



MINISTRY OF FINANCE
REPUBLIC OF SOUTH AFRICA

SPEECH BY MINISTER OF FINANCE MR NHLANHLA NENE

2018 TAX INDABA

DATE: 10 SEPTEMBER 2018

The Acting Commissioner of SARS
The Tax Ombud, Judge Ngoepe
Honoured guests
Ladies and gentlemen
Good morning

It is my honour to give this opening address to the 2018 Tax Indaba. Tax policy and tax administration are not usually seen as especially interesting topics in the eyes of the general public, but that has certainly changed after the events of the past few years.

Tax revenues are critical to the functioning of any democracy, a point that has always been top of mind for Ministers of Finance, even if this fact might have previously been taken for granted by many citizens. Lower tax collections have serious consequences and can impact everyone, whether it be through lower expenditures on education or health, or through increases in tax rates to make up for shortfall. The ability of a government to borrow at reasonable interest rates is also dependent on its ability to collect taxes.

Given such wide repercussions that may arise from any under-performance in our tax revenues, I am encouraged that there is greater public debate about numerous tax issues, from discussions around the value-added tax rate increase and zero-rating, to the role of illicit trade and non-compliance. Greater debate and introspection can only improve our understanding of these topics and hopefully lead to more just, efficient and considered policies and actions. Events such as the Tax Indaba play an important part in contributing to those debates.

Unfortunately, much of this debate has arisen due to the substantial shortfalls in tax revenue of R30 billion and R49 billion during the past two fiscal years. To make up for

these shortfalls, we first increased personal income tax rates and taxes on capital gains and dividends, and subsequently raised the value-added tax rate.

The revenue and expenditure measures announced in the 2018 Budget were necessary to ensure that our public finances are sustainable. If we were to pile on more debt onto our books, we would have ended up spending more money on debt service costs which are already the fastest growing expenditure item. Spending more on debt service costs would crowd out social expenditures. Delays in stabilising our finances, on the other hand, will merely delay the pain for later but also certainly ensure that the amount of fiscal pain we have to take in the future is that much more. Decisive action was therefore necessary for the overall benefit of everyone. The 2018 Budget charted a credible path forward, one that was sufficient for the country to keep the investment-grade rating from one of the three main rating agencies.

There is now an additional downside risk to tax revenue projected at the beginning of year because of the contraction in the economy in the first six months of the calendar year. Fixing our economy to ensure it grows faster and in a more sustainable manner is therefore critical. Faster economic growth simply means we will have more revenue to collect. Economic growth is pivotal to what we want to achieve as a country. Only a growing economy can create jobs and opportunities for lifting the poorest out of poverty. Growth will expand the tax base to create the resources necessary for government to implement much needed reforms that will allow for a fairer society, through measures such as the implementation of the National Health Insurance or Comprehensive Social Security. Without higher levels of economic growth, these social programmes will be difficult to implement.

Cabinet last week emphasised that constraints to growth will be addressed. These measures include the overhaul of the visa regime to allow for easier access by workers who bring skills that are scarce in our country, the stabilisation of state-owned enterprises, and the creation of policy certainty in the mining sector. We must spare no effort in raising the level of economic growth, but must also equally work hard to fix public finances.

The tax revenue shortfalls over the past few years have partly been due to the fact that the economy has been growing slower than had been projected. However, we cannot ignore the potential impact of a reduction in the effectiveness of tax administration. Tax avoidance and tax evasion will be on the rise in any economy which is growing more slowly and where taxes have been increased. A strong, capable and effective revenue authority must be there to limit those activities and make sure the correct amount of revenue continues to be collected.

It is during these tough times that it becomes increasingly clear just how important it is to have strong institutions that can hold firm. Institutional strength should be the foundation for our democracy.

On that note I was particularly pleased with the theme for your opening day of “Tax Policy Meets Ethics”. Economists like Daron Acemoglu, Simon Johnson and James Robinson distinguish between the hard and soft institutions that jointly form a set of formal and informal “rules of the game” in a society. Their argument is that the quality of these institutions is perhaps the most important determinant of long-run growth and prosperity. Hard institutions include laws, regulation, standards and organisations. Soft institutions - that is our habits, preferences, perhaps even our fears and prejudices are passed on from one generation to the next, through, for example, societal norms for acceptable and impermissible behaviour.

