B

Tax expenditure statement

Introduction

The tax system is aimed primarily at raising sufficient revenues to finance government spending. It can also be used to promote socio-economic objectives through targeted tax exemptions, deductions or credits. Tax expenditures are estimates of the total revenue forgone as a result of 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.

In the 2015/16 fiscal year – the latest year for which data is available – tax expenditures were estimated at R159.3 billion, or 3.9 per cent of GDP. There were 29 tax expenditures estimated in 2015/16, and the largest four expenditures accounted for nearly 65 per cent of the total. These related to deductions for pension and retirement annuity contributions, vehicle manufacturer incentives, value-added tax (VAT) relief for basic food items, and credits for medical contributions and qualifying expenses.

Tax expenditure estimates

The estimates presented in Table B.1 are calculated using the "revenue forgone" method. This entails comparing actual revenue collections with revenues that would have been collected without the incentives in place.

Changes to estimation methods since the 2017 Budget

There have been no significant changes in the tax expenditure estimation methodology since the 2017 Budget. Most of the personal income tax and corporate income tax expenditure estimates are calculated using South African Revenue Service administrative data, allowing expenditures to be accounted for on an accrual basis.

More accurate data and estimation methodologies have prompted revisions to the historical tax expenditure estimates in Table B.1. In addition, film incentive expenditure estimates are now based on data relating both to allowances under section 24F of the Income Tax Act (1962), which was repealed in 2013, as well as exemptions under section 12O, which is now the sole tax incentive for films.

Trends in tax expenditure: 2012/13 – 2015/16

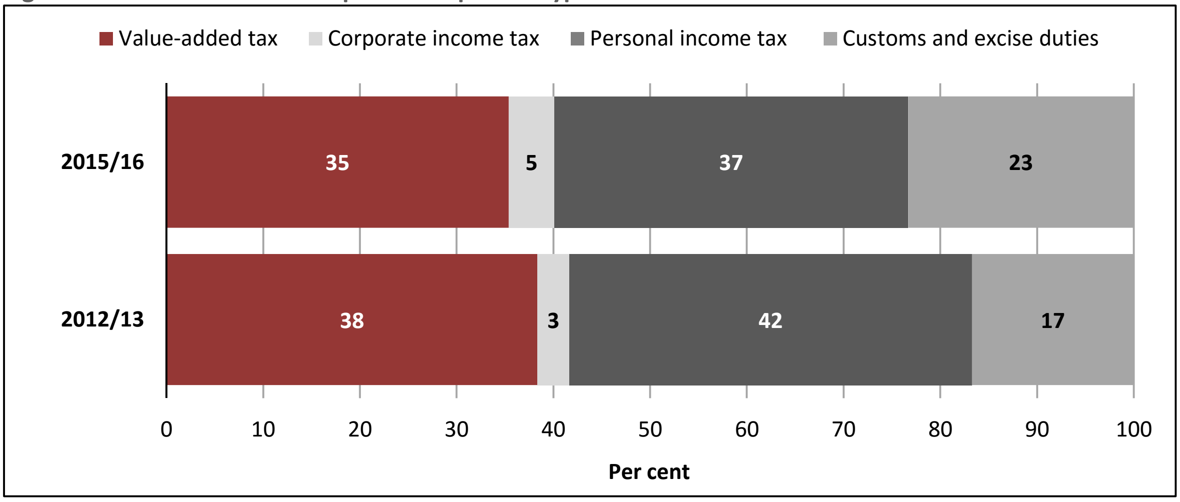
This section uses historical data to analyse trends in tax expenditures between 2012/13 and 2015/16.

In total, 29 tax expenditures were estimated for both 2012/13 and 2015/16. Tax credits for medical contributions and qualifying expenses were introduced in 2012/13 to replace income tax deductions for medical scheme contributions, while the employment tax incentive was introduced in 2013/14.

Monitoring the cost of tax expenditures improves fiscal transparency by allowing greater public scrutiny of government's tax policy decisions. Presenting total tax expenditures relative to benchmarks such as

GDP contextualises the forgone revenue and aids comparison of direct and indirect government expenditures.

