Report of the Standing Committee on Finance on the Rates and Monetary Amounts and Amendment of Revenue Laws Bill [B21 - 2021] (National Assembly- section 77), dated 24 November 2021

The Standing Committee on Finance, having considered the Rates and Monetary Amounts and Amendment of Revenue Laws Bill [B21 - 2021] (National Assembly- section 77), referred to it, and classified by the JTM as a Money Bill, reports the Bill as follows:

1. INTRODUCTION AND BACKGROUND

1.1. The Rates and Monetary Amounts and Amendment of Revenue Laws Bill (Rates Bill) was tabled in Parliament by the Minister of Finance on 11 November 2021, together with the 2021 Medium-Term Budget Policy Statement. The Rates Bill is a section 77 (of the Constitution) Bill dealing with national taxes, levies, duties and surcharges.

1.2. The tabling of this Bill was preceded by the publication of the draft version of the Bill (Draft Rates Bill) together the 2021 Budget on 24 February 2021. It was published again on 28 July 2021, together with the Draft Tax Laws Amendment Bill (Daft TLAB), and the Draft Tax Administration Laws Amendment Bill (Draft TALAB), to solicit public comment.

1.3. The Rates Bill gives effect to changes in rates and monetary thresholds to the personal income tax tables and increases of the excise duties on alcohol and tobacco.

2. PUBLIC PARTICIPATION

2.1. The Committee was briefed by National Treasury and SARS on the Draft Bills on 17 August 2021 and held public hearings on 31 August 2021.

2.2. On 10 November 2021, National Treasury and SARS presented their detailed responses to the Draft Bills to the Committee, addressing all the comments made during the public hearings and Committee briefings and deliberations.

2.3. The National Treasury and SARS reported that they received 76 written submissions from the public and responded to these comments during their own consultation processes. They also hosted workshops which ran for three days on 07, 08 and 09 September 2021.

2.4. The Committee received written and oral submissions from the following organisations and/or individuals: South Africa Tobacco Transformation Alliance (SATTA), British American Tobacco South Africa (BATSA), Limpopo Tobacco Processors (LPT), Phillip Morris (PM), South African Liquor Brandowners Association (SALBA), Beer Association of South Africa (BASA), AgriSA, Agbiz, Dr. Seun Muller, Banking Association of South Africa, South African Institute of Taxation (SAIT), South African Institute of Chartered Accountants (SAICA), PwC, Tax Consult. It also received only written submissions from the Johannesburg Stock Exchange (JSE) and the Black Tobacco Farmers Association (BTFA).

3. OVERVIEW OF THE KEY TAX PROPOSALS IN THE DRAFT RATES BILL

3.1. The Rates Bill contains measures to fix the rates of normal tax: to amend the Income Tax Act, 1962, so as to amend rates of tax and monetary amounts; to amend the Customs and Excise Act, 1964, so as to amend rates of duty in Schedule 1 to that Act; to insert new tariff items; to delete tariff items; to delete rebate items; to insert rebate items; to amend the Carbon Tax Act, 2019, so as to amend rate of tax; and to amend the Rates and Monetary Amounts and Amendment of Revenue Laws Act, 2020, so as to provide for corrections; and to provide for matters connected therewith.

3.2. The Bill consists of nine clauses as follows: Clause 1 – fixing of rates of normal tax as detailed in Schedule 1; Clause 2 – increase in primary, secondary and tertiary rebates; Clause 3 – increase values of medical tax credits; Clause 4 – adjustment to align with new tax free threshold; Clause 5 – amendment of customs and excise Act to include the excise schedule dealing with increase in alcohol and tobacco; Clause 6 – increase in carbon tax rate; Clauses 7 and 8 – technical amendments to 2020 Rates Bill; and Clause 9 – Short title.

3.3. The main tax proposals in the 2021 Budget and Rates Bill include a personal income tax (PIT) relief above inflation increase in the brackets and rebates, an increase of 15 cents per litre in the general fuel levy, increasing the Road Accident Fund (RAF) levy by 11 cents per litre, and an above-inflation increase in excise duties on alcohol and tobacco. It also contained proposals on medical tax credits increases in line with inflation.

3.4. Another measure announced in the Rates Bill is the increase in the carbon tax rate by 5 percent from R127 to R134 per tonne of carbon dioxide equivalent from 1 January 2021.

4. KEY ISSUES RAISED IN THE PUBLIC HEARINGS

4.1. Key submissions were made on the general increase in the excise duty on alcohol and tobacco by 8 per cent (Main reference: Schedule No 1 to the Customs and Excise Act, 1964: clause 5 of the Draft Rates Bill).

