B

Tax expenditure statement

Introduction

The primary aim of the tax system is to generate sufficient revenue to support government's funding priorities. By providing relief to taxpayers via targeted tax exemptions, deductions or credits, government also encourages socio-economic development. Tax expenditures are estimates of the 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 to assess the costs, benefits and overall effectiveness of this expenditure. The National Treasury aims to enhance its tax expenditure reporting in future, depending, to a large extent, on the availability of quality data.

In 2016/17 – the latest year for which data is available – tax expenditures were estimated at R209 billion or 4.7 per cent of GDP. For 2016/17, 33 tax expenditures were estimated compared to 32 for 2013/14, and the largest four expenditures accounted for more than half of the total. These relate to deductions for pension contributions by employers, vehicle manufacturer incentives, medical tax credits and value-added tax (VAT) relief for basic food items.

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 incentives 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). This allows expenditure estimates to be accounted for on an accrual basis.

Changes to estimation methods since the 2018 Budget

The most significant changes to the tax expenditure methodology since the 2018 Budget relate to the calculation of expenditure estimates for retirement fund contributions.

From 1 March 2016, the tax treatment of pension fund, provident fund and retirement annuity fund contributions was harmonised. As a result, retirement fund contributions are deductible up to either 27.5 per cent of gross remuneration or R350 000 per tax year. Employee contributions to provident funds became deductible and employer contributions were treated as though they were made by the employee and taxed as a fringe benefit. For the first time, SARS tax returns included accurate data on employer contributions.

This new data allows more accurate calculation of the tax expenditure for retirement fund contributions. The tax expenditure statement now includes provident fund employer contributions and the adjusted expenditure estimates of employer-provided contributions to pension funds. As a result, previous estimates have been revised significantly higher.

Compared to the revised 2015/16 estimates, the personal income tax expenditure estimates for 2016/17 show a marked increase for two main reasons: employee provident fund contributions have become deductible and the allowable deduction for retirement annuity contributions has increased. The estimates, however, do not include the tax that is eventually paid on withdrawals or annuity payments arising from the contributions that received a deduction. The figures thus overestimate the true tax expenditure as they only reflect the upfront tax deduction.

More accurate data and estimation methodologies have prompted revisions to the historical tax expenditures estimates in Table B.3. For the first time, tax expenditure estimates are published for the venture capital company tax incentive that was introduced in 2008 through section 12J of the Income Tax Act (1962). These estimates are included from 2014/15. In addition, expenditure estimates for the energy-efficiency savings tax incentive, introduced in 2013 through section 12L of the Income Tax Act, are included from 2013/14.

Venture capital company tax expenditure

The venture capital company tax incentive increases funding to support small businesses, create jobs, and grow the economy. It allows taxpayers to deduct their investment into a venture capital company from their taxable income for that year of assessment. The venture capital company must then invest in qualifying companies (generally small businesses) for at least five years, otherwise the tax deduction will be recouped.

The fiscal cost of this deduction is partially offset through capital gains tax when the taxpayer disposes of the investment. To estimate the tax expenditure accurately, these two events should be reconciled.

When the taxpayer disposes of the investment, he or she is liable for capital gains tax where, for tax purposes, the base cost of the asset is assumed to be zero. In this tax incentive, capital gains tax is calculated on two levels: first, on the venture capital company, and second, on the qualifying company. As a result, the effective capital gains tax rate is higher than for a direct investment. If the taxpayer is in the 45 per cent marginal tax bracket, then the capital gains tax rate will exceed 36 per cent.

Table B.1 Comparing direct investments with venture capital company investments[1]

	Direct investment	Venture capital company investment
Initial investment	No tax deduction	Tax deduction at 45 per cent
Upon disposal	CGT at maximum 18 per cent	CGT on base cost of zero, and on two levels
	Can exit anytime	ETR > 36 per cent
		Can only exit after 5 years
Overall	Not compensated for risk	Compensated for risk
	Overall lower ROE and higher overall ETR	Lower ETR and higher ROE
	Cheaper to exit, with more flexibility	Less flexible and more expensive to exit

1. Assumption: Taxpayer in 45 per cent marginal tax bracket. CGT = capital gains tax; ROE = return on equity; ETR = effective tax rate

Source: National Treasury

As Table B.2 indicates, over 80 per cent of the tax expenditure accrues to taxpayers who have a taxable income before the venture capital company deduction of more than R1 million. There are a small number of taxpayers in these income brackets due to some very large single investments. The majority of taxpayers benefiting from the incentive are in the lower income tax brackets and they contribute modestly to overall tax expenditure. This incentive is due to expire in June 2021. It will be evaluated in line with its objectives during 2019/20.