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

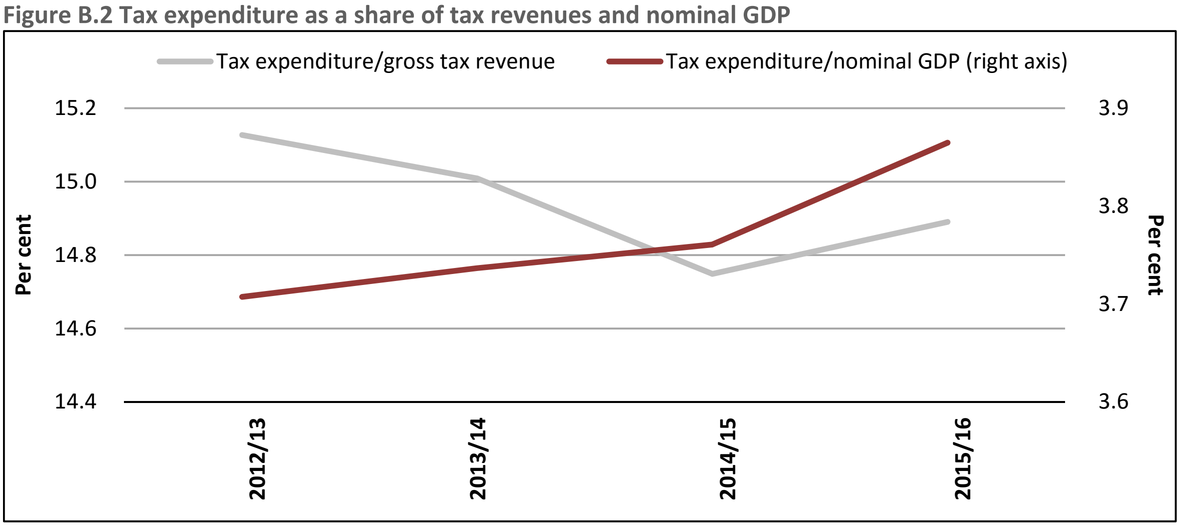


Source: National Treasury

Figure B.1 compares the share of tax expenditures by tax type between 2012/13 and 2015/16. Personal income tax and VAT expenditures have historically made up the majority of tax expenditures, respectively accounting for 42 per cent and 38 per cent of total tax expenditures in 2012/13. By 2015/16, customs and excise expenditures increased to 23 per cent, up from 17 per cent in 2012/13.

The total value of tax expenditures grew by R36.2 billion over the period, from R123.1 billion in 2012/13 to R159.3 billion in 2015/16. This was equivalent to average tax expenditure growth of 9.8 per cent per year, compared to average annual nominal GDP growth of 7.6 per cent over the same period. Much of the increase in total tax expenditures stems from higher customs and excise expenditures, largely the result of strong growth in expenditures related to the Motor Industry Development Programme. Tax expenditures due to this programme, which was replaced in 2013 by the Automotive Production Development Programme, grew by 14 per cent compounded annually over the period. In 2015/16, forgone revenue related to the Automotive Production Development Programme was the largest tax expenditure item at R26.9 billion, which is about 17 per cent of total tax expenditures. Expenditures related to VAT zero-rated municipal property tax collections and diesel refunds also grew strongly over the period.

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



Source: National Treasury

Figure B.2 shows that tax expenditure has increased relative to nominal GDP as government maintained its level of support for policy objectives through the tax system, despite slower economic growth. Over the past four years, nominal GDP growth continued to slow, averaging 7.6 per cent annually. As a result, tax expenditures as a share of nominal GDP increased from 3.7 per cent in 2012/13 to 3.9 per cent in 2015/16. Tax revenue growth outpaced both that of output and tax expenditures over the period, with expenditure as a share of revenue decreasing marginally. The share of tax expenditures to total revenue declined from 15.1 per cent in 2012/13 to 14.9 per cent in 2015/16.

Tax expenditures have experienced strong growth over the last four years. Government will continue to evaluate these tax incentives to determine their effectiveness relative to their increased cost to GDP.

Evaluation of tax expenditures

Evaluating tax expenditures is complicated, but important to prevent wasteful spending. Tax expenditures are often not subject to the same level of oversight as other spending decisions in the budget, but they can become a drain on the fiscus if they are not reviewed periodically. Tax expenditure evaluations assess the success of the policy in achieving its stated objectives and its effects on the behaviour of recipients. For example, they can determine whether an incentive promoted an activity that would not have occurred in its absence, such as stimulating investment or creating additional jobs. In addition, economic efficiency, sustainability in terms of revenue forgone and administrative complexity should be key elements of the evaluation.

Government has started assessing the merit of these tax expenditures, along with the business incentives offered more broadly. The Department of Planning, Monitoring and Evaluation is evaluating business incentives to maximise the efficiency and effectiveness of the current system. The evaluation