4.2. Stakeholders raised concerns that the proposal to increase the excise rate by 8 per cent with the current status of a struggling economy and high unemployment rate of 32.6 per cent (as it then was) was inconceivable. They argued that the increase was unsustainable and detrimental to the continued survival of the already distressed legal cigarette industry in South Africa. To this submission, NT clarified that excise taxes on tobacco products are intended to reduce consumption and improve public health whilst generating revenue for Government. NT stated that the World Health Organisation recommends an excise incidence of at least 70 per cent to effectively reduce consumption. An 8 per cent increase will shift the excise duty incidence to only around 45 per cent in South Africa.

4.3. Other stakeholders commented that the excise hike has placed the excise incidence on the cigarette's Most Popular Price Category (MPPC) at 45 per cent compared to a targeted incidence of 40 per cent as per the National Treasury's excise policy. They said that the total tax incidence on the MPPC now sits at a significant 58 per cent against the background of falling consumer affordability. They stated further that the excise increase is non-compliant to the extent to which it exceeds Government's own excise policy on tobacco products, being the higher of 40 per cent excise incidence on the MPPC or projected consumer price inflation.

4.4. NT clarified that although the proposed increase keeps the tax incidence above the 40 per cent policy guideline, the industry has continued to absorb a portion of the excise increases as opposed to passing them through to consumers, which leads to an overestimated tax incidence. NT said that the adjustments correct for any price movements that tend to undermine Government's policy intention to reduce consumption and improve public health. NT further added that the excise increase also seeks to ensure that tobacco products do not become affordable over time as this will increase consumption, which goes against public health policy objectives. It further clarified that the targeted incidence of 40 per cent is a policy guideline and need not be followed by Government every year. It added that given that the incidence has remained above the guideline in recent years, the 2021 Budget Review announced a review on the excise policy framework for tobacco.

4.5. Stakeholder commented that the excise policy was communicated to all stakeholders including investors in the tobacco sector, thereby creating a legitimate expectation Government will always abide by its own policy pronouncements. They submitted that this clear disregard of the cigarette excise policy violates Government's commitment to fair administrative treatment of investors, as provided under the Protection of Investment Act and the Constitution. They explained that it has been stated that under the fair administrative treatment standard, Government is generally expected to implement changes to policies in good faith and in a manner that is not arbitrary, following due process. They said that the excise policy is still in place and National Treasury only intends to review the policy during this current financial year. It is therefore improper for Government to openly ignore its own excise policy for four consecutive excise review periods.

4.6. NT responded that the adjustments in excise duties do not disregard excise policy, they instead prioritise the policy objectives communicated to all stakeholders – discouraging consumption and revenue generation. It explained that the adherence to the policy guidelines is not only dependent on Government's annual excise rate increases but also on the behaviour of the industry regarding the excise pass-through and pricing of tobacco products. If the tobacco products' price increases are lower than excise rate increases, it's inevitable that the incidence will be exceeded.

4.7. Stakeholders commented that NT uses Peter Stuyvesant as the anchor brand in the calculation of the MPPC. However, according to an Ipsos Market Analysis, the MPPC now sits at the low value for money segment, with the anchor brand retailing for R 22.70 (Revised MPPC). They said that based on the proposed excise rate, excise alone will constitute 85 per cent of the MPPC against an excise policy of 40 per cent of the MPPC. They submitted that the total tax incidence on the Revised MPPC is 99 per cent – and makes South Africa by far the leading country in the world in terms of total tax incidence on cigarettes. They said that this position is clearly unsustainable and unreasonable and NT should determine the appropriate tax increases based on this Revised MPPC.

4.8. NT explained that a revision of the MPPC to the proposed R22.70 will be a fundamental or substantive policy change with significant ramifications for tobacco control policy in South Africa. It said that the current benchmarking using MPPC already has differential impacts on cigarette products in terms of excise burdens, and as a result NT does not envisage a situation where there is a reversal on the current levels of excise duty rates. However, as announced in the 2021 Budget Review, the excise policy framework for tobacco products is currently under review and some of these issues will be considered; inputs from all stakeholders will also be considered.