Table B.2 Venture capital company tax expenditures by taxable income in 2016/17

Taxable income before 12J deduction (R thousands)	Tax expenditure (R million)	Number of taxpayers
50 - 100	0.7	319
100 - 150	8.0	1 326
150 - 200	9.3	1 198
200 - 300	8.3	823
300 - 400	3.0	249
400 - 500	1.7	88
500 - 750	3.0	74
750 - 1 000	3.5	39
1 000 - 2 000	16.7	95
2 000 - 5 000	48.8	110
5 000 +	93.1	61

Source: National Treasury

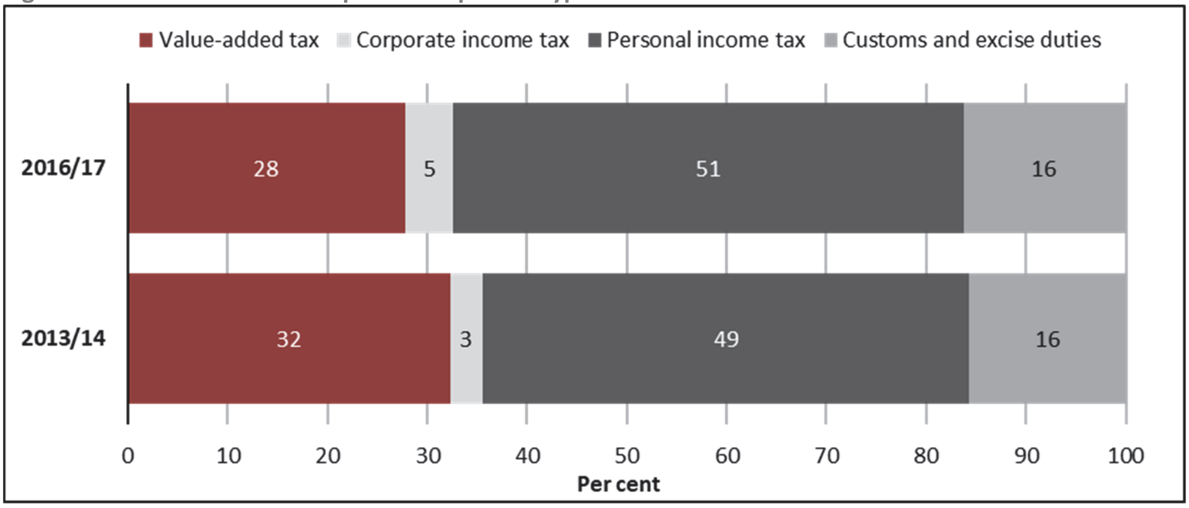
Energy-efficiency savings tax expenditure

The section 12L energy-efficiency savings tax incentive complements government's proposed carbon tax by supporting low-carbon technologies. Businesses can claim deductions against their taxable income for verified energy-efficiency savings achieved at a rate of 95c per kilowatt hour. The South African National Energy Development Institute monitors and endorses energy-efficiency savings claims by issuing certificates to compliant taxpayers. To estimate the tax expenditure, the value of the deduction is multiplied by the headline corporate income tax rate (currently 28 per cent).

Trends in tax expenditure: 2013/14 – 2016/17

This section uses historical data to analyse trends in tax expenditure between 2013/14 and 2016/17. Including the new estimates for provident fund contributions, and the venture capital company and energy-efficiency savings tax incentives, 33 tax expenditures were estimated for 2016/17.

Figure B.1 Share of total tax expenditure per tax type

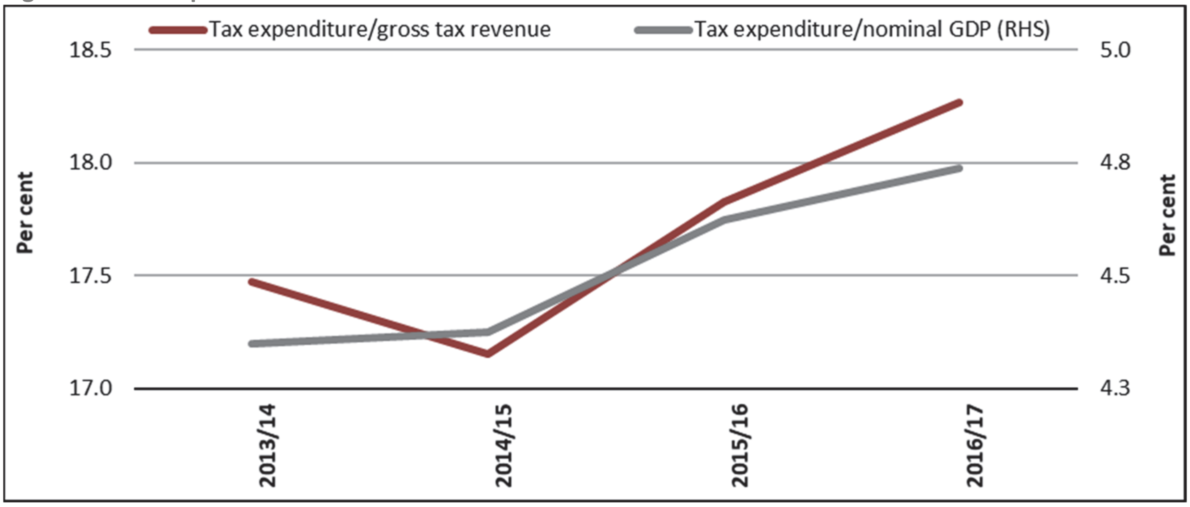


Source: National Treasury

Figure B.1 compares the breakdown of tax expenditures between 2013/14 and 2016/17. Personal income tax and VAT expenditures together accounted for about 80 per cent of the total in both periods. Personal income tax expenditures increased as a share of the total mainly due to the introduction of employer and employee provident fund contributions, and the significant upward adjustment in the estimates for employer-provided contributions to pension funds. The employment tax incentive also contributed to higher expenditures in corporate income tax over the same period.

