4

Tax policy

- Government continues to broaden the tax base, simplify the tax system and, where appropriate, reduce tax rates. The abolition of the retirement fund tax and reforms to the secondary tax on companies, including the proposed move to a dividend tax in the hands of shareholders in 2008 or 2009, are the latest major tax reforms.
- Revenue growth remains buoyant, reflecting continued increases in business profitability, high commodity prices, strong household spending, employment growth and higher salary increases. Due to a rebalancing of the economy away from consumption towards investment, revenue growth is slowing slightly and is expected to moderate further over the medium term. Over the past four years, government has learnt more about the cyclicality of revenue sources, and factors this information into analysis and forecasts.
- It is estimated that tax revenue collections during 2007/08 will exceed the budgeted amount by R9.5 billion, mainly as a result of higher inflation and higher wage settlements, which are reflected in rising personal income tax yields.
- Continued improvements in tax administration and a greater service-oriented approach from the South African Revenue Service (SARS) contribute to rising tax compliance and broader improvements in business accountability and transparency.

Introduction

Collection trends during the first half of the fiscal year suggest a tax revenue overrun of R9.5 billion for 2007/08. This healthy revenue performance is primarily the result of above-inflation wage settlements, increasing employment and sustained levels of profitability in the corporate sector.

Revenue continues to exceed estimates as a result of inflation and cyclical factors

A more modest tax overrun for 2007/08

Although the revised tax revenue estimates for 2007/08 will exceed the February 2007 budgeted figures, the anticipated overrun is more modest than those of the previous three fiscal years. This trend is reflected in consumption-related revenue instruments, such as VAT and the fuel levy, which are expected to be below budget estimates.

Factors contributing to moderation in consumption expenditure include rising interest rates and the implementation of the National Credit Act (2005). As the pattern of economic growth shifts towards higher levels of investment, revenue buoyancy is likely to decline marginally. However, strong commodity prices and higher-than-normal consumption spending imply that some of the revenue growth over the past three years, particularly in company taxes, is probably of a cyclical nature.

Cyclical revenue should either be invested in infrastructure or saved

Sound fiscal policy suggests that cyclical revenue overruns should either be invested in long-term economic or social infrastructure, or saved so that public expenditure growth remains sustainable. It is not prudent to spend cyclical tax revenues on recurrent expenditure or use it to provide tax relief given present conditions of buoyant demand.

Final draft Royalty Bill to be released

One tax policy matter that warrants specific mention is the Mineral and Petroleum Royalty Bill. A third and final draft of the bill will be released by mid-November 2007 for consideration by Parliament's Portfolio Committee on Finance. The new royalty regime is scheduled to start on 1 May 2009 to coincide with the conversion to the new mineral rights regime as required by the Mineral and Petroleum Resources Development Act (2002).

National budget revenue 2006/07

Audited main budget revenue for 2006/07 was R34.8 billion higher than the budget estimate

The audited main budget revenue outcome of R481.2 billion for 2006/07 was R34.8 billion higher than the original budget estimate of R446.4 billion and R5.4 billion higher than the revised estimate of R475.8 billion published in the 2007 *Budget Review*. The main variances in revenue were higher-than-budgeted:

- Income tax of R23.8 billion from the corporate sector
- Personal income tax revenues of R8.1 billion
- VAT collection of R3.3 billion.

The audited main budget revenue outcome for 2006/07 is presented in Table 4.1.

Medium-term revenue estimates

Gross tax revenue for 2007/08 is revised upwards by R9.5 billion

Based on revised macroeconomic projections set out in Chapter 2 and the revenue trends for the first six months of this fiscal year, expected gross tax revenue for 2007/08 is revised upwards by R9.5 billion to R566.1 billion. This is mainly due to extra revenues from personal income tax (R11.7 billion), secondary tax on companies (R2.0 billion) and corporate income tax (R1.6 billion).

Table 4.1 National budget revenue, 2006/07 estimates and audited outcome

R billion	Budget estimate	Revised estimate	Audited outcome	Deviation from Budget estimate	Deviation from Revised estimate
Taxes on income and profits	**245.8**	**274.3**	**280.0**	**34.2**	**5.7**
Persons and individuals	132.5	139.0	140.6	8.1	1.6
Companies	95.2	114.8	119.0	23.8	4.2
Secondary tax on companies	13.9	15.7	15.3	1.4	-0.4
Other[1]	4.3	4.8	5.1	0.8	0.3
Taxes on payroll and workforce	**5.6**	**5.9**	**5.6**	**–**	**-0.3**
Taxes on property	**8.9**	**10.3**	**10.3**	**1.4**	**–**
Domestic taxes on goods and services	**171.9**	**174.7**	**174.6**	**2.7**	**–**
Value-added tax	131.2	134.6	134.5	3.3	-0.1
Specific excise duties	16.6	16.1	16.4	-0.2	0.3
General fuel levy	21.8	21.8	21.8	–	0.1
Other	2.3	2.3	2.0	-0.3	-0.3
Taxes on international trade and transactions	**23.6**	**23.9**	**24.0**	**0.4**	**0.1**
Stamp duties and fees	**1.0**	**0.6**	**0.6**	**-0.3**	**–**
State miscellaneous revenue[2]	**–**	**–**	**0.3**	**0.3**	**0.3**
Total tax revenue	**456.8**	**489.7**	**495.5**	**38.7**	**5.9**
Non-tax revenue and repayments[3]	9.3	11.3	10.9	1.6	-0.5
Less: Estimate of SACU payments	-19.7	-25.2	-25.2	-5.5	–
Main budget revenue	**446.4**	**475.8**	**481.2**	**34.8**	**5.4**

1. Includes tax on retirement funds and interest on overdue income tax.

2. Revenue received by SARS in respect of taxation which could not be allocated to a specific tax instrument.

3. Preliminary outcome.

However, revenues from VAT and the general fuel levy are expected to be R8.1 billion and R0.7 billion respectively below budget estimates. The lower VAT collections result from larger VAT refunds due to higher non-wage input costs, higher levels of fixed investment, and inventory accumulation caused by a moderation in household consumption expenditure.

Revenues from VAT and general fuel levy expected to be below budget estimates

Additional adjustment payments to Southern African Customs Union (SACU) member countries of R1.7 billion in terms of the preliminary outcome of the common revenue pool for 2006/07 raises SACU payments for 2007/08 to R24.7 billion.

Main budget revenue for 2007/08 is expected to increase by R8.5 billion to R553.1 billion. Revised revenue projections for 2007/08 are set out in Table 4.2, along with medium-term projections.

Longer-term tax revenue trends

Nominal gross tax revenue was buoyant during the three fiscal years from 2004/05 to 2006/07. This buoyancy was reflected in strong nominal growth in VAT, corporate income tax and customs revenues.

Table 4.2 National budget revenue, 2006/07 – 2010/11

	2006/07	2007/08			2008/09	2009/10	2010/11
R billion	Audited outcome	Budget estimate	Revised estimate	Deviation	Medium-term estimates		
Taxes on income and profits	**280.0**	**312.2**	**327.3**	**15.1**	**368.1**	**406.5**	**445.5**
Persons and individuals	140.6	155.3	167.0	11.7	192.1	210.3	230.7
Companies	119.0	138.5	140.1	1.6	157.8	176.0	193.6
Secondary tax on companies	15.3	16.0	18.0	2.0	16.0	17.8	18.5
Other[1]	5.1	2.3	2.2	-0.1	2.2	2.4	2.7
Taxes on payroll and workforce	**5.6**	**6.5**	**6.8**	**0.3**	**7.5**	**8.2**	**9.0**
Taxes on property	**10.3**	**11.0**	**12.1**	**1.1**	**13.5**	**14.9**	**16.4**
Domestic taxes on goods and services	**174.6**	**199.2**	**191.1**	**-8.1**	**211.0**	**232.9**	**254.4**
Value-added tax	134.5	155.1	147.0	-8.1	162.4	179.5	195.6
Specific excise duties	16.4	17.8	18.5	0.7	20.4	22.5	25.0
General fuel levy	21.8	23.9	23.2	-0.7	25.6	28.3	31.0
Other	2.0	2.4	2.4	–	2.5	2.7	2.8
Taxes on international trade and transactions	**24.0**	**27.5**	**28.0**	**0.5**	**31.7**	**36.1**	**38.1**
Stamp duties and fees	**0.6**	**0.2**	**0.8**	**0.6**	**0.7**	**0.6**	**0.5**
State miscellaneous revenue[2]	**0.3**	**–**	**–**	**–**	**–**	**–**	**–**
Total tax revenue	**495.5**	**556.6**	**566.1**	**9.5**	**632.4**	**699.3**	**764.0**
Non-tax revenue and repayments[3]	10.9	11.1	11.8	0.7	11.9	12.5	13.3
Less: Estimate of SACU payments[4]	-25.2	-23.1	-24.7	-1.7	-28.4	-32.1	-36.8
Main budget revenue	**481.2**	**544.6**	**553.1**	**8.5**	**616.0**	**679.6**	**740.5**
Percentage of GDP	*26.9%*	*28.1%*	*27.4%*		*27.6%*	*27.6%*	*27.2%*
Changes from 2007 Budget							
Total tax revenue			9.5		25.5	39.5	
Main budget revenue			8.5		24.8	38.1	

1. Includes tax on retirement funds, interest on overdue income tax and small business tax amnesty.

2. Revenue received by SARS in respect of taxation which could not be allocated to a specific tax instrument.

3. Preliminary outcome.

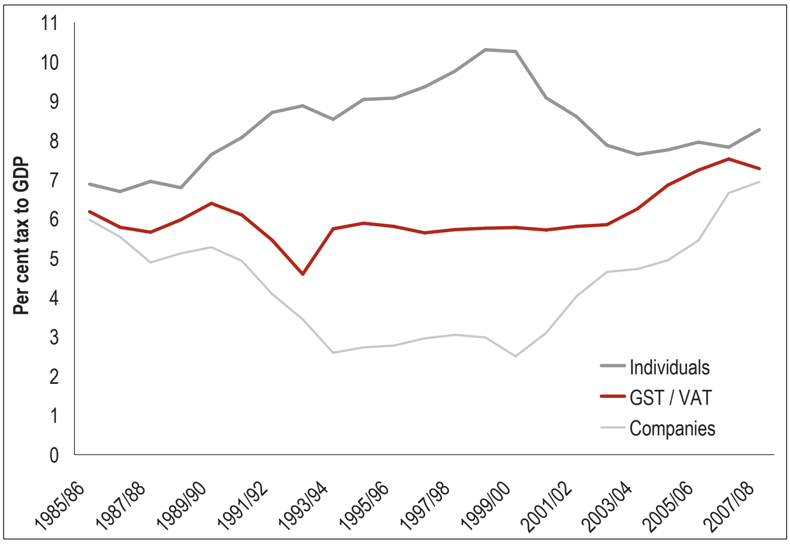
4. The revised estimate for 2007/08 includes adjustment payments to SACU member countries.

The three main tax instruments – personal income tax (individuals and unincorporated businesses), VAT and corporate income tax – account for nearly 80 per cent of total budget revenue. The next three important sources of tax revenues are the general fuel levy, excise duties and customs duties, which together make up between 12 and 14 per cent of budget revenue.

Corporate tax as a share of GDP is trending upward

The ratio of corporate income tax revenues to GDP decreased from 6 per cent in 1985/86 to a low of 2.5 per cent in 1999/00, and has since increased to nearly 7 per cent. Tax reforms accompanied by substantial improvements in tax administration and robust economic growth have supported this rise in the share of corporate taxes.

Figure 4.1 Tax to GDP ratio, 1985/86 – 2007/08



The improved corporate revenue performance was accompanied by a gradual reduction in the headline corporate tax rate, from 48 per cent in 1993/94 to 30 per cent in 2000/01 and to 29 per cent in 2005/06.

Ratio of tax from individuals has been declining, but may rise in 2007/08

The ratio of tax revenues from individuals (including unincorporated businesses) to GDP increased from 6.9 per cent in 1985/86 to a high of 10.3 per cent in 1999/00, and subsequently decreased to 7.8 per cent in 2006/07. The decrease in this ratio is the result of substantial tax relief provided to individuals over the past seven years. However, this ratio is expected to increase to 8.3 per cent in 2007/08, largely due to above-inflation wage settlements and improved tax compliance.

The ratio of VAT revenue to GDP was relatively stable at about 5.8 per cent during the decade between 1993/94 and 2002/03. This ratio increased to a high of 7.5 per cent in 2006/07, despite the fact that the standard VAT rate remained unchanged at 14 per cent.

VAT revenue robust, but likely to moderate

Factors contributing to this improved VAT revenue performance include improved efficiency at SARS, robust growth in consumption expenditure, and a shift in consumption expenditure towards non-zero rated non-zero-rated goods and services such as cellphones. Given that some of the increased consumption expenditure over the past three years should be ascribed to cyclical factors, it is expected that the increase in VAT revenues will moderate over the near term.

Over the period ahead VAT as a share of GDP is likely to stabilise. It is also expected that corporate income tax will slow over the short term in certain sectors, such as mining, where investment is rising. These trends are not likely to affect the sustainability of the fiscal position. They do, however, strengthen the case for taking greater account of the cyclicality in revenue in the fiscal stance.

Outcome of the small business tax amnesty

The small business tax amnesty announced in the 2006 Budget provided small businesses with a turnover of R10 million or less in 2006 with an opportunity to regularise their tax affairs. The amnesty process was also aimed at broadening the tax base, improving the culture of tax compliance and facilitating the entry of small businesses into the formal economy.

The application period opened on 1 August 2006 and closed on 30 June 2007. SARS received a total of 353 388 applications, of which 298 814 were for amnesty and 54 574 were for the waiver of additional taxes, penalties and interest. The taxi industry contributed 24 174 applications. Initial analysis of the amnesty applications indicates that about 22 per cent of the applicants are new registrants.

Subsequent to the amnesty, SARS stepped up its enforcement efforts. Targeted enforcement resulted in the issue of more than 200 arrest warrants, nearly 1 000 summonses and the collection of more than R70 million through writs of execution.

Conclusion

South Africa is on the road to improved tax morality and compliance

South Africa’s tax policy continues to emphasise the need for a broader tax base, simplicity in the tax system and high service levels in tax administration. This combination is the most likely route to improved tax morality and compliance.

We are also ever mindful of the role that tax administration can play to support small businesses and, ultimately, more rapid economic growth.

Where base-broadening efforts and improved efficiency lead to higher revenue, government will endeavour to continue to lower tax rates. However, revenue growth that results from cyclical factors should neither be spent on recurrent items nor provided in tax relief given the present buoyant demand conditions.

Government is obtaining a greater understanding of the relationship between a host of economic variables and revenue collection. This growing understanding will inform both fiscal policy and tax policy in the years ahead.