B

Tax expenditure statement

Introduction

The primary aim of the tax system is to raise sufficient revenue for government spending. It can also promote socioeconomic objectives through targeted tax exemptions, deductions or credits. Tax expenditures are estimates of the total revenue foregone as a result of this preferential tax treatment. This annexure presents government's latest estimates of the fiscal cost of tax expenditures, as well as the methodology used to produce these estimates.

Tax expenditure documents promote transparency and accountability. They help government and the public assess the costs, benefits and overall effectiveness of this expenditure. The National Treasury has enhanced its tax expenditure reporting and evaluation in recent years by adding several new expenditure estimates based on tax administrative data. Including more estimates and improving evaluation methodologies will largely depend on the availability of quality data.

In 2018/19 – the latest year for which data is available – tax expenditures were estimated at R249 billion or 5.1 per cent of GDP. For that year, 35 tax expenditures were calculated compared to 34 in 2015/16, and the largest five expenditures accounted for more than half of the total. These relate to deductions for employers' pension contributions, vehicle manufacturer incentives, value-added tax (VAT) relief for basic food items and petrol fuel sales, and medical tax credits on contributions to medical schemes.

Tax expenditure estimates

The estimates presented in Table B.3 are calculated using the "revenue foregone" method. This entails comparing actual revenue collections with revenue that would have been collected without the incentive in place.

Most of the personal income tax and corporate income tax estimates are calculated using administrative data from the South African Revenue Service (SARS), which allows expenditure estimates to be accounted for on an accrual basis.

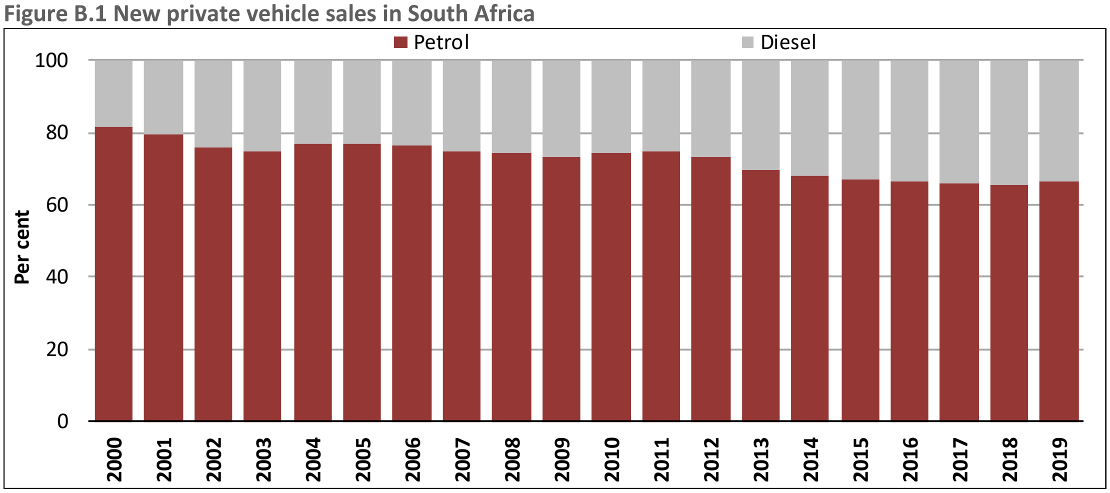
Changes to estimation methods since the 2020 Budget

The most significant change to the tax expenditure methodology since the 2020 Budget relates to the calculation of expenditure estimates for VAT zero-rated fuel levy goods. VAT zero-rating in this context means the supplies of petrol and diesel purchased by private consumers and businesses are levied VAT at 0 per cent instead of 15 per cent.

Fuel purchases used for private purposes represent a significant share of the total tax expenditure, as VAT input credits cannot be claimed, unlike for commercial purchases. An increase in private diesel-fuelled vehicle sales has necessitated a change in the tax expenditure formula used to calculate the revenue foregone.

Analysis of data from the National Association of Automobile Manufacturers of South Africa (NAAMSA) indicates that the market share of vehicle types sold in South Africa has changed significantly over time (see Figure B.1), in line with international trends. Consumer preferences have been shifting in favour of diesel- rather than petrol-fuelled vehicles for private use. Since 2000, new diesel-fuelled vehicle sales increased by 15 percentage points, reaching 33 per cent in 2019.

