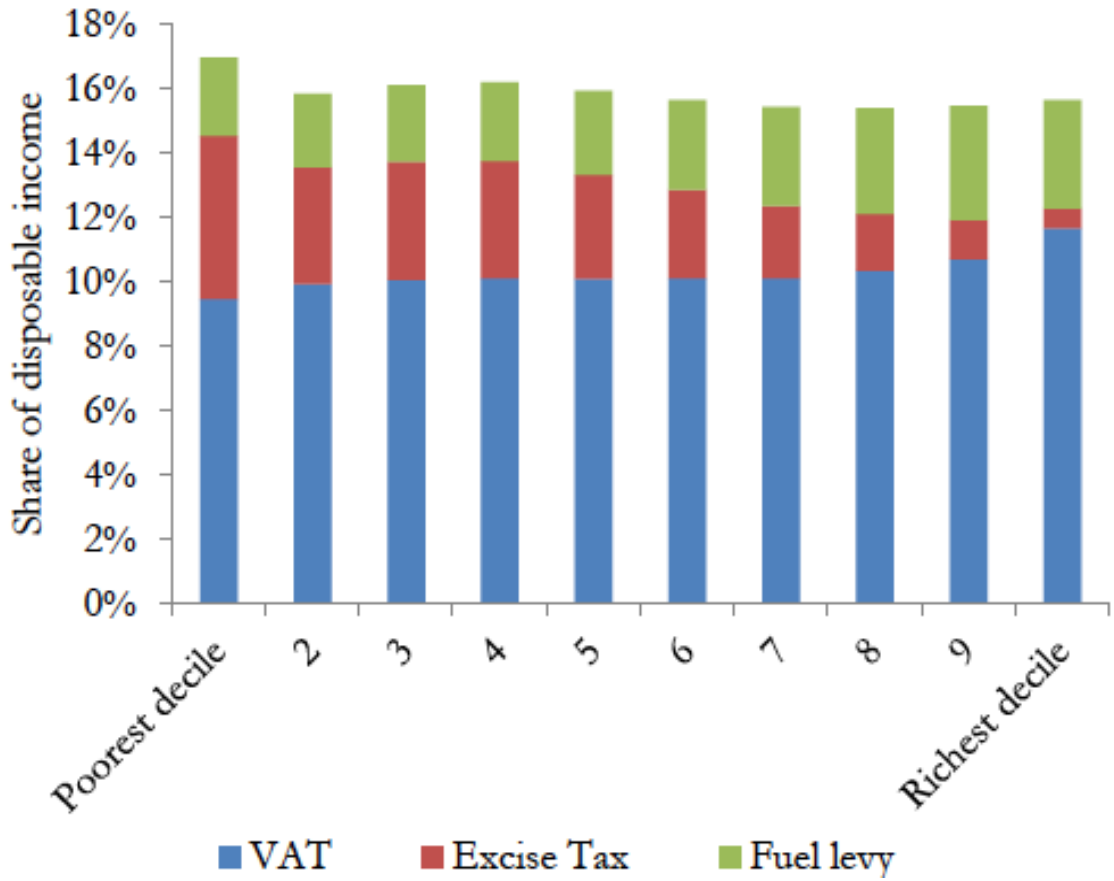
- For a progressive tax higher income earners would pay a progressively higher *share of the tax itself, as their wealth increases* and this would constitute a higher *share of their disposable income*.
- Because the wealthier earn and spend more they will naturally pay a larger proportion of the rand value of indirect taxes, and a larger proportion of any increase – but this tells us little of the impact an increase to these taxes may have for the livelihoods of the majority of South Africans.
- When considering the impact on the poor we need to concentrate on the *share of disposable income* this tax takes up.

The context

- Limited increases or declines in the real value of social spending, including grants on which the lowest-income households rely, already limit disposable income
  - Over the last five years the old age pension and child support grant have risen below CPI inflation twice each, and below food price inflation on all but one occasion for the old age pension and two occasions for the child support grant.
- Recent increases in poverty: according to StatsSA 55.5% of people lived below the upper-bound poverty line in 2015, up from 53.2% in 2011.
- Low wage growth for the majority of workers and very high levels of unemployment are also critical factors: working poor and the adult unemployed don’t benefits directly from grants

Share of disposable income

Figure 6: Share of disposable income spent on indirect taxes by income decline



Source: Inchaste et al. (2015), p. 19

Cumulative share of indirect taxes paid by the lowest 70% of income earners exceeds their cumulative share of disposable income.