4.9. Other stakeholders argued strongly that Government should be focusing excise duty on pipe tobacco products. They argued that pipe tobacco has an elevated toxicant profile compared to cigarettes. Ironically, the excise rate on pipe tobacco is only 21 per cent of the excise paid on factory manufactured cigarettes, they added. They explained that excise incidence on the weighted average price of pipe tobacco is as little as 29 per cent compared to an excise incidence of 45 per cent on the MPPC of factory manufactured cigarettes. Contrary to the National Treasury's position on this category, there is sufficient room to increase the price further, according to the toxicant continuum argument, without impacting sales in the significant way. It can also be argued that this favourable excise treatment of the pipe tobacco category amounts to unfair and discriminatory treatment of "like or similar" products, in violation of the national treatment principle as enshrined in many treaties to which South Africa is party to. Clearly, this position poses a legal challenge for Government in the future. Accordingly, we recommend that excise on pipe tobacco be increased to at least 75 per cent of the excise rate of cigarette excise. The foregoing is in line with best practice and ensures equality and fairness in the tax treatment of tobacco products in South Africa.

4.10. NT did not accept these submissions highlighting that the reasons for the divergence in excise duty rates per category include the application of the benchmark guideline of 40 per cent of the retail selling price of the most popular brand within each product category (i.e. excise tax incidence) and the disproportionate pricing of tobacco products concerned. It added that cigarettes make up a larger proportion of the tobacco market.

4.11. Other stakeholders raised a similar argument as above about heated tobacco products' (HTPs) excise duty being 25 per cent less than that of cigarettes, is significantly below the excise tax differential in most of the other countries where these products are now available and where switching from cigarettes, as the most harmful way of consuming nicotine, is being partly driven through excise tax policy. NT responded that excise taxes on all tobacco products are intended to reduce consumption and improve public health. It explained that in line with the World Health Organisation's Framework Convention on Tobacco Control's guiding principles, specifically, the one contained in Article 4.2(b), South Africa also intends to discourage initiation because Government recognises that all forms of tobacco use are harmful, including the use of HTPs. It explained that the concessionary rate given to HTPs should not be interpreted as de facto support for either cigarettes or HTPs, but as an introductory rate that is subject to review.

4.12. On the increased excise on alcohol, stakeholders commented that the impact of deviation from tax policy guidelines is a negative investor sentiment resulting in the inability for business to forecast; inability for business to plan; loss of jobs; reduced investment and reduced revenues. They said that the tax incidence has far outgrown the economic viability relative to the inflation rate and that of the excise tax instrument, therefore, it can no longer be a viable economic growth or stimulus metric without due consideration for the related tax incidence. They submitted that at minimum, given the factors under consideration, an increase in excise duties should be considered in line with or below the inflation rate.

4.13. NT stated that the adjustments in excise duties prioritise the main policy objectives communicated to all stakeholders – discouraging harmful consumption and revenue generation. The incidence targets relating to wine, beer and spirits which are currently set at 11, 23 and 36 per cent of the weighted average of the retail price respectively apply, but only as a policy guideline.

4.14. Other stakeholders urged Government in the short to medium term to create a stable investment environment by operating within the existing policy framework. They said that this may mean that in the next round of excise adjustments that Government, and National Treasury in particular, will have to consider freezing further adjustments until such time as Government returns to its policy framework, where after adjustments in line with inflation will give investors the certainty that they require to continue investing in the sector.

4.15. NT responded that there is an excise tax policy in place to increase the excise rates by at least inflation or targeted incidence, whichever is higher, on an annual basis. It added that the adherence to the policy guidelines is not only dependent on Governments' annual excise rate increases but also on the behaviour of the industry regarding the excise duty pass-through and pricing of alcoholic products. If the price increases are lower than excise rate increases, it is inevitable that the incidence will be exceeded.

4.16. Stakeholders commented that excise tax increases impact more than just the beer manufacturer: packaging companies, equipment providers, technicians, transport, advertising agencies, bars, retailers, restaurants, moreover, the consumer. They explained that tax legislation applicable to excise duties in beer are administered on a Duty at Source (DAS) basis. The excise duties incurred during manufacturing and removal are levied by the manufacturer but subsequently passed on throughout the supply chain. They said that while this is an efficient mechanism for tax administration; the unintended consequence of DAS in the beer industry is that the excise duty levied at production is ultimately levied, with a multiplier effect, on the consumer. The consumer ends up partially absorbing the cost of the excise duty. Given this, it is contended that due consideration should be given to the consumer when considering excise duty increases, especially given the current economic climate and the impact that another above inflation rate increase of 8 per cent would have throughout the supply chain and ultimately the consumer.

