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Committee Secretaries
Ms Teboho Sepanya
Mr Allen Wicomb
Standing Committee on Finance

By email:
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1 March 2021

Dear Ms Sepanya; Mr Wicomb

SUBMISSION ON THE FISCAL FRAMEWORK AND REVENUE PROPOSALS THAT WERE TABLED WITH THE 2021/2022 BUDGET ON WEDNESDAY, 24 FEBRUARY 2021

1. INTRODUCTION

This submission is respectfully made to the Standing Committee on Finance ("**The Committee**") in terms of its oversight over the National Treasury and the South African Revenue Service (**"SARS"**)

2. OVERVIEW

2.1. South Africa is in a debt trap and our economic future rests on a knife edge.

2.2. The expected Debt to GDP ratio in this fiscal year is expected to be 80.3%, rising to 87.3% in 2023/24. Debt-service costs will rise from R232.9 billion in 2020/21 to R338.6 billion in 2023/24.

2.3. The debt service costs this year will siphon off 19.2% of our revenue that could have been utilised on pressing economic and social priorities. We are mortgaging our future tax revenues.

2.4. The next few years will determine if we can grow the economy sufficiently to escape a sovereign debt crisis. We are not that far from a debt to GDP ratio of 100%.

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2.5. Our economy is faced with –

2.5.1. real GDP per person falling since 2013/14, meaning that the average South African is poorer as each year goes by;

2.5.2. by the third quarter of 2020, there were 1.7 million fewer jobs than in 2019 and our unemployment rate is forecast to be 36.5% by the end of the year;

2.5.3. personal income tax and VAT account for 65% of our tax revenue;

2.5.4. company income tax revenue has steadily dropped and is around 16%;

2.5.5. less than 39% of South Africa's population is registered for tax;

2.5.6. less than 5% of individuals pay 40% of personal income tax;

2.5.7. tax revenue is estimated to be R213.2 billion lower than projected in February 2020.

2.6. We cannot tax our way to economic prosperity or out of the debt trap. Our tax base is paper thin and we just do not have sufficient fiscal resources to sustain the current debt levels. Our country has run out of road and is rapidly approaching the edge of a precipice from which there is no return.

3. THE ECONOMY

3.1. The Budget rightly focusses on the economy and removing structural constraints that obstruct faster growth. It emphasises structural reforms for inclusive growth by improving access to reliable electricity, water and sanitation services; enabling cost effective digital services; promoting the green economy; and supporting industries with high employment potential, such as tourism and agriculture. We have to grow our way out the debt trap in partnership with private-sector investment. Business confidence must be raised.

3.2. The obstacles facing economic growth include -

3.2.1. private and public investments being lower than at any time since 2005, having declined to 12.5 % and 5.4 % of GDP, respectively, in 2019;

3.2.2. the high cost of doing business in South Africa, low levels of competitiveness and a weak public-sector balance sheet;

3.2.3. low business confidence.

3.3. Correcting these problems can unlock large-scale investment by the private sector, which will be the primary source of growth and job creation, with the public sector playing a crucal enabling role. We desperately require growing investment and job creation, economic reforms to remove barriers to growth, lowering the cost of doing business, and bolstering confidence and investment.

3.4. A key sector in our economic growth lies with the export sector. Many of our export companies are owned by foreign investors and it is a valuable source of foreign currency and job creation.

3.5. The International Monetary Fund expects global economic growth to rebound to 5.5 % in 2021 and 4.2 % in 2022. China is expected to spearhead a recovery among developing economies, with 8.1 % GDP growth forecast in 2021. The USA is introducing an expansive fiscal stimulus and accommodative monetary policy. India's is expected to grow at 11.5 % in 2021.

4. **THE EXPORT INDUSTRY AND SARS**

4.1. The promotion of exports will be imperative in the support of our economy, our currency and foreign direct investment. The Budget plans to support our export industry by improving the quality of and access to infrastructure; implementing new and renegotiated agreements in key markets; increasing awareness of South African products abroad; and improving access to export credit and credit insurance.

4.2. A major concern for the export industry however is the structure of the VAT Act and the Tax Administration Act (**"TAA"**) and more specifically the manner in which SARS is able to conduct VAT audits and withhold VAT refunds due.

4.3. In brief, the VAT zero rating of exports generally cause export companies to fall into a net VAT refund position and their business models build such refunds into their cash flow projections.

4.4. The concern may be explained as follows.

4.4.1. how was it possible that during the "*State Capture*" era of SARS, it was able to unjustifiably withhold some R20-billion of VAT refunds due to taxpayers?

4.4.2. former and current senior SARS officials, who appeared at the Nugent Commission, investigating the destabilisation of SARS, testified that VAT refunds were withheld to manipulate the tax revenue collection numbers. There was a slowdown in VAT repayments due, which cost taxpayers and the economy dearly.

4.4.3. the Tax Ombudsman told the Nugent commission that delayed VAT refunds had been raised in its annual reports tabled in Parliament and there were unnecessary stoppages on taxpayer refunds. Finance Minister Mboweni acknowledged that withheld tax refunds had harmed company cash flows and the economy.

4.5. It was possible because of SARS' interpretation of the VAT Act.

4.6. I do not submit that the current VAT refund withholdings by SARS are due to State Capture but simply wish to illustrate the enormous powers that SARS enjoy in order to withhold VAT refunds.