Davis Tax Committee (DTC) notes, increases to indirect taxes can exacerbate poverty and inequality.

Indirect taxation rising

- These indirect taxes will make up a larger share of the revenue mix rising from 33.5% in 2017/2018 to 34.8% in 2020/2021. This is in contrast to trends across the OECD where the contribution of these taxes has fallen.
- Indirect taxation has increased faster than social grants.
- **Increasing indirect taxation will lower the disposable income of households.**

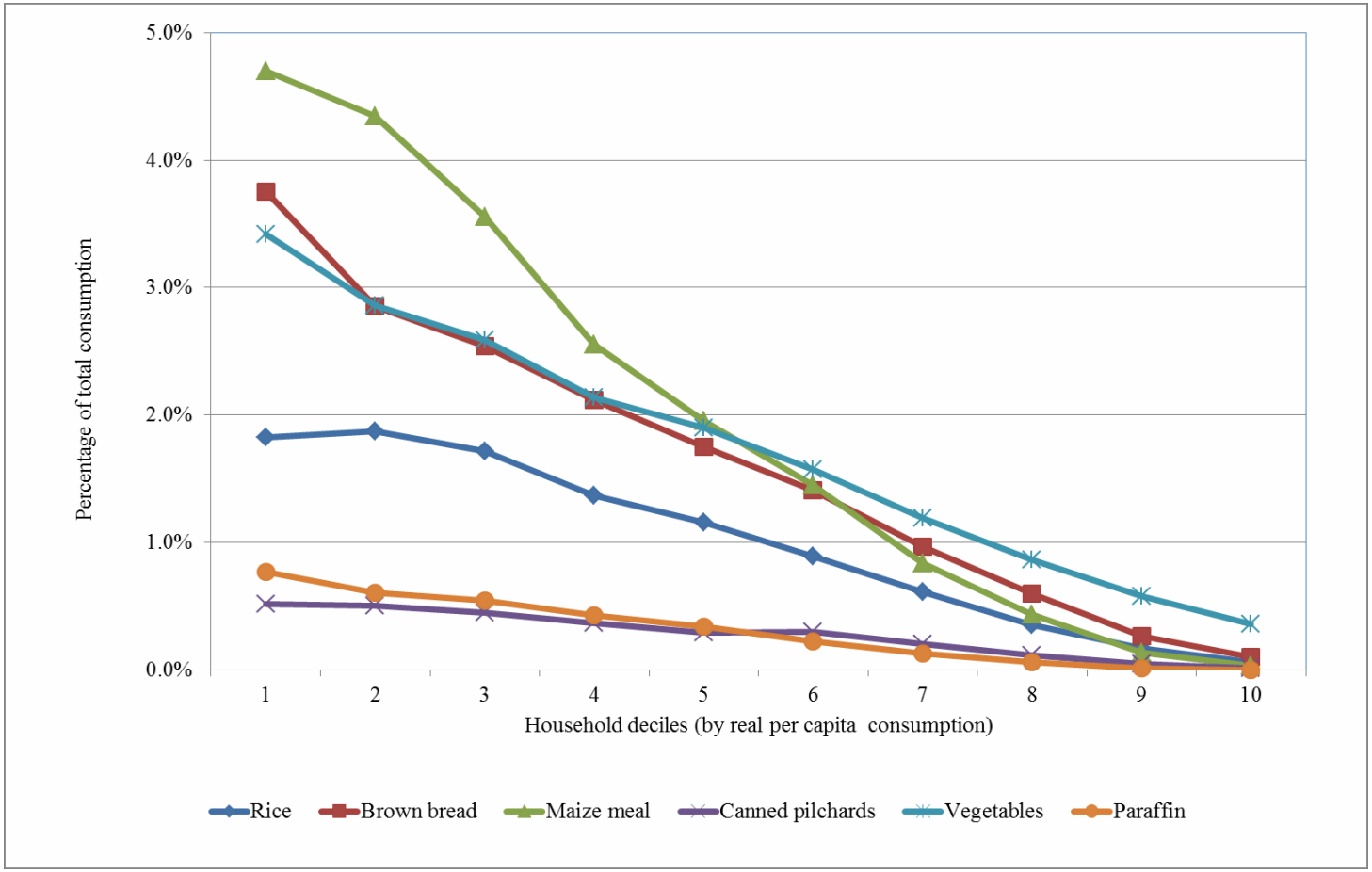
	Old Age Pension Grant	Child Support Grant	Fuel levy (petrol, diesel average)
2015/16	-0.7%	-0.8%	8.0%
2016/17	0.8%	0.8%	6.6%
2017/18	0.3%	2.0%	4.2%
2018/19	1.0%	1.6%	2.2%

Does zero-rating help?