It pains me to say that South Africa’s hard and soft institutions have both been tested over the last years, and found wanting in many respects. At its heart, ethics is about behaviour and choices and their impact. I realise that what I’m doing at the moment is talking about ethics, but my deep desire is for us to move from a society where ethics is approached from the view that others should “do-as-I-say” to an approach where ethical behaviour is so apparent that others can “do-as-I-do”.

In that spirit, I hope that I can start by exploring some of the ethical dimensions of my daily work as the Minister of Finance. I’m very sure that you have encountered at least a handful of clients that question the ethical nature of taxation itself. Indeed, I am reminded annually by libertarians that they view all taxation as theft. I disagree, of course. Taxation lies at the heart of any social contract that underpins a democratic state.

In my view the ethical cornerstone for our society is the Constitution. The preamble to the Constitution is perhaps the most eloquent expression of our best hopes for ourselves and our society. I will try to relate our fiscal policy to each of the ideals mentioned there, and leave it to you to judge how far we’ve come to live up to these ideals.

The exhortation to “heal the divisions of the past” is visibly expressed in the progressive design of our taxes in general, and personal income tax in particular. This design aims to ameliorate the impacts of a very unequal distribution of income. Of course, the current patterns of income inequality are by-and-large the legacy of our history which discriminated against the majority. The design of our tax system therefore compares favourably to many of our emerging market peers, as evident by recent fiscal incidence studies.

It would be an injustice to this topic to assume that more can't be done. Indeed, there have been many calls for tax measures to address the skewed distributions of different forms of wealth. Deliberations on such policies are certainly delicate, since they can have far-reaching consequences for the economy. But we can't shy away from answering the difficult questions about our distribution of income and wealth, and the lived-experience of many who have become frustrated with limited social mobility and an incomplete transformation of people's daily struggle to make ends meet. During tough economic times, such as we are in now, these struggles will be even more acute.

We aim to be a "society based on democratic values, social justice and human rights" and a "democratic and open society". For me, this is about the democratic values of transparency and accountability. National Treasury has regained the top spot in the 2017 Open Budget Index survey, reflecting the honest intent to reflect how public money is raised and allocated. Transparency and certainty are well-understood as characteristics of a good tax system. The tax administration act sets out precise methods and standards for tax administration to be fair, transparent, equitable and predictable.

During deliberation on proposed tax amendments, comment is often made that our tax legislation itself should be more simple and easy to understand. While we take that plea to heart, it would be very easy to write simple tax laws if no one tried to circumvent them. In fact, the passages of the Income Tax Act that are more difficult to chew have probably contributed significantly to the job creation and stability, if not decent income, for many in this audience.

Let me turn now to transparency and accountability of public expenditure, which is closely related to another goal in the preamble of the Constitution, namely to "Improve quality of life". The social legitimacy of our taxes is determined by the developmental impact of our public expenditure. While there have been many successes to improve access to services and social infrastructure, I am acutely aware that more must be done – and with less money available.

We have a high level of transparency in how public money is allocated, but that does not automatically translate into value-for-money in spending. Nor does it automatically mean that those to whom the expenditure has been entrusted will be held to account for wasteful and fruitless expenditure. Treasury instructions can set the parameters for acceptable practices, but good rules can never trump good discretion. This requires public servants to spend public money to fulfil its original purpose, and to do so judiciously and honestly.

Apart from the injustice that stems from rerouting public resources to a select handful of private purses, corruption threatens our hard-won gains in tax compliance and tax

morality. In fact, I suspect that some of your clients may have pondered the ethical dimensions of paying taxes which may fund wasteful or fruitless expenditure. The work of the Office of the Chief Procurement Officer has started to yield successes in combating some corrupt practices in procurement. The trimming of budgets over the last 3 fiscal years has also focused officials' minds on achieving more with less. The Public Finance Management Act (PFMA) provides us with a strong legal framework against mismanagement of public funds. We do, however, need to see those who misappropriate public funds being prosecuted.

As an aside, let me perhaps share one last thought on corruption. A corrupt system consistently expects us to stoop to the level of our worst impulses and our flawed nature. It is inherently cynical: it waits for us to make one mistake, in order to exploit that misstep. Building a fair and democratic society, in turn, requires a sustained commitment to our better nature. I am optimistic about our ability to do so.

