THE NATIONAL TREASURY/SARS TAX SYMPOSIUM
CSIR CONFERENCE CENTRE, TSHWANE, 17 MARCH 2008

ADDRESS BY TREVOR A MANUEL, MP, MINISTER OF FINANCE

Chairperson
Distinguished Contributors
Ladies and Gentlemen

Thank you all for having offered up your time to join us in this symposium. It is appropriate that a government should periodically pause to evaluate its policies, to be advised of changing global trends, to test its policies against its intended socio-economic policies and then to undertake the detailed work necessary to plot a new course ahead. This symposium addresses the first three of those objectives.

We are one country who can proudly proclaim that the changes to tax policy and administration have served us incredibly well over the last fourteen years. And, we have no intention of any let up on our success rate.

Reminding ourselves of the road traversed, however is not intended to signal a change, or to give tax dodgers any comfort. In fact, I hope that at the end of this symposium they should be filled with much more dread.

We have undertaken significant tax reforms since 1994, giving effect to many of the recommendations of the Katz Commission. The Commission was appointed soon after our transition to democracy, and set the task to review all of the tax laws at that time. The Katz Commission issued a series of reports on different topics, issuing its ninth and final report in March 1999.

Amongst the significant proposals was the replacement of the source-based system of taxation with a residence-based tax in 2001. The reports included proposals for the broadening of the tax base, reduction of tax rates, phasing out of certain taxes, and radically improving our administrative and collection capacity.

Corporate and individual rates were significantly reduced since 1994. The headline corporate income tax rate was decreased from 40 per cent to 29 per cent (and to 28 per cent in 2008/09) and the top marginal personal income tax rate from 45 per cent to 40 per cent. The income level at which this top marginal rate becomes effective increased from R120 000 in 1999/00 to R490 000 in 2008/09. At the bottom end the marginal personal income rate decreased from 19 per cent to 18 per cent. However, increases in this income tax bracket and of the primary and secondary rebates over the period 1999/00 to 2008/09 resulted in an increase in the income tax thresholds (level below which no personal income tax is payable) from R19 526 to R46 000 for individuals younger than 65 years and from R33 717 to R74 000 for individuals 65 years and older. The VAT rate has remained unchanged at 14 per cent.

These reforms have resulted in significant changes to the level and composition of tax revenue. Our tax-to-GDP ratio has risen from 22.8 per cent in 1994/95 to a projected 28.0 per cent in 2007/08, in spite of the significant reduction in tax rates. Over 80.0% of our revenue is now from three tax instruments, the personal income tax (PIT), value added tax (VAT) and corporate income tax (CIT). Whilst PIT is relatively stable, corporate income tax revenues as a percentage of GDP increased from a low of 2.6 per cent in 1993/94 to a high of 6.6 per cent in 2006/07, though it was very volatile as a share. VAT fluctuated around 5.9 per cent of GDP between 1994/95 and 2002/03 and increased to 7.4 per cent in 2006/07. Most years, SARS collects more revenue that originally budgeted, and in most years, this is very significant.

I suppose that for me, as an avowed social democrat, the scariest aspect of all of this is that we prove the correctness of the Laffer curve with each move.

We have clearly achieved much since 1994. However, we operate in a world of fierce contest between tax authorities and tax advisers. In this world of rapid change and innovation, we have seen aggressive tax structuring as firms with healthy balance sheets suddenly move into high gearing as a result of the intervention by new players such as private equity funds. We observe the speed of the devastation caused by financial turmoil, and we know that this could never be confined by sovereign borders. Across the world, countries seek to maximize their attractiveness to direct investment, sometime even in a headlong race to the bottom. All of these features are real, they are hard, and they are an integral part of this highly competitive globalised world. The worst any government can do is to be complacent. This symposium has been convened to allow us to take stock of past reforms, and review where we are today compared to other countries.

Part of my job is to remind South Africans all, and especially my colleagues in government of the downside risks. So, I have to repeatedly – yes, even early on a Monday morning – mention the deficit on the current account. That gap of just over 7 per cent between our investment rate of just over 21.2 per cent of GDP, compared to our 13.8 per cent savings rate is the major chink in our armour – somewhat accentuated by the current turmoil on global financial markets. We are dependent on foreign capital inflows to fund our rising current account deficit of 7.4 per cent in 2007.

It is also important to remind ourselves that South Africa is a poor country with an open economy. We have too many people still trapped in a grinding poverty. Our conscience compels us to extend social grants to just over 12 million – that is almost 1 in 4 South Africans. We are also deeply concerned about the low labour participation rates. Our statistical agency has just released the results of the 2005 Income and Expenditure Survey which confirms the extent of inequality. The top 10 per cent of households receive 51 per cent of total income and the bottom 40 per cent of households receives only 6.5 per cent of total income. President Mbeki has declared war on poverty, and focused government departments and their budgets towards attaining this objective.