4.7. According to SARS, when a taxpayer is subject to a VAT audit:

4.7.1. SARS cannot be held to any deadline in which to complete the audit. It may carry on from 6 months to 24 months or longer - all the while withholding the VAT refunds;

4.7.2. an automatic stopper on VAT refunds is applied i.e. there is no decision required by SARS to withhold and therefore there is no discretion exercised that may be reviewed by a court;

4.7.3. SARS may not make any part-payment of a refund. The taxpayer must provide security for the whole amount of the refund/s withheld and only the total refund/s may be paid - or none at all. It was an all or nothing refund situation;

4.7.4. SARS may continually keep requesting additional information for the period/s under audit and continually extend the audit periods, despite the first audits not been finalised.

4.8. The Ombud's Report during the Moyane era, noted the complaints that SARS auditors keep audits pending while repeatedly requesting information from taxpayers. Apart from delaying the refund, the incidental consequence is that if successive requests for further information are sent out each within 21 days of the other, interest will not start accruing on the refund.

4.9. The Ombud's provisional recommendation was that SARS should request all relevant information once, at the outset of an audit/verification. The Ombud also disagreed that while an audit/verification is in progress that refunds for other periods should be withheld.

4.10. SARS cannot sustain its argument that the audit process including the withholding of refunds should take place in a manner and at a pace that is entirely at SARS's discretion with no consideration of fairness. The TAA does not allow SARS to take an indefinite time to complete an audit, particularly where the VAT refunds are integral to the business model of the taxpayer. The audit must be completed in a reasonable time, taking into account the circumstances.

4.11. SARS' contention that no decision is made or is necessary to withhold the refunds and therefore there is no decision that may be reviewed, is patently inconsistent with both the TAA and with SARS' practice.

4.12. SARS' contention that it could not make part payment of a refund and that the taxpayer had to offer security for the whole amount of the refund and the only the whole refund would be paid, or none at all – is an unreasonable position to take and is not supported by the plain language or obvious purpose of the statute. The taxpayer is entitled to a refund of as much as it can provide acceptable security.

4.13. The practice cannot be condoned when SARS unlawfully withholds refunds for periods not yet under audit and only issues audit notices, after the taxpayer complains. It is also not open to SARS to continue requesting information to delay the finalization of the audit.

4.14. A recent Gauteng High Court judgement supported the points 4.10 to 4.13 above. SARS applied to appeal the judgement and failed. The recent judgement provides respite for taxpayers but the battle is not over.

4.15. The reality is that taxpayers in the face of a VAT audit are totally powerless unless they have the financial resources and capacity to litigate. Recourse to the courts is costly and time consuming.

4.16. SARS may be forced to complete an audit within a reasonable time, issue a letter of findings and simply on the basis of unreasonable suspicion and conjecture, issue a revised VAT assessment. The taxpayer must then proceed with dispute resolution through the courts, which could take 4 to 5 years to finally resolve. All the while, SARS withholds VAT refunds unless security may be provided (which has its limits).

4.17. Taxpayers' cash flows are significantly compromised and may be driven into insolvency.

4.18. Taxpayers in the export sector, many of which are owned by foreign shareholders, are particularly exposed - a sector that brings in valuable foreign investment and hard currency to South Africa and whose business model relies on the lawful zero rating of its exports and the claiming of VAT input credits on its standard rated inputs. This could happen to any taxpayer with a clean tax record, based on a SARS official's unproven suspicions. SARS acts as judge, juror and executioner.

4.19. In disputes with SARS, the TAA usually provides a moderating provision to appeal the enormous powers that SARS enjoy. For example, following an income tax audit and an additional assessment to pay the tax assessed, the taxpayer may request SARS to waive the "*pay now argue later*" rule where for example:

4.19.1. the taxpayer has a good compliance history with SARS; and

4.19.2. where payment will result in irreparable hardship to the taxpayer, not justified by the prejudice to SARS or the fiscus until the dispute is resolved.

4.20. This is not possible where VAT refunds are continually withheld by SARS during a VAT audit and the result is the taxpayer's cash flow is irreparably harmed during the period of the VAT dispute - which may proceed for 4 to 5 years.

4.21. During a VAT audit, taxpayers can be met with a brick wall of obstinance by SARS and their only recourse is to the courts, which is time consuming and very costly. A successful finding by the courts does not mean the taxpayer can financially survive the 4 to 5 year dispute proceedings.

5. RECOMMENDATION

5.1. Discussions must be held between the export industry representatives, SARS and National Treasury to find an acceptable resolution to the valid concerns raised. The Office of the Tax Ombud, the South African Institute of Tax Practitioners and I - are prepared to engage directly with SARS and National Treasury.

5.2. For example, provisions may be introduced into the VAT Act and TAA providing certainty that -

5.2.1. SARS must complete a VAT audit within 2 months from the date that the taxpayer provides all the relevant material requested by SARS;

5.2.2. SARS may not withhold VAT refunds for more than 2 VAT periods under audit i.e. it may not continuously roll out audits into future periods and withhold the VAT refunds due, until the original audit has been completed.

5.3. More specifically where -

5.3.1. SARS audits the VAT periods - January and February (**"the original audit periods"**), SARS must first complete the audit and issue assessments for the original audit periods before withholding the VAT refunds for any future periods;

5.3.2. taxpayers may apply to SARS for release of VAT refunds if they have a good compliance record and will suffer irreparable harm by the non-refunds;

5.3.3. SARS may not withhold VAT refunds simply on the basis of pure conjecture and suspicion. There must be a factual basis for the withholding.

Yours faithfully

(Electronically transmitted, therefore unsigned)

ERNIE LAI KING

MANAGING DIRECTOR