MINISTRY OF FINANCE
REPUBLIC OF SOUTH AFRICA

SPEECH BY DEPUTY MINISTER OF FINANCE DR DAVID MASONDO

2019 TAX INDABA

DATE: 26 August 2019

Good morning Ladies and Gentlemen

It is a pleasure to address you this morning on the role that tax policy can play in rejuvenating government and the economy. While I know hardly anyone in this room enjoys paying their taxes, I am certain we can all agree that tax revenue is a critical building block for a fair and sustainable society.

Unfortunately, the last ten years have been especially tough for us as a country. Some of the revelations that have emerged from the various commissions have been very concerning. The tax system has not escaped unscathed, with the findings from the Nugent Commission revealing serious lapses in governance at SARS. This has undoubtedly led to a deterioration in tax morale and in the trust in government.

This period of instability has coincided with increasingly large tax revenue shortfalls. From a shortfall of R7 billion in the tax year that ended in 2015, the under-collections have consistently increased to the latest shortfall of R57 billion. And this has happened over a period where tax rates have been increasing, with a higher personal income tax rates across the income distribution, a new top rate of 45 per cent on incomes over R1.5 million, higher capital gains tax and dividends tax rates, increases in fuel levies and even an increase in the rate of value-added tax.

Despite all these measures, weak economic growth and lower than anticipated revenue have led to persistent budget deficits, which are also increasing. The budget deficit was 3.6 per cent in 2015, yet our latest published projections from February anticipated an increase to 4.5 per cent this year, and that is before the impact of transfers to Eskom. Given the deteriorating budget balance, debt-to-GDP has been tracking upwards, although at the time of the Budget it was expected to stabilise at 60.2% in 2024.

An ever increasing reliance on debt leads to debt-service costs that start to crowd out social expenditure. We need to ensure that our fiscal position is sustainable so that we can serve our citizens and enable them to enjoy the rights promised to them under the Constitution. Significant tax policy adjustments have been made in recent years to get the country back on a sustainable path, and this should be our collective responsibility.

How do we do so?

Firstly, we need to determine whether our tax policy design is suitable for the future, based on the key principles of good tax policy design. In one of the most unequal societies in the world, is our tax system equitable, and are taxpayers treated fairly? Is it efficient so that taxpayers do not distort their decisions? Is it transparent, and does it offer taxpayers certainty? Is it simple enough to understand, comply with and administer? Most importantly, given that revenue raising is the primary objective of the tax system, is our tax system responsive and resilient to the economic environment? We need to ensure that tax policy meets the goals of revenue raising and redistribution without unduly dampening economic growth.

It is not easy to achieve these conflicting objectives, especially in a dynamic and global economic environment. This means that tax policy and tax legislation is organic and evolves – requiring constant maintenance. But, we should be careful not to let constant maintenance interfere with the big picture. We need to consider whether our tax system and the instruments that form part of it are suitable for what the future holds.

Secondly, by ensuring that we have a strong, capable and technologically proficient revenue authority. SARS has suffered immensely from governance failures in recent years – to the detriment of staff morale, taxpayer morale and tax revenue collections. We stand wholeheartedly behind Commissioner Kieswetter and his staff in rebuilding this important institution to the high standards it became renowned for internationally.

Thirdly, by spending more effectively and deriving visible value for the revenue that we raise. The developmental impact of our spending legitimises our taxes.

With improvements in these core functions, taxpayer morale will improve naturally.

There are 3 key themes that will be integral to shaping tax policy for our future and the generations who come after us:

1. Inequality

The principle of equity and objective of redistribution are crucial to the design of our tax system. Our personal income tax system, which generates the largest share of tax revenue relative to the other tax instruments, is progressive and based on the ability-to-pay principle. We have gradually been reforming our personal tax expenditures to improve equity. For example, in 2012 we changed medical deductions to medical tax credits so that every taxpaying member of a medical scheme received the same benefit – regardless of their tax bracket. This vastly improved the equity for personal income tax payers – the 1.9 million taxpayers with taxable income below R300 000 who claim medical tax credits.

On the other side, spending should be pro-poor.

A World Bank study[i] found the tax and social spending system in South Africa to be overall progressive, with the spending side being strongly progressive.

But, the authors also point out that while *"fiscal policy is equalizing and poverty-reducing, the levels of inequality and poverty that remain still rank among the highest in middle-income countries."* South Africa desperately needs a higher level of inclusive economic growth.

We still have a lot to do though – we need to grow the economy, and spending should also induce growth in an inclusive manner. There should be opportunities for our people to improve their skills and enter the labour market.

Tax expenditures are often called for to encourage investment and growth. We are in the process of evaluating tax incentives to evaluate whether they are meeting their objectives and to ensure that we get more value for the money spent. We also aim to continually expand our tax expenditure reporting.

It is important to determine how effective tax incentives are at inducing growth in an inclusive manner. In an economy with such high levels of unemployment, we need to question whether we may be encouraging capital deepening at the expense of labour.

2. Sustainability

Decisions we take today have long-lasting impacts, beyond our generation.

Questions of sustainability are essentially pressing us to move the time horizon from the present to the future, so that our decisions now don't create problems for us later.

a) Environmental sustainability

Perhaps the most serious global question today is how to act prudently to ensure that our economic activities are environmentally sustainable. While many adults have considered it a "nice-to-have" thought exercise, it is the number one economic concern for many school-going children, some of whom have joined protests to demand greater action today. Indeed, many view employability as an obsolete question, if environmental sustainability is not achieved.

More than any of our challenges, global cooperation is necessary to ensure effective action is taken, and taken timeously. There are no "free riders" in climate policy – if we fail to change our harmful habits, we will all face the consequences of climate change.

Climate change is the greatest threat facing humankind. South Africa intends to play its role as part of the global effort to reduce greenhouse gas emissions, enabling our country to meet its targets as per the Paris Agreement. For about a decade, a succession of Finance Ministers proposed a Carbon Tax as a mechanism put a price on carbon emissions and give effect to the polluter pays principles. The carbon tax came into effect in June 2019. While the tax is aimed at correcting the market failure by pricing carbon to encourage sustainable decision-making and behaviour, the design is such that adaption activities are favoured. While not well-known, the tax incentives for energy efficiency savings could benefit many enterprises to adapt their processes now.

We pride ourselves on a consultative process for tax policy making, and should endeavour to maintain and improve the openness, fairness and transparency of all fiscal policy processes. But, we should not allow excessive discussions to delay important tax policy reforms.

b) Sustainability of current business practices

A business corporation is a body that combines the efforts and resources of shareholders, managers, workers and consumers to produce goods and services. If the interests of one of these groups are neglected, then the corporation's purpose is surely in question.

Perhaps you noticed last week that the Business Roundtable – a group of nearly 200 CEOs of major US Corporations – said the same. A statement issued last week (19 August) by the Business Roundtable repositions the purpose of corporations beyond the primacy of "shareholder value" toward "value to our customers"; "investing in our employees"; "dealing fairly and ethically with our suppliers"; supporting the communities in which we work"; and "generating long-term value for shareholders".[ii]

South Africa has suffered its fair share of corporate scandals over the last few years – irregular financial statements of Steinhoff and Tongaat; the findings of the provisional report of the Health Market Inquiry on rising health care costs; the looting of VBS bank; irregularities in public sector contracts of EOH; and finally, the litany of allegations of corrupt collusion between consulting firms and public entities evident from the various commission of inquiry. This series of scandals points to a set of unsustainable practices, where people in a position of power place short-run gains over long-run sustainability.

We need to think carefully about whether the tax system promotes this present-bias, through the favourable treatment of some share schemes and debt finance.

3. The Sovereignty of our State

Globalisation means that borders separating sovereign states are becoming less important. People and activities cross borders easily and the tax system must evolve. Laws are based on jurisdiction, which already led to challenges for the tax system a century ago. The result was a complex network of tax treaties to prevent taxpayers experiencing the burden of double taxation.

Unfortunately, globalisation has also provided opportunities for double non-taxation. Taxpayers have been able to use treaties in combination with domestic tax laws to avoid paying tax to any government – while simultaneously making use of public goods (like road, rail and port infrastructure or human capital) paid for by tax revenue in the countries they operate in – because in many cases it was legal to do so.

Spurred on by the fiscal consequences of the Global Financial Recession, many countries became increasingly concerned with protecting their tax bases. Requested by the G20 Finance Ministers and led by the OECD, a lot of progress has been made in closing down these loopholes. South Africa has been actively involved in these debates and has implemented the minimum standards.

However, we need to remain agile and continue to aspire to policy design that is equipped to raise sufficient revenue for our needs. The Base Erosion and Profit Shifting (BEPS) Project did not find answers for the increasing digitisation of our economy. The main finding from the original report is that the digital economy cannot be ring-fenced. It is an integral part of our economy – even for some traditional business models. In the absence of political consensus, we find tussles like those playing out between France and the U.S. with the recently legislated Digital Services Tax.[iii]

In a world of so much uncertainty, how can we provide certainty for taxpayers, as well as certain tax revenue for government to fulfil its social and economic spending needs?

We are a *"sovereign state in the family of nations"* and we need to protect our tax base.

Even so, we need to play our role in advocating for policies that are in our best interest. The current international tax system that relies on transfer pricing for cross-border transactions with connected parties is fraught with difficulties and there are continual disputes – even between tax authorities of developed countries. We are actively engaged in the OECD discussions that are seeking to find solutions for the challenges arising from the digitalisation of the global economy.[iv]

To effectively protect our tax base and the ability of government to provide for our citizens, we need to recognise that *strong tax policy making requires strong institutions* and that *good tax administration is good tax policy*.

Like a table that cannot stand with less than three legs, the success of South Africa's tax policy system and its ability to generate the revenue we require to serve our citizens effectively rests on three important foundations: political leadership, good tax policy design (based on the principles mentioned), and a capable and efficient tax administration. We have recently had a renewal in our political leadership and we are committed to working towards good policy design based on robust analysis. We are equally committed to working with our colleagues at SARS to ensure that we rebuild the trust that has been diminished over time to the detriment of taxpayer morale.

How we address each of these 3 areas is important. We need revenue to realise all of them.

To do so, in addition to good policy design, we are dependent on our colleagues at the South African Revenue Service for helping us to achieve what we envision for our future. The accounting/consulting profession has also struggled with its credibility in recent times. We all have a role to play in striving for better! None of us can forego our collective responsibility to continuing to strive towards a better future.

Do we all want to be part of building our country up again? We have faced many difficulties before and overcome them.

As Mandela liked to remind us – "*It always seems impossible until its done."*

Thank you.

---

[i] Inchauste et. al. (2015), *The Distributional Impacts of Fiscal Policy in South Africa. Available:* http://documents.worldbank.org/curated/en/502441468299632287/pdf/WPS7194.pdf

[ii] The statement is available here: https://opportunity.businessroundtable.org/ourcommitment/

[iii] See, for example, this article from the Financial Times: https://on.ft.com/2P6JZuT

[iv] See the OECD website outlining the current work on the digital economy