Any review of our tax policy must be mindful of all these trends, both domestic and international.

The symposium also needs to review what new set of tax reforms we need to consider for the next 10 years if we want to accelerate our growth path to much higher levels than the current 5% growth per annum, and also significantly reduce unemployment. A symposium such as this will work, only if we spare ourselves no blushes – so feel free to ask some tough questions to assist us in assessing our tax system, and provide us with your own comments on how to align our tax system within an economic growth strategy that is based on higher levels of investment. But we also want the comparative advice in order that we benchmark ourselves against our peers.

Given our reliance on foreign capital flows to fund our current account deficit, we would be particularly interested in whether the SA tax system is friendly enough for such capital flows. In particular, is our treatment of foreign direct investment and multinationals in line with international practices.

How do you view our policy to phase out STC and replace it with a withholding dividends tax? Are there lessons to be learnt in how we treat debt-financed and equity-financed initiatives – should we try and be neutral in this respect, and if so, how?

We have followed the spirit of the Katz Commission to the letter. We have thus continually lowered corporate rates across the board, in preference to a complex maze of exclusions and incentives. Our choice has been to limit administrative discretion – the dividends of this are self-evident from our higher tax yields. Now there is fresh pressure to reconsider this – and we do so from a much stronger position of significantly improved administrative ability. Again we ask, what is the comparative experience? We ask this because we set as one of the key objectives of government the halving of unemployment rates over the next five years. Significant improvements in labour absorption are not optional extras for us – it has to be at the very epicentre of the choices we make.

In the 2008 Budget government has set aside R5.0 billion over three years to support its industrial strategy; in particular we have to deploy most of these resources via tax incentives in support economic growth and employment creation. We are well aware that there will be efforts towards rent seeking, efforts that should resisted. We must design a set of interventions that will address market failures; these interventions will have to be transparent and will take us on a higher and employment creating growth path.

I want to move from the economic to the administrative challenges. I do so from a fervent belief in the maxim, “Tax administration IS tax policy.” In addition to the economic incidence of taxes it is also important to take into account the cost of collecting taxes – administrative costs on the side of the revenue authority and compliance costs on the side of individuals and especially businesses, given that a legal liability for many taxes rest with businesses, even if the economic tax incidence is on individuals.

The creation of SARS in 1997 and its outstanding success in collecting revenue and reducing the scope for evasion creates the very foundation of the South African state, allowing it to have the capacity and scope to provide basic services to all and to set this country on the path to progressively eliminate poverty.

In January this year the OECD Forum for Tax Administration convened in Cape Town and formulated and approved a framework to enhance the relationship between business and tax administration on the one hand, and between tax administration and intermediaries on the other. The prospect of an enhanced relationship which entails a level of trust, openness and a willingness to improve disclosure of information, is going to provide interesting challenges for South Africans. SARS has invited corporates, the tax intermediary industry and tax advisers to engage with it on this matter.

We are keenly aware that it is onerous to amend tax legislation so significantly each year, yet I do not know if it is possible not to do so when the tax structuring industry is so aggressive. The process for amending tax policy or legislation is always a contested process, and it is in most instances not possible to consult first before making announcements. Consulting is only feasible before the legislation is approved by Parliament.

There are a host of other challenges facing our tax system, including the appropriate type of tax decentralization. Contrary to conventional wisdom, the devolution of taxes in a developing country like South Africa carries great risk, and increases the scope for avoidance and evasion. South Africa has shown that its approach to revenue-sharing clearly has distinct advantages, and emphasizes the need to guard against fragmenting the tax system, which tends to undermine the objectives of simplicity and efficiency. We have struggled to find appropriate taxes for local government, beyond the property tax, after we phased out the Regional Services Council levy.

The area of environmental taxes also poses new challenges, as these taxes are not always motivated by the need to raise revenue, but by the objective of reducing consumption. A phasing in of environmental taxes will mean that we will be opting for many more small taxes, which might increase administrative and compliance costs. We have started on this road with the implementation of a plastic bag levy for which we are again slaughtered in the press today – the collections work like a charm, the spending, well that is an altogether different story. We have also just announced our intention to impose an electricity levy cleverly, with a clearly stated intention to reduce consumption. This is going to be a difficult road, and will require international co-ordination if those moving first to save our environment become less competitive than their rivals who care less about the environment.

Our tax system will be profoundly affected by the coming retirement reforms which will compel all employees to contribute towards retirement funds, and the possible introduction of a wage subsidy to encourage the creation of low-income jobs.

I want to end by once again thanking you for participating in this tax symposium, and inviting you to pose the tough questions to assist us in reviewing our tax system, and to provide an analytical framework for determining the next set of tax reforms for the next decade.

We are listening closely. We are learning feverishly. We do not want the world's second best tax system, that will fail our democracy.

Thank you.