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. The 2022 Budget presents selected tax expenditures on a sectoral basis for the first time. Two corporate tax expenditures are included: the research and development (R&D) tax incentive and the participation exemption.

In 2019/20 – the latest year for which data is available – tax expenditures were estimated at R268.3 billion or 4.7 per cent of GDP. For that year, 35 tax expenditures were calculated, as in 2018/19, and the largest five expenditures accounted for more than half of the total. These relate to deductions for employers' and employees' pension contributions, vehicle manufacturer incentives, value-added tax (VAT) relief for basic items, and medical tax credits on contributions to medical schemes.

Tax expenditure estimates

The estimates presented in tables B.1 and B.2 are calculated using the "revenue foregone" method. This entails comparing actual revenue collections with the revenue that would have been collected without the incentive in place.

The revenue foregone approach assumes that taxpayers do not change their behaviour in response to a tax expenditure being withdrawn. In reality, behaviour is likely to change if an incentive is withdrawn, so the additional revenue collected may be less than estimated.

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 2021 Budget

The diesel refund tax expenditure estimates were understated in the 2021 Budget because they did not include the diesel refund previously offset against domestic VAT. This has been updated and estimates in the 2022 Budget are correctly reflected over the reporting period.

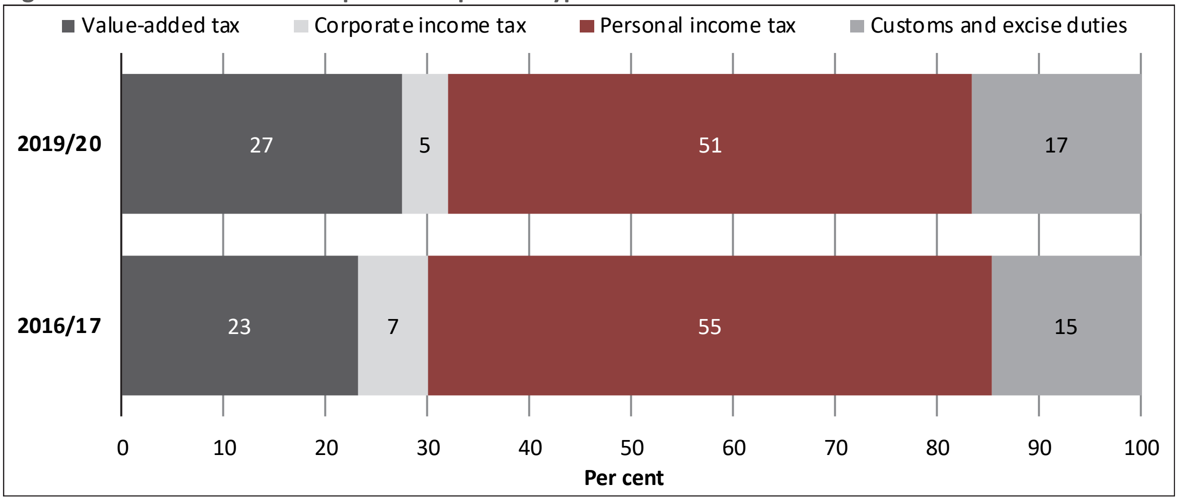
Following the 1 percentage point increase in the VAT rate on 1 April 2018, and the recommendations of the panel of experts appointed to review the list of VAT zero-rated items, government expanded the list to include white bread flour, cake flour and sanitary towels. This was intended to mitigate the effect of the rate increase on low-income households, and had an estimated cost of R852 million in 2018 prices. The revenue forgone on these items is included from the 2019/20 estimate for VAT zero-rated basic items.

More accurate data and estimation methodologies have prompted revisions to the historical tax expenditure estimates in Table B.2.

Trends in tax expenditure: 2016/17 – 2019/20

This section uses historical data to analyse trends in tax expenditure at an aggregate level between 2016/17 and 2019/20. The total value of tax expenditures grew by R28 billion or 2.8 per cent over the period, which is below nominal GDP growth of 4.2 per cent. As a result, tax expenditures decreased as a share of nominal GDP, reaching 4.7 per cent by the end of the period.

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



Source: National Treasury

Sectoral trends in tax expenditure: 2016/17 – 2019/20

The SARS tax administrative data is aligned with the Standard Industrial Classification, rather than SARS sector codes, for the sectoral analysis.

Table B.1 Selected corporate tax expenditure estimates by sector

R million	2016/17	2017/18	2018/19	2019/20
Research and development	**234**	**266**	**279**	**119**
Manufacturing	123	128	144	57
Financial intermediation, insurance, real estate and business services	42	41	41	27
Agriculture, hunting, forestry and fishing	22	35	27	12
Community, social and personal services	17	24	18	5
Mining and quarrying	14	23	30	0
Other	16	15	19	18
Participation exemption	**5 544**	**8 383**	**16 259**	**4 172**
Financial intermediation, insurance, real estate and business services	3 684	3 725	11 951	3 234
Transport, storage and communication	647	2 298	1 557	17
Mining and quarrying	868	1 431	1 364	256
Wholesale and retail trade, repair of motor vehicles, motorcycles, and personal and household goods, catering and accommodation	21	60	584	141
Manufacturing	197	456	514	149
Other	127	412	288	375

Source: National Treasury

Research and development tax incentive (section 11D of the Income Tax Act (1962))

The R&D tax incentive provides a 150 per cent deduction for expenditure on eligible scientific or technological R&D undertaken by companies in South Africa. Its objective is to encourage private-sector companies to invest in R&D. Table B.1 shows the five sectors that received the largest R&D tax expenditures between 2016/17 and 2019/20.

