MINISTRY OF FINANCE
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South Africa's tax system and the tax reform agenda for 2015 and beyond
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Good morning and thank you for inviting me to address you on these pertinent issues.

The tax system of a country is central to the functioning of the state, in that it enables the state to do what the country expects it to do. This includes funding for schools, for health services, for good roads and infrastructure, for policing and for the provision of a safety net for the most vulnerable in our society. It follows that the primary objective of our tax system is therefore to raise sufficient revenue to support the priority expenditure programmes of government, to facilitate the provision of public goods and services for the benefit of its citizens and to meet its international obligations.

However, it also follows that government's expenditure programme should be efficient, and provide value for money, and that there be no wastage or illegitimate use of public funds. Taxation is, therefore, a public contract with the people of the country, where the people entrust government with funds to provide the basic services and infrastructure they expect from the use of these funds.

Taxation is also about nation-building, as it provides the underlying core for the functioning of the state, and ensures that we are able to meet our constitutional, as well as humanitarian obligations, and enable our society to function as a normal society, to enable both the private and public sectors to generate jobs and investment into the economy, and to boost economic growth. Investments in, and spending on, social infrastructure and social programmes are important for social cohesion and social solidarity.

For all these reasons, the issue of tax morality is critical to the success of implementing our tax policies, to collect the necessary revenue that the state requires to fulfil its functions. The democratic process implies a social contract between government and its citizens, where all citizens contribute towards the fiscus according to their ability and government in turn ensures that tax revenues are used productively for the benefit of the country's inhabitants The emphasis on the mobilisation of domestic sources of revenue is important as such ability ensure the country's sovereignty.

I should add that the tax system is not the only source of revenue for the state. Beyond taxes, excise duties and import duties, user charges are also important, particularly where specific goods and services are provided by the state. Hence organs of the state charge users for electricity, water, passports, and yes, for certain roads as well, through tolls. Though we subsidise basic water and electricity, we have to make consumers pay for such services to ensure there is no wastage, as happens when a product is free or too cheap.

Indeed, the tax system also has to correct for negative externalities when the price (and user-charge system) fail, and fails to incorporate the cost to society, as is the case with smoking, alcohol abuse and pollution – in these instances, the secondary objectives of the tax system come into play, to change behaviour towards widely-accepted social goods.

Taxes can thus help to address concerns about certain production and consumption patterns that might result in undue social and / or environmental harm, thereby imposing a social cost on society which is not necessarily born by the producers or consumers of such goods or services. Such outcomes, sometimes referred to as market failures, require corrective actions of which taxes might be one of range of intervention.

I will come back to these points later.

Tax process is not ad-hoc and is deeply consultative

Given that the tax system is necessary, good policy takes into account the need for tax policy to function in a way that does not discourage those who want to work and produce for the economy.

Tax policy and tax legislation need to provide certainty to businesses. For this reason, tax policy needs to be boring, and where new taxes come into being, like the carbon tax or mining royalty, we take a deeply consultative approach over many years before we legislate and implement the new measures.

In this context we also set up an objective process, like the Katz Commission at the birth of our democracy, and almost twenty years later, the Davis Tax Committee, to advise government on how to reform the tax system where needed.

The inputs by experts and public comments are helpful to inform and revise tax proposals. We also consult further as we legislate for that policy, and on the specifics of draft legislation. We do not have an ad-hoc approach to taxation- it is always a considered and deeply consultative process, which takes a few years for the major tax changes like the mining royalty or carbon tax.

For small changes to an existing tax, we have a consultative process that is in place, including the two rounds of consultation for any tax announcements made in the annual Budget, which then gets legislated later in the year, after we publish draft tax bills and take comments, and then and only then table in Parliament as a money bill.

The challenge that we have, when we consult over our tax proposals, is that very few independent economists actually participate in such processes. Most comments received are usually from affected stakeholders, who have a vested interest and tend to provide comments with narrower interests in mind, rather than the broader public interest. No economists from BER, as far as I can remember, have come forward to provide an assessment or comment on some of the main tax proposals from a public finance perspective.