Figure B.1 New private vehicle sales in South Africa



Source: NAAMSA

The analysis shows that the fuel use by private diesel vehicles can no longer remain at 10 per cent as assumed in the previous VAT zero-rating tax expenditure formula for fuel levy goods. As such, the formula has been changed to more accurately represent the current market structure of at least 30 per cent for private diesel-fuelled vehicle sales since 2013.

Since 2005/06, the tax expenditure formula has always assumed that 20 per cent of petrol sales and 90 per cent of diesel sales are for business purposes by VAT vendors, and would have qualified for VAT input credits. Therefore, the foregone revenue was based on the assumed market share of 80 per cent for petrol-fuelled vehicles and 10 per cent for diesel-fuelled vehicles, respectively.

These assumptions underlying the formula have been amended, with an increase in the private diesel portion of fuel use from 10 per cent to 30 per cent from 2013/14. The higher share of diesel-fuelled vehicles increases the amount of foregone revenue on diesel fuel sales. As shown in Table B.1, this increases the total diesel fuel tax expenditures between 2015/16 and 2018/19 by about 200 per cent.

Table B.1 Diesel fuel tax expenditure estimates

R million	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Share of private diesel fuel use						
10 per cent	2 101	2 146	1 911	1 842	2 049	2 696
30 per cent	6 304	6 437	5 733	5 525	6 147	8 089

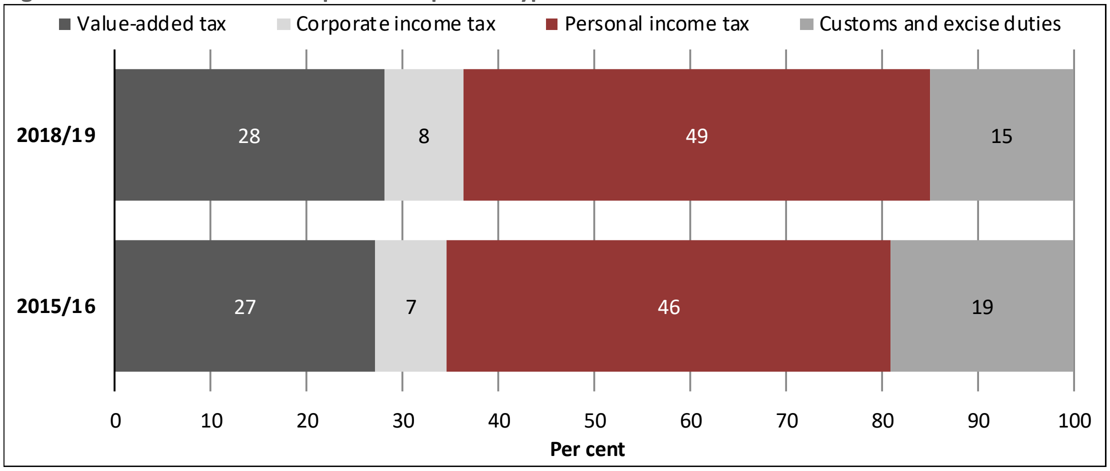
Source: National Treasury

More accurate data and estimation methodologies have prompted revisions to the historical tax expenditure estimates in Table B.3. For example, estimates for the tax expenditure on donations for 2015/16 to 2018/19 were revised after a calculation error was discovered in 2020.

Trends in tax expenditure: 2015/16 – 2018/19

This section uses historical data to analyse trends in tax expenditure between 2015/16 and 2018/19. The total value of tax expenditures grew by R54 billion or 6.3 per cent over the period, which exceeds nominal GDP growth of 4.5 per cent. As a result, tax expenditures increased as a share of nominal GDP, reaching 5.1 per cent by the end of the period.

Figure B.2 Share of total tax expenditure per tax type



Source: National Treasury

Compared with the 2020 Budget, expenditure estimates for employers' pension and provident fund contributions were revised upwards by about R11 billion for 2016/17. This is likely due to salary restructuring in light of changes made to the personal income tax system in 2016, and the inclusion of additional assessments filed after the deadline. Personal income tax expenditures accounted for just under half of total tax expenditures in 2018/19.