Roughly half of the total R&D tax expenditure has supported the manufacturing sector over this period. The large share of support directed towards manufacturing, and to a lesser extent to the agricultural sector, shows that this incentive encourages R&D within sectors that are important for creating jobs. An average of 291 taxpayers received the benefit of the R&D tax incentive for the first three fiscal years presented (the latest year has a low level of assessment). Of these, 101 taxpayers are from the manufacturing sector; 68 from the financial intermediation, insurance, real estate and business services sector; and 50 from the agricultural sector.

Participation exemption in terms of foreign dividends and share sales (section 10B(2) of the Income Tax Act)

Table B.1 shows the five sectors that benefited most from the participation exemption between 2016/17 and 2019/20. To qualify for the exemption, a resident company (or group of companies) must hold at least 10 per cent of the total equity shares and voting rights of the company declaring the foreign dividend. The exemption is intended to encourage the repatriation of dividends and prevent economic double taxation – for example, if dividend withholding tax is due in the foreign country. Qualifying companies are also exempt from capital gains tax on the sale of shares.

Annexure B of the 2020 *Budget Review* explains how the tax expenditure for the participation exemption is calculated. The numbers reported here relate solely to the exempt foreign dividend element, as there is not enough information to publish the tax expenditure associated with the capital gains tax exemption.

The financial sector benefits the most from this exemption, with a significant increase in 2018/19. An average of 1 147 taxpayers received the benefit of the participation exemption for the first three fiscal years presented (the latest year has a low level of assessment). Of these, 778 taxpayers are from the financial intermediation, insurance, real estate and business services sector; 85 from the community, social and personal services sector; 80 from the manufacturing sector; 67 from the wholesale sector; 23 from the transport sector; and 11 from the mining sector.

The 2020 Budget reported a lower number of taxpayers using the participation exemption as that assessment was based on the number of taxpayers that responded affirmatively to the participation exemption question in the SARS company tax form. Since then, the numbers have been updated based on the number of taxpayers that reported amounts larger than zero for this exemption on the form.

Table B.2 Tax expenditure estimates

R million	2016/17	2017/18	2018/19	2019/20
Personal income tax				
Retirement fund contributions[1]	93 622	86 030	91 238	94 122
Pension contributions – employees	*21 212*	*21 511*	*21 780*	*20 778*
Pension contributions – employers	*34 825*	*32 474*	*35 296*	*36 690*
Provident contributions – employees	*4 409*	*4 954*	*5 546*	*6 630*
Provident contributions – employers	*17 556*	*13 389*	*14 801*	*15 706*
Retirement annuity	*15 620*	*13 702*	*13 815*	*14 318*
Medical	30 796	33 155	37 599	34 523
Medical tax credits on contributions	*25 420*	*26 983*	*30 882*	*27 081*
Medical tax credits on out-of-pocket expenditure	*5 376*	*6 172*	*6 717*	*7 442*
Interest exemptions	3 306	3 493	3 596	3 659
Secondary rebate (65 years and older)	3 310	3 238	3 155	3 405
Tertiary rebate (75 years and older)	280	270	238	264
Donations	318	383	422	481
Capital gains tax (annual exclusion)	707	677	536	511
Venture capital companies	284	542	839	793
Total personal income tax	**132 623**	**127 788**	**137 623**	**137 758**
Corporate income tax				
Small business corporation tax savings	3 114	3 198	3 127	2 633
Reduced headline rate	*3 069*	*3 151*	*3 085*	*2 588*
Section 12E depreciation allowance	*44*	*47*	*42*	*45*
Research and development	234	266	279	119
Learnership allowances	1 071	721	576	415
Strategic industrial projects (12I)	693	563	361	16
Film incentive[2]	15	6	0	19
Urban development zones	277	318	307	325
Employment tax incentive	4 656	4 317	4 512	4 754
Energy-efficiency savings	1 223	608	1 913	120
Participation exemption[3]	5 544	8 383	16 259	4 172
Total corporate income tax	**16 827**	**18 380**	**27 334**	**12 572**

Table B.2 Tax expenditure estimates *(continued)*

R million	2016/17	2017/18	2018/19	2019/20
Value-added tax				
Zero-rated supplies	54 185	56 926	65 255	71 884
22 basic items [4]	*24 411*	*26 023*	*29 390*	*31 834*
Petrol [5]	*16 150*	*17 080*	*20 259*	*20 079*
Diesel [5]	*5 525*	*6 147*	*8 089*	*8 258*
Paraffin [5]	*569*	*665*	*931*	*849*
Municipal property rates	*7 267*	*6 704*	*6 252*	*10 528*
Reduced inclusion rate for commercial accommodation	*263*	*307*	*334*	*336*
Exempt supplies (public transport and education)	1 426	1 520	1 603	1 687
Total value-added tax	**55 612**	**58 446**	**66 857**	**73 571**
Customs duties and excise				
Motor vehicles (MIDP/APDP, including IRCCs)[6]	28 362	28 754	31 250	34 107
Textile and clothing (duty credits – DCCs)[6]	725	712	734	725
Furniture and fixtures	181	198	178	168
Other customs[7]	963	875	600	625
Diesel refund[8]	5 037	3 025	5 846	8 767
Total customs and excise	**35 268**	**33 564**	**38 608**	**44 393**
Total tax expenditure	**240 330**	**238 178**	**270 423**	**268 295**
Tax expenditure as % of total gross tax revenue	**21.0%**	**19.6%**	**21.0%**	**19.8%**
Total gross tax revenue	**1 144 081**	**1 216 464**	**1 287 690**	**1 355 766**
Tax expenditure as % of GDP	**5.0%**	**4.6%**	**5.0%**	**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) 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, and two food items and sanitary towels (pads) added from 1 April 2019

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

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