4.17. NT explained that the alcohol tax regime applies a specific excise duty rate which is the same throughout the supply chain. The application of DAS is cost effective for the administration of the excise duty regime. Unfortunately, SARS (or National Treasury) cannot prescribe how the pricing mechanisms should work in the industry supply chain. The implementation of excise duties on alcoholic products is done with consumers in mind –only price increase that are felt by the consumer will reduce consumption.

4.18. On illicit trade of alcohol and tobacco products, stakeholders commented that it was important for Government to use excise policy to suppress the growth of the illicit market, by closing the gap between duty not paid (DNP) and duty paid (DP) prices, through gradual excise increases typically in line with inflation. They said that this allows the recapture of illicit volumes into the legal market and the meeting of public health objectives (which include the reduction of consumption from both the legal and illegal market).

4.19. NT responded that the problem of illicit trade cannot be sorted out through the excise rate adjustments but needs to be effectively addressed through robust compliance and law enforcement mechanisms. It sad that SARS has been working hard to rebuild internal capacity and has also, through the Inter-Agency Working Group (IAWG) on Illicit Trade, been implementing compliance and enforcement measures. This is evident from a number of raids, seizures and destruction of illegal cigarettes conducted recently as profiled in the media.

4.20. There were other comments made and responses made which are not covered in this report but can be accessed from NT and SARS' response document presented to the Committee on 10 November 2021.

5. COMMITTEE OBSERVATIONS

5.1. The Committee notes that the 2021 Budget contained no measures to raise additional revenue, despite the projected shortfall of R213.2 billion compared to the estimates of the 2020 Budget. The Committee notes further that this was done in order to support households and businesses as the pandemic continued. Instead, previously announced tax increases of R40 billion were withdrawn.

5.2. The main tax proposals in the 2021 Budget and Rates Bill included: a personal income tax (PIT) relief above inflation increase in the brackets and some rebates; an increase of 15 cents per litre in the general fuel levy; increasing the Road Accident Fund (RAF) levy by 11 cents per litre, and an above-inflation increase in excise duties on alcohol and tobacco by 8%. It also contained proposals to adjust the medical tax credits increases in line with inflation.

5.3. The Committee further notes that the projected relief on personal income tax was projected at R2.2 billion, offset by R1.9 billion increase in excise duties and R0.4 billion in export duties. The 2021 Budget proposed the adjusting of PIT brackets and rebates by 5 per cent, which was above the expected inflation of 4.2 per cent. The Committee further notes that without any of these adjustments, government would have raised around R11.2 billion.

5.4. The Committee further notes and welcomes that the proposals in this Bill increased medical tax credits from R319 per month to R332 for the first two beneficiaries and from R215 to R224 for additional beneficiaries, which is an increase of R4.2 per cent in line with inflation.

5.5. The Committee further notes and welcomes that the bulk of the relief in these announcements were targeted at middle to lower income earners.

5.6. The Committee further notes the above inflation increases in alcohol and tobacco excise duty that were expected to raise about R1.8 billion, with the targeted excise burden for wine, beer and spirits being 11, 23 and 36 per cent of the weighted average retail selling price, respectively. The targeted excise burden for tobacco was 40 per cent of the retail selling price of the most popular brand. Most categories on the latter were adjusted by more than inflation (8 per cent) and effective from 24 February 2021. The Committee further notes that excise payments for alcohol were deferred to take account of lockdown selling restrictions, thus providing some relief to the industry.

5.7. The Committee notes that the key submissions received on this Bill were on the alcohol and tobacco excise. While there was a lot of opposition to these amendments, the Committee believes that they were necessary as they are aimed at behavioral modification of reducing consumption and promoting public health. The Committee believes that excise duties on alcohol and tobacco will always be strongly opposed, for reasons not related to the policy objectives of reducing consumption and promoting public health.

5.8. The Committee further notes and welcomes the announcement in the 2021 Budget Review that the excise policy framework for tobacco products is currently under review and believes that some of these contentious policy issues raised by stakeholders in the hearings and inputs from all stakeholders will also be considered.

5.9. The Committee notes the illicit trade in alcohol and tobacco is a serious problem, and believes more needs to be done in terms of compliance and law enforcement mechanisms to curb this issue.

6. CONCLUSION

6.1. The Standing Committee on Finance, having considered the Rates and Monetary Amounts and Amendment of Revenue Laws Bill [B21 - 2021] (National Assembly- section 77), referred to it, and classified by the JTM as a Money Bill, reports that it has agreed to the Bill.

The Democratic Alliance (DA) reserves its position.

Report to be considered