The total value of tax expenditures grew by R52 billion or 7.4 per cent between 2013/14 and 2016/17, which exceeds nominal GDP growth of 5.1 per cent over the period. As a result, Figure B.2 shows an increasing share of tax expenditures to nominal GDP. This growth was largely a result of revisions to the tax expenditure estimates for pension and retirement annuity contributions and the inclusion of provident contributions. The addition of the energy-efficiency savings tax expenditures also contributed to the growth, although to a lesser extent. Compared with the 2018 Budget, the average share of tax expenditures to nominal GDP increased significantly, implying much higher foregone revenue.

Figure B.2 Tax expenditure as a share of tax revenues and nominal GDP



Source: National Treasury

Evaluation of tax expenditures

Government continues to monitor and evaluate tax incentives to prevent wasteful spending. SARS administrative data estimates the cost of tax incentives more accurately, which allows government to ensure that it is achieving its objectives as expenditures continue to grow relative to GDP.

Table B.3 Tax expenditure estimates

R million	2013/14	2014/15	2015/16	2016/17
Personal income tax				
Retirement fund contributions[1]	49 418	53 707	58 980	72 991
Pension contributions – employees	*11 999*	*13 019*	*14 363*	*15 579*
Pension contributions – employers	*22 010*	*23 882*	*26 348*	*28 578*
Provident contributions – employees	–	–	–	*3 928*
Provident contributions – employers	*9 297*	*10 087*	*11 129*	*12 071*
Retirement annuity	*6 113*	*6 718*	*7 141*	*12 835*
Medical	21 874	19 341	22 297	27 051
Medical contributions & deductions	*4 313*	–	–	–
Medical tax credits [2]	*17 561*	*19 341*	*22 297*	*27 051*
Interest exemptions	2 216	2 458	2 762	2 987
Secondary rebate (65 years and older)	1 716	1 748	1 939	2 041
Tertiary rebate (75 years and older)	153	160	178	188
Donations	825	965	691	737
Capital gains tax (annual exclusion)	397	474	510	591
Venture capital companies	–	26	208	196
Total personal income tax	**76 599**	**78 878**	**87 565**	**106 782**
Corporate income tax				
Small business corporation tax savings	2 423	2 556	2 669	2 329
Reduced headline rate	*2 391*	*2 523*	*2 626*	*2 293*
Section 12E depreciation allowance	*32*	*33*	*42*	*36*
Research and development	219	209	268	218
Learnership allowances	912	949	990	926
Strategic industrial projects (12I)	473	423	479	693
Film incentive[3]	36	13	5	5
Urban development zones	299	232	257	126
Employment tax incentive	140	2 420	4 063	4 656
Energy-efficiency savings	690	128	974	1 070
Total corporate income tax	**5 192**	**6 930**	**9 706**	**10 022**
Value-added tax				
Zero-rated supplies	49 611	51 123	55 013	56 783
19 basic food items [4]	*20 107*	*21 503*	*22 793*	*24 411*
Petrol [5]	*16 276*	*16 065*	*15 901*	*16 150*
Diesel [5]	*2 101*	*2 146*	*1 911*	*1 842*
Paraffin [5]	*702*	*659*	*536*	*569*
Municipal property rates	*10 209*	*10 522*	*13 639*	*13 548*
Reduced inclusion rate for commercial accommodation	*216*	*228*	*233*	*263*
Exempt supplies (public transport and education)	1 175	1 256	1 332	1 426
Total value-added tax	**50 786**	**52 379**	**56 345**	**58 210**
Customs duties and excise				
Motor vehicles (MIDP/APDP, including IRCCs)[6]	18 415	23 467	26 936	28 362
Textile and clothing (duty credits – DCCs)[6]	468	539	788	725
Furniture and fixtures	156	180	217	181
Other customs[7]	665	911	1 040	963
Diesel refund[8]	4 955	5 870	8 175	3 762
Total customs and excise	**24 659**	**30 967**	**37 156**	**33 993**
Total tax expenditure	**157 237**	**169 155**	**190 772**	**209 007**
Tax expenditure as % of total gross tax revenue	**17.5%**	**17.2%**	**17.8%**	**18.3%**
Total gross tax revenue	**900 015**	**986 295**	**1 069 983**	**1 144 081**
Tax expenditure as % of GDP	**4.4%**	**4.4%**	**4.6%**	**4.7%**

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) is included for the first time this year.
2. Medical credits were introduced in 2012/13 to replace income tax deductions for medical scheme contributions
3.Tax expenditure for all years is attributable to allowances under section 24F and exemptions under section 12O
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 Automative Production Development Programme (APDP); import rebate credit certificate (IRCC); duty credit certificates (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

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