We want to be "citizens equally protected by law". The horizontal equity of our tax design implies that people in similar circumstances should be liable to similar levels of taxation. While we often think of this in terms of levels of income, it is also useful to think of it from the perspective of different sources of income. There remains a lot of work to be done to ensure that the tax system does not lead to distortions of economic activity. Not only is this good economic sense, but it promotes economic activity based on fundamentals. What should matter is the substance, not the form of an activity.

Another dimension of this right, is the expectation by taxpayers that the tax administration will act at all times without fear or favour. The appointment and the outcome one of the Nugent Commission of Inquiry will hopefully show the public that government is committed to acting ethically and is prepared to openly investigate any possible areas of wrongdoing. The Nugent Commission is an important step towards rebuilding trust between government and taxpayers. If you believe that you have information that could aid the work of the Commission, I'd like to encourage you to approach the Commission with that information.

The most optimistic hope contained in the preamble to the Constitution, is that we can "free the potential of each person". In order for our society to thrive, we need to harness the contribution of every person's energy, skills, insight and ability. A society that does not draw on the productive capacity of 27.2 per cent of its economically active labour force, cannot claim to have reached this goal.

Finally, we aim to be a "sovereign state in the family of nations". Perhaps you've not considered international taxation in this light, but in essence the various initiatives to protect our domestic tax base is an expression of our sovereignty and growing interaction with the global economy. In many respects the notions of taxation at source

or residence are under pressure from new methods of transacting that may be difficult to link to a specific tax jurisdiction. The BEPS initiative and our cooperation in the Global Tax Forum is a starting point for tax jurisdictions to consider remedies jointly, and is likely to be a large component of your work for clients in the coming years.

In closing, achieving any of the goals set in the preamble to the Constitution requires ethical leadership in the work place. A large part of the strength of organisations lies in the senior management and officials of the organisation, and ethics should be the guiding principle behind upholding and carrying out the specific mandate for each organisation. The public has in recent years lost trust in public institutions. This loss of trust has been fuelled by public concerns about how public funds have been spent.

With regards to SARS, some taxpayers began to lose trust in the institution because of how they had been treated by the revenue authority. Some taxpayers may have taken it upon themselves to try to pay as little tax as possible in retaliation. Such behaviour not only negatively affects collections and our financial position as a country, but undermines the fairness of our tax system and creates more social discontent. Government has an obligation to act ethically and correct any possible failings as far as possible, but equally so, individuals and corporates have an obligation to act in a responsible manner.

Many South African professions and professionals are at a cross-road. It so happens that this audience comprises of lawyers, accountants and auditors, professions whose conduct has attracted public scrutiny locally and abroad. The behaviour of a number of corporates has fallen visibly short of the level of ethics that one would expect, especially given the reputations of those firms.

Let me take this opportunity to also address myself to SARS employees. This must be one of the very difficult periods for them because the institution that they have dedicated their lives to has been the subject of much speculation and accusation of wrong doing in recent years. I salute SARS employees. Thank you for sticking it out to fulfil a monumentally important task for our country. When you interact with them, I do hope that you will have due regard for the dedication they have shown. Though they do not expect it, they do deserve our respect. SARS officials are civil servants and in effect work for the public, yet it is useful to remember that they have to tread a fine line between providing a service and cracking down on avoidance. Ultimately, though, they are accountable to the public and I'm glad to see that the Acting Commissioner and members of the SARS Executive Committee will be addressing you today. I do hope you can provide them with robust questions.

I am also pleased that the Tax Ombud, Judge Ngoepe, will be here to add to the deliberations on the ethical obligations of each party when it comes to paying taxes.

Once again, the importance of an institution such as the Tax Ombud cannot be understated, and the public should have confidence in their ability to listen to the concerns and make sure that SARS are treating taxpayers fairly and correctly.

I have not spoken at length on the changing landscape of tax policies themselves, but measures to limit avoidance across all spheres of taxes and address issues such as base erosion and profit shifting, and the move to the digital economy, will continue to receive attention. It is notable that many of you make considered inputs into the tax legislation each year, which creates an improved and more certain tax landscape, and for that I would like to thank you. Your efforts in helping to build a sound tax system are appreciated.

We are, however, certainly not naïve to think that all submissions are solely for a wider benefit and we are cognisant that each change that is made is carefully scrutinised for methods in which you can minimise your tax liabilities. As such, there should be a healthy tension between government and tax advisors, tax practitioners and taxpayers, but I hope that these relationships can be founded on respect, and with trust that a high level of integrity and ethics will govern all our actions and behaviours.

Thank you.