- From the 2010/11 Income and Expenditure Survey we see that the poorest 70% of the population (all below the income tax threshold) derived 70% of the monetary benefit of zero-rating.
- DTC notes: “the zero-rating of basic foodstuffs reduces the regressively of VAT and mitigates the impact of VAT on the poor to some extent”.
- Zero-rating is not hugely expensive, R23bn in 2015/2016, about 40% of the value of tax breaks that favour higher-income households (e.g. medical aid and pensions)

Does zero-rating help?

Figure 7: Share of total consumption of select zero-rated items by household income decile



Source: Jansen and Calitz (2017)

Does zero-rating help?

Four concerns:

1. Zero-rated goods do not necessarily make up the majority of low-income households food consumption needs. PACSA analysis shows only 45% of food basket is zero-rated.
2. The current basket of zero-rated goods is not, in some cases, optimally targeted.
3. The current basket of zero-rated goods excludes a number of goods consumed heavily by the poor, for example, white flour, canned beans, margarine, chicken, polony, candles, airtime and data, and soap.
4. Food consumption patterns matter and food and fuel price rises can push low-income households *away* from zero-rated items.

OTHER OPTIONS EXIST

Back to the tax mix

- **PIT** tax rates have dropped dramatically since 1999 and risen only modestly in last few years (the 45% rate on the top marginal bracket notwithstanding).
- **CIT** has also dropped dramatically and corporate tax is below international averages. SMMEs pay higher effective CIT rate.
- **Property taxes** raise a very small share of tax revenue, below international averages.
- There is strong evidence that raising these progressive taxes can shift income from capital to labour (the functional distribution of income) and from wealthier people to poorer people. **These taxes reduce inequality, improve social outcomes and increase economic growth.**
- Critical to raise enough tax to substitute for VAT increase and ensure vital social spending can be maintained.

Potential scenarios: increase PIT

Table 4: Potential revenue from PIT rate increase

	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**

Potential scenarios: increase CIT

Table 5: Potential revenue from CIT rate increase

	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	235.3	4.1
Scenario 2	825.8	32%	264.2	33.0	251.0	19.8
Scenario 3	825.8	35%	289.0	57.8	274.6	43.4

Potential scenarios: tax wealth

Table 6: Potential revenue from property taxes

Rbn	2017/2018		Scenario		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	1.20
STT	2.5%	5.45	3%	6.54	1.09
Property tax (residential > R1mn)*			0.5%	11.94	11.94
Property tax (commercial > R5mn)*			0.5%	3.98	3.98
Property tax (unused urban land)*			0.1%	0.64	0.64
Property tax (farm)**			0.1%	1.57	1.57
Net wealth tax***			2%	130.212	130.21
Net wealth tax***			1%	65.106	65.11
Net wealth tax***			0.5%	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

Cut breaks and increase luxury taxes

- Revenue can be gained from VAT through making it more progressive, by introducing a luxury tier for goods mainly consumed by the wealthy, as has been done in a number of other countries.
- Reduce tax breaks that favour the wealthy.

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[7]	**18 628**	**20 107**	**21 503**	**22 793**

Two considerations

- Treasury claim that VAT is “least detrimental to growth”:
  - Shows they consider all taxes detrimental
  - Is based on a statistical model used that can only show negative growth impact from rising taxes
  - Distributional issues (within the main macro model) are ignored
  - International evidence is ignored
  - Narrow reliance on neoclassical economic theory
- A government budget is not the “same as a household budget”.

CONCLUSION

Civil society organisations call on Parliament to:

- **Withhold approval of the tax proposals**, in particular the increases to indirect taxes, including keeping VAT at its current level of 14%.
- Institute a **proper process of public engagement** regarding the optimal revenue raising mechanisms.
- To **review the processes of public participation** – its timeframes, format, and implementation – which presently limit public participation in the budget process.
- **Require National Treasury to**:
  - **Make available, in full, the evidence** upon which it bases its claim that raising direct taxes (such as PIT and CIT) is more harmful to economic growth, including the assumptions and models upon which these are based.
  - **Provide its analysis of the distributional effects of its proposals**.
  - **Provide evidence of its reasoning on the proposal level and rate of contraction in borrowing** in relation to the need to boost economic growth.