VAT expenditures grew by 7.1 per cent between 2015/16 and 2018/19 on a compound annual basis. This significant increase in the cost of VAT relief was primarily due to the 1 percentage point increase in the VAT rate in 2018, along with moderate growth in household consumption expenditure. Compared with 2020 Budget estimates, VAT expenditures were on average 7.5 per cent higher between 2015/16 and 2017/18 due to the change in the VAT zero-rating formula for fuel levy goods.

The majority of corporate tax expenditures trended downwards between 2015/16 and 2018/19, in line with slowing economic activity. Its share of total tax expenditure increased, however, as participation exemption expenditures more than doubled in 2018/19, primarily due to one large claim.

Evaluation of tax expenditures

Government views the monitoring and evaluation of tax expenditures as an important component of ensuring transparency and accountability. As recommended by the Davis Tax Committee, government is systematically reviewing all business tax incentives in order to repeal those that are redundant, inefficient or inequitable.

During 2020, sunset clauses – or end dates – were included for the tax incentives presented in Table B.2. Barring section 12O, none of these incentives previously had sunset dates. Without end dates, tax incentives become entrenched in the tax system, while often not being evaluated regularly to determine their efficacy.

Table B.2 Tax expenditures to lapse in 2022

Income Tax Act	Effective date	Current deduction	Number of beneficiaries and tax expenditure (R million) 2014/15	2015/16	2016/17	2017/18	2018/19	Sunset date
Section 12F	01/01/01	5% for 20 years	< 10 146.4	< 10 157.3	10 173.8	10 210.4	< 10 220.2	28/02/2022
Section 12DA	01/01/08	20% for 5 years	< 10 9.6	< 5 0.1	< 5 2 726.1	< 10 2 756.1	< 5 2 693.7	28/02/2022
Section 13*sept*	21/10/08	10% for 10 years	< 10 0.79	< 10 0.56	< 5 0.42	10 1.29	< 10 1.64	28/02/2022
Section 12O	01/01/12	Exemption	< 10 13.9	< 10 13.2	< 10 16.2	< 10 5.6	< 5 0.1	01/01/2022

Source: National Treasury

As part of the review of the incentives listed in Table B.2, stakeholders are invited to motivate why these incentives should not be allowed to lapse on reaching their respective sunset dates. These motivations should be submitted to the National Treasury by 31 March 2021.

In 2021, tax incentive reviews will continue for:

- *Section 11D (research and development)* – Introduced in 2006, the research and development tax incentive provides government support to reduce the cost of research and development for private companies. The public is encouraged to provide comment on a joint discussion paper to be released by the National Treasury and the Department of Science and Innovation during 2021.
- *Section 13quat (urban development zones)* – The urban development zones tax incentive was introduced in 2003 to encourage property investment in the central business districts of 16 designated municipalities. Its main objective is to promote urban renewal by stimulating investment in the construction and renovation of commercial and low-cost residential buildings. The incentive will be extended for a further two years beyond its current sunset date of 31 March 2021 as the review process continues. Stakeholders will be invited to answer a questionnaire in 2021.

The review process for *section 12J (venture capital companies)* has concluded. Government introduced the venture capital company tax incentive in 2008 to encourage the establishment and growth of small, medium and micro enterprises. The incentive aims to help them obtain funding that would otherwise not be available. Taxpayers investing in a venture capital company are allowed an upfront deduction for their investment, whereas most equity investments are not tax deductible.

The National Treasury has determined that the incentive has not adequately achieved its objectives. The incentive has instead provided a generous tax deduction to wealthy taxpayers and most support has gone to low-risk ventures that would have attracted funding without the incentive. The incentive will therefore not be extended beyond its current sunset date of 30 June 2021.

