Standing Committee on Finance/Select Committee on Finance

Parliament of the Republic of South Africa

Plein Street

Cape Town

South Africa

By e-mail: [awicomb@parliament.gov.za](mailto:awicomb@parliament.gov.za)

[zrento@parliament.gov.za](mailto:zrento@parliament.gov.za)

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Chair, Members,

2018 Medium Term Budget Policy Statement – Comment

1. We present herewith our comments on the fiscal policy aspects of the 2018 Medium Term Budget Policy Statement (MTBPS).

**VAT refunds**

1. We are deeply concerned with the downward revision (by R20 billion) of forecast VAT revenues due to a backlog in VAT refunds which now needs to be cleared. We, along with others, had raised concerns relating to the holding back of refunds for a number of years, seemingly as part of a deliberate strategy on the part of SARS to boost revenue collections. At the time, these concerns were dismissed by both SARS and the Committee. The Tax Ombud confirmed that VAT refunds were indeed not being paid timeously in a number of instances, but stopped short of stating that this was a deliberate strategy on the part of SARS to boost revenue collections.
2. It is now apparent that the holding back of VAT refunds was indeed happening and now needs to be unwound at great cost. Of the R22 billion increase in the forecast consolidated budget deficit for 2018/19, R20 billion of that is directly attributable to the clearing of the backlog of VAT refunds. However, the impact is not limited to the current year, but has a knock-on effect to the forecasts over the medium term which are also significantly reduced, resulting in significantly higher than forecast budget deficits than had been forecast at the time of the 2018 Budget in February.
3. The implications could be far-reaching. Moody’s has already indicated that the MTBPS is credit negative and the result could be that the last of the major credit rating agencies reduces its sovereign credit rating for South Africa to sub-investment grade with potentially disastrous implications for the exchange rate, borrowings costs, inflation and the economy in general.
4. There are two concerns that arise with the holding back of VAT refunds:
   * Firstly, they result in the true extent of the tax base being overstated. This has an impact on the ability of National Treasury to accurately forecast tax revenues for the following fiscal year (and over the medium term) as part of the Budget process. This is because the starting point for such forecasts is the tax revenues for the previous fiscal year. In simple terms, National Treasury forecasts the tax revenues for the following fiscal years by applying its forecast nominal GDP growth for such years and a tax:GDP multiplier to the prior year tax revenues. An overstatement of tax revenues as a result of such actions on the part of SARS results in the tax base (and potentially the historic tax:GDP multiplier) being overstated, resulting in the forecast of future tax revenues being overstated.

The overstatement of the tax revenue forecasts results in a vicious cycle of evermore aggressive actions in order to achieve the inflated revenue forecasts. Not only do these measures need to be repeated in subsequent fiscal years just to prevent the overstatement of tax revenues from the previous year unwinding, but the scale thereof also needs to be increased in order to keep up with the overstated revenue growth forecasts. At some point, it becomes unsustainable and the financial implications become apparent. In the fiscal context, the implications will be a substantial revenue shortfall in the year in which it unwinds. This is exactly what has transpired this year.

* The second concern is that such measures as the holding back of tax refunds effectively understate Government debt. In effect, tax revenues from the following fiscal year are borrowed from taxpayers to fund expenditure in the current year. This is effectively a form of “off-balance sheet” debt and is not reported in the Government accounts as debt. In effect, the true level of sovereign debt is understated. When it unwinds, as it will now do, the additional shortfall in tax revenues needs to be funded with debt in order to maintain levels of spending and this off-balance sheet debt is now substituted with on-balance sheet debt. However, an added risk is that it would potentially derogate from the credibility and reliability of Government accounts and would likely be viewed in a negative light by credit rating agencies.

1. We would add that the MTBPS gives the impression that this is a relatively new phenomenon having only appeared in the last few years (from about 2014/15). However, this is not the case. As is apparent from the below table which reflects the VAT credit book as reported by SARS in its annual reports, SARS has seemingly held back refunds to some degree or another dating back to at least 2007/8 when one has regard to the admission by SARS that a normalised VAT credit book would amount to approximately R19 billion (in today’s money).



1. We feel strongly that this practice that has been adopted by SARS is both unlawful as well as unethical. We note that the acting Commissioner has indicated that the matter is to be investigated. We note also that the acting Commissioner has been somewhat evasive when questioned by the media as to whether this was a deliberate strategy on the part of SARS to boost revenue collections.
2. In light of the above, we don’t believe that it is appropriate that SARS should investigate itself. An independent investigation should be conducted by an appropriate body, following which appropriate action should be taken against any SARS officials implicated in any wrong-doing.

**Other concerns**

1. If one accepts that VAT refunds have been held back by SARS in order to boost revenue collections, it would be naïve to believe that this was the only mechanism employed by SARS to do so. We are aware, anecdotally, of other mechanisms apparently employed by SARS in this regard.
2. Within the tax profession, it is an open secret that SARS has taken such steps through a variety of mechanisms, including the coercion of taxpayers to pay taxes earlier than they are legally payable. What these measures have in common is that they are designed to either accelerate the collection of taxes that would ordinarily only be payable by taxpayers to SARS in the following fiscal year or to delay the payment of refunds to the subsequent fiscal year (and in certain instances permanently eliminate refunds).

***Employees’ tax and VAT payments***

1. We are aware of situations where large employers have been requested by SARS to make early payment of employees’ tax that is only payable in April of a year. From what we have heard, this practice is particularly prevalent with regard to state owned entities, but we are also aware of private sector employers having been approached by SARS with such requests.
2. We understand also that this practice has been applied in the context of VAT payments.

***Corporate income tax***

1. We are aware of instances in recent years where large corporate income taxpayers were approached by SARS with requests to make early payment of provisional tax during March notwithstanding that provisional tax was only payable at a later date. However, we have no knowledge of any such taxpayers actually having complied with SARS’ requests in this regard.

***Employees’ tax***

1. Many complaints have been raised by numerous taxpayers in relation to employees’ tax credits (refunds due to employers for overpayments of employees’ tax) not being refunded by SARS, but instead being eliminated by SARS raising assessments or passing journal entries to eliminate these refunds for no valid reason. The only inference that can be drawn from this practice is that it is a practice designed to frustrate the payment of refunds in this regard, whether on a temporary or permanent basis.
2. We understand that this matter should be investigated by the Tax Ombud as part of his recently announced investigation into PAYE statements of account.

***Income tax refunds***

1. Concerns have also arisen that SARS holds back income tax refunds for an inordinately long time and this has become an increasing concern in recent years. The below table, which summarises the income tax credit book as reported by SARS in its Annual Reports, is suggestive that this may very well be the case. The credit book has more than doubled in the last three years.



1. The concern is that, if it is indeed correct that SARS has used such measures in the past to boost revenue collections, were these to be unwound it would have a substantial negative impact on the tax base, forecasts of future tax revenues, the fiscal deficit and debt levels.
2. In light of the above, we would urge the Committee to actively engage with SARS and National Treasury on these concerns given the significant fiscal implications that they could have.
3. We thank you for the opportunity to offer our opinion on the Medium Term Budget Policy Statement, and we trust that you find this to be of assistance in your deliberations. Please do not hesitate to call on us should you require further clarification on any of the matters discussed.

Yours sincerely,

**Kyle Mandy**

Tax Policy Leader

[kyle.mandy@pwc.com](mailto:kyle.mandy@pwc.com)

+27 (11) 797 49 77