Indeed, I am surprised that we do not have greater focus on public finance and taxation in particular in the economics faculties of universities in South Africa – the focus on taxation at our universities are mostly in the accounting and legal faculties.

Principles guiding tax policy in SA

In developing a sound tax system the principles of equity, efficiency, certainty, simplicity and revenue buoyancy should always be taken into consideration. In practice there are trade-offs between some these principles, and the challenge is to find the right balance, taking into account the income and wealth distribution of our country, and the stage of our development.

The three main taxes in South Africa in terms of their contribution to total tax revenue are Personal Income Tax (PIT), Value Added Tax (VAT) and Corporate Income Tax (CIT). These three taxes account for over 80 per cent of total tax revenues.

PIT accounted for an average of 33 per cent total tax revenues between 2004/05 and 2014/15, the average for VAT over the same period was 27 per cent and for CIT was 22 per cent. That those with greater means on average contribute more to the fiscus is the outcome of an equitable tax system and not the result of a too narrow tax base.

A key factor to take into account in the structure of the tax system is incidence, or who ultimately pays for that tax. It is important to draw a distinction between the economic incidence or burden and legal incidence or burden of taxes. What matters most is the economic incidence of the tax system and not necessarily those who are legally responsible to pay (over) the tax revenue to the South African Revenue Service.

The incidence of the PIT is the individual on whom the economic and legal tax incidence falls directly. On the other hand, the economic incidence of the 49 per cent of tax revenue from VAT and CIT is not so obvious, as it tends to fall on consumers, workers or shareholders, even though it may be companies that actually pay the tax over.

The principle of equity, both horizontal and vertical, has been an important driver of tax reforms over the past two decades. The income tax base (for both individuals and corporations) was broadened in 2001 by the introduction of capital gains tax. The international comparability of the tax system was also improved by the phasing-out of the secondary tax on companies (STC) and the introduction of a dividend withholding tax regime.

It should be noted that in broadening the tax base for income tax, this also provided the fiscal space to reduce the marginal PIT rate and the headline CIT rate in the first twenty years of our democracy.

The PIT is also designed to be progressive, to enable it to redistribute income. The need for some measures of income distribution on the tax and the expenditure sides of the budget has been highlighted by challenges of inequality, as outlined recently in the books of Thomas Piketty and Anthony Atkinson.

Of the approximately 15 million workers and / or registered individual taxpayers in SA, about 6.5 million recorded taxable income above the annual income tax threshold of R70 000 per year, with the remainder, 8.5 million, earning taxable income below that threshold. This is largely a reflection of the income distribution in South Africa and is indeed a sad reflection of the significant degree of income inequality that we still have to confront. It is a reflection of the high unemployment and low participation in our economy, rather than an indication of a narrow tax base.

Another consideration in any tax system is the balance between direct and indirect taxes. Between 1994/95 and 2014/15 direct taxes accounted for about 58 per cent of total national tax revenues and indirect taxes for about 42 per cent. The question we need to ask is whether this is the right balance for our economy. Should we move more towards indirect taxes, as many in the business community argue, or should we move more towards direct taxes as many in the labour movements and NGOs tend to argue?

From an equity perspective, we appear to have the right balance but from an efficiency point of view and to encourage higher levels of savings, we need to consider whether even a small shift toward more indirect taxes may be appropriate. Payroll taxes could also be viewed as a special type of direct taxes (not the same as PIT) and are imposed in some countries to mostly fund social security initiatives.

South Africa’s indirect tax system is well-developed. The main indirect tax instrument VAT has a relatively broad base and can been seem as part of the modern VAT systems around the world.

The challenge has been and remains that of maintaining the relatively broad VAT base, with few exemptions and domestic zero-ratings. The perceived regressive nature of indirect taxes has resulted in many requests for special exemptions and even multiple rates. Some have argued that the standard VAT rate is South Africa is on the low side and should be increased. This could be explored.

Tax policy is also about effective tax administration. Hence an important policy consideration is to ensure that taxes are collected where and when they were due. To the extent that some individuals or companies might under-declare their income it is up to the South African Revenue Service to try their best to uphold the law and bring such tax avoiders or evaders to book.

One aspect to consider is transfer pricing, which is a major project of the G20 and OECD. South Africa has in the last twenty years made significant investments to improve tax administration and tax collection capacity. At the same time efforts were made to reduce the compliance burden on taxpayers. The introduction of e-filing eased the administrative burden on taxpayers and modernised the way SARS collects taxes.

Lastly, we also need to consider the area of subnational taxation and the appropriate funding models for provincial and local governments, given their spending responsibilities and need for local accountability.

Using tax policy to incentivise social objectives

I want to make the point that tax policy is not only about revenue. There is a growing trend for tax policy to be used to change behaviour, to deal with the problem of negative externalities, like making polluters pay the real price of their impact on the environment.

I want to emphasise that we are not saying that tax policy can by itself lead to behaviour change, but it can be effective as part of a package of measures to achieve such objectives. For example, the excise duties on tobacco together with the strong laws to forbid smoking in public areas and education programmes on the dangers of smoking have shown how the tax system can assist socially accepted causes. More and more, we are working with our colleagues in health to see whether the tax system can assist in the fight against obesity, or to make our roads safer using tools that are being used by many insurance companies.

South Africa has been active in introducing a range of environmentally related taxes to help deal with challenges such as climate change and waste. We intend to table the carbon tax later this year. The tax system also plays a role in incentivising our people to save, as our retirement and tax-free incentives show. The recent introduction of the employment tax incentive is meant to be part of a broader package to promote the employment of more of our youth, to deal with the problem of youth unemployment.

Future tax reforms

No country has a perfect tax system. Whilst there is a need for certainty and stability in the tax system, we live in a dynamic world, and have to take into account challenges that the world in general, and the tax system in particular, face. We are all aware of the problem of the one per cent, and how we can reduce inequality as we also reduce poverty. We are aware of the growing focus on the challenges we face from multinational corporations who shift their profits to shift their tax base to low-tax regimes or tax havens. We are aware that we face challenges from the digital economy. The corporate income tax base is also being eroded as a result of highly geared financing structures, mismatches of international tax rules and the exploitation of double taxation agreements.

Indeed, the current buzzword amongst international tax policy makers, tax administrators and tax practitioners is BEPS – base erosion and profit shifting.

Government has referred many of the above challenges to the group of wise people who serve in the Davis Tax Committee, to advise the Minister of Finance as to how to deal with many of the above challenges. First appointed in 2013 by my predecessor, the Committee, which is part-time, is hard at work investigating a range of issues, including how our tax system can promote inclusive economic growth, employment creation, development and fiscal sustainability, and evaluate our tax system against international trends, principles and practices. .

The committee has looked at the areas of small business taxation, VAT, estate duty and will shortly comment on mining taxes. I want to encourage the BER, as a more independent player, to comment on all its reports, and participate in its processes.

We have also requested the Davis Tax Committee to assess our current tax incentives, to ensure that such incentives actually achieve their objectives. We need to focus more on the tax expenditures that we currently have, in the same way as when we appropriate expenditure, as this represents revenue foregone. The review that we plan of the ETI in 2016 should be extended to all other tax incentives in our system.

Conclusion

I would like to conclude by noting that though South Africa has a good tax system, and recent tax reforms have contributed to a relatively robust and equitable tax system, we cannot take it for granted that our tax system will remain appropriate for the future. This is what we want the Davis Tax Committee to advise on.

Whilst we need as much certainty as possible in our tax system, we do face pressures to introduce reforms when we consider fiscal pressures, globalisation, growing inequality, tax avoidance through BEPS etc.

Further reforms must adhere to principles of efficiency, equity, transparency, certainty, convenience, revenue buoyancy. However, we are also aware that the combined effects of an appropriate tax system and efficiency of the expenditure system ensure that the fiscal system supports economic growth – we know that we cannot divorce the revenue side from the expenditure side.

Thank you