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TOWARDS AN APPROPRIATE TAX MIX IN LIGHT OF REVENUE SHORTFALLS OUTLINED IN THE 2016 MEDIUM-TERM BUDGET POLICY STATEMENT (MTBPS)

SUBMISSION BY BUSINESS UNITY SOUTH AFRICA (BUSA)

January 2017

Background

BUSA is a confederation of business organisations including chambers of commerce and industry, professional associations, corporate associations and unisectoral organisations. It represents South African business on macro-economic and high-level issues that affect it at the national and international levels. BUSA's function is to ensure that business plays a constructive role in the country's economic growth, development and transformation and to create an environment in which businesses of all sizes and in all sectors can thrive, expand and be competitive.

As the principal representative of business in South Africa, BUSA represents the views of its members in a number of national structures and bodies, both statutory and non-statutory. BUSA also represents businesses' interests in the National Economic Development and Labour Council (NEDLAC).

Introduction

The 2016 MTBPS announced R43 billion in revenue increases over the next two years, divided into R28 billion in 2017/2018 and R15 billion the following year. The tax increases proposed for 2017/18 represent a further R13 billion over what was originally proposed in the February 2016 Budget. The further revenue increases are derived in large part by a tax revenue shortfall of R12.2 billion in Personal Income Tax (PIT) and R7.9 billion in Value Added Tax (VAT), offset to a certain extent by minor outperformance in Corporate Income Tax (CIT) and dividend withholding tax. As is the norm, specific revenue measures will be announced in the February 2017

National Budget. The context within which the 2017 Budget will be announced is one of weakening domestic economic growth (projected at 0.5% by Treasury for 2016), low business confidence, stubbornly high and unsustainable levels of unemployment and inequality, a challenging and uncertain global economic environment, and the continued possibility of a sovereign ratings downgrade.

General

National Treasury, together with the South African Reserve Bank, have for some time underpinned South Africa's commitment to a stable macroeconomic framework and fiscal sustainability. Recent Budgets, despite a steadily growing sovereign debt-to-GDP ratio, have retained the balance between fiscal prudence and building on the significant advances made in social and economic transformation since 1994.

Maintaining this balance in the forthcoming budget requires – in addition to revenue increases – further efforts towards fiscal consolidation, including cost containment measures, eradicating wasteful and fruitless expenditure and curtailing losses of State-owned Enterprises (SoEs). Business remains profoundly concerned about continued loss-making by SoEs and applicable guarantees by Treasury. If Treasury guarantees to SoEs are included, government net debt is slightly below 70% of GDP – significantly higher than the international benchmark of 60%. Business perceives this to be an ongoing threat to the fiscal consolidation process and urges government to implement measures to ensure that SoEs are governed responsibly and sustainably. The current fiscal space simply no longer allows for public funds to be channelled to chronically underperforming entities which contribute questionable value to the economy over the long term.

Whilst business recognises that the revenue shortfall outlined in the MTBPS requires revenue increases, the weakness in the economy requires that these be kept to a minimum and done in the least-damaging manner. In view of this, business urges government to consider making use of other sources of revenue over the longer term, including the disposal of stakes in non-core assets where appropriate in order to reduce debt.

Tax Increases

South Africa's fiscal sustainability has been generated in recent years through a steady growth in taxes, at a rate far in excess of economic growth. Net consolidated tax revenues are projected to increase from 26.4% of GDP in 2007/2008 to a forecast of 28.5% of GDP in 2018/2019. Partly as a result, South Africa now has one of the highest levels of taxation globally when social security taxes are excluded, with taxation levels on an upward trend. In the current context of low economic growth, it is critically important to ensure that taxes are raised in a manner that is least disruptive to economic growth and employment and that they are used efficiently and effectively.

Business has engaged with the Davis Tax Committee (DTC) in promoting an efficient, fair and progressive tax system that minimises disruption to sustainable economic growth. When assessed against peers, South Africa has relatively high CIT and PIT rates (particularly for a middle-income country) and low levels of VAT. Whilst we note the DTC's unequivocal position that it does not support an increase in VAT, Business nonetheless agrees with the DTC that a rise in VAT would have a less negative impact on GDP and employment than increases in either PIT or CIT. According to the DTC:

"*Raising VAT will have a (albeit very small) negative impact on inequality, but will be much more efficient than an increase in direct taxes. It is also important to consider the longer-term: increases in direct taxes dampen growth, which in turn leads to reductions in tax revenues and constrains the ability of the state to reduce inequality through the expenditure side of the budget"*[1].

The DTC's first interim report on VAT goes on to state the following:

"Should it be necessary to increase the standard rate of VAT, it will be important for the fiscal authorities to think carefully about compensatory mechanisms for the poor who will be adversely affected by the increase. A

[1] Davis Tax Committee: First Interim Report on VAT. Available at http://www.taxcom.org.za/mediacentre.html

range of measures should be considered, such as increases in social grants or the strengthening of the school nutrition programme."[2]

Business, similarly to the DTC, is concerned about the potential negative impact on inequality of a rise in VAT and the fact that a modest increase in VAT will in itself not be enough to generate the R28 billion additional revenue required for 2017/2018. Sustainable revenue collection therefore needs to strike an appropriate balance between limiting negative impacts on economic growth (a likely result of any increase in CIT or PIT) and inequality (a likely result of an increase in VAT). To secure the R28 billion tax increases required for 2017/18, the following is proposed:

Tax	Percentage Increase	Rand amount obtained	Compensatory Mechanism for Poor
Sugar-Sweetened Beverages	N/A	Approximately R5 billion	N/A
Donations Tax on Interest-free Loans to Trusts		Approximately R1 billion estimated	N/A
Personal Income Tax	1% across the board except for lowest tax bracket	Approximately R9 billion	Exemption from increase for lowest tax bracket
Value Added Tax	1%	Approximately R20 billion (gross);	Increased social expenditure (e.g.

[2] Davis Tax Committee: First Interim Report on VAT. Available at http://www.taxcom.org.za/mediacentre.html

		approximately R15 billion (net) when combined with compensatory mechanisms for the poor	enhanced social protection).
Total	N/A	Approximately R30 billion in 2017/2018	Reduced inequality through expenditure/tax relief.

In addition to the above, we would like to see an announcement made in the 2017 Budget as to how the additional tax revenues of R15 billion in 2018/19 is to be raised as a package alongside the 2017/18 proposals. To this end, it is suggested that the bulk of this should be raised through limiting fiscal drag relief for PIT. This is important to demonstrate that the vast majority of the burden of tax increases is to be borne by higher-income earners and not by the poor.

Conclusion

The 2017 Budget is one of the most critical in South Africa's recent history. The country cannot afford the prospect of a sovereign ratings downgrade, recession or long-term economic stagnation. A balanced budget that incorporates cost containment measures with sustainable, fair tax increases holds the only prospect of sustaining over the long-term government's pro-poor, pro-growth policies. Business stands ready to work with and engage government in ensuring the success of South Africa's fiscal policy.