Table B.3 Tax expenditure estimates

R million	2015/16	2016/17	2017/18	2018/19
Personal income tax				
Retirement fund contributions[1]	59 587	87 187	80 450	87 290
Pension contributions – employees	*14 391*	*16 018*	*17 626*	*18 962*
Pension contributions – employers	*26 348*	*34 474*	*32 018*	*34 825*
Provident contributions – employees	–	*4 066*	*4 645*	*5 202*
Provident contributions – employers	*11 129*	*17 744*	*13 528*	*15 751*
Retirement annuity	*7 719*	*14 885*	*12 633*	*12 550*
Medical	23 860	26 296	27 631	25 021
Medical tax credits on contributions	*19 384*	*20 978*	*21 661*	*18 698*
Medical tax credits on out-of-pocket expenditure	*4 476*	*5 318*	*5 970*	*6 323*
Interest exemptions	2 846	3 269	3 409	3 363
Secondary rebate (65 years and older)	2 881	3 361	3 273	3 504
Tertiary rebate (75 years and older)	252	322	295	318
Donations	261	318	357	366
Capital gains tax (annual exclusion)	536	696	656	482
Venture capital companies	263	309	538	745
Total personal income tax	**90 485**	**121 758**	**116 609**	**121 089**
Corporate income tax				
Small business corporation tax savings	2 900	3 008	3 014	2 420
Reduced headline rate	*2 856*	*2 964*	*2 969*	*2 386*
Section 12E depreciation allowance	*44*	*44*	*45*	*34*
Research and development	277	233	262	172
Learnership allowances	1 072	1 079	717	442
Strategic industrial projects (12I)	461	693	599	344
Film incentive[2]	12	15	5	0
Urban development zones	259	276	314	205
Employment tax incentive	4 314	4 656	4 317	4 512
Energy-efficiency savings	1 058	1 201	600	1 804
Participation exemption[3]	4 198	5 483	5 094	11 010
Total corporate income tax	**14 551**	**16 644**	**14 923**	**20 909**

Table B.3 Tax expenditure estimates *(continued)*

R million	2015/16	2016/17	2017/18	2018/19
Value-added tax				
Zero-rated supplies	51 763	54 204	58 352	68 345
19 basic food items [4]	*22 793*	*24 411*	*26 023*	*29 390*
Petrol [5]	*15 901*	*16 150*	*17 080*	*20 259*
Diesel [5]	*5 733*	*5 525*	*6 147*	*8 089*
Paraffin [5]	*536*	*569*	*665*	*931*
Municipal property rates	*6 567*	*7 285*	*8 130*	*9 342*
Reduced inclusion rate for commercial accommodation	*233*	*263*	*307*	*334*
Exempt supplies (public transport and education)	1 332	1 426	1 520	1 603
Total value-added tax	**53 095**	**55 630**	**59 872**	**69 947**
Customs duties and excise				
Motor vehicles (MIDP/APDP, including IRCCs)[6]	26 936	28 362	28 754	31 250
Textile and clothing (duty credits – DCCs)[6]	788	725	712	734
Furniture and fixtures	217	181	198	178
Other customs[7]	1 040	963	875	600
Diesel refund[8]	8 175	3 762	2 165	4 623
Total customs and excise	**37 156**	**33 993**	**32 704**	**37 385**
Total tax expenditure	**195 287**	**228 025**	**224 108**	**249 330**
Tax expenditure as % of total gross tax revenue	**18.3%**	**19.9%**	**18.4%**	**19.4%**
Total gross tax revenue	**1 069 983**	**1 144 081**	**1 216 464**	**1 287 690**
Tax expenditure as % of GDP	**4.7%**	**5.2%**	**4.8%**	**5.1%**

1. Some of this tax expenditure is recouped when amounts are withdrawn as either a lump sum or an annuity. From 2016/17 onwards provident fund employee contributions became deductible and a higher percentage contribution for all retirement funds was allowed, alongside a monetary cap of R350 000. The estimate for the tax expenditure of provident fund employer contributions (for all years) was included for the first time in the 2019 Budget
2.Tax expenditure for all years is attributable to allowances under section 24F and exemptions under section 12O
3. Tax expenditure only attributable to foreign dividends. Capital gains tax on share sales not included
4. VAT relief in respect of basic food items based on 2010/11 Income and Expenditure Survey data
5. Based on fuel volumes and average retail selling prices
6. Motor Industry Development Programme (MIDP), replaced in 2013 by the Automotive Production Development Programme (APDP); import rebate credit certificate (IRCC); duty credit certificate (DCC)
7. Goods manufactured exclusively for exports, television monitors and agricultural goods exempted
8. Diesel refund previously offset against domestic VAT has been added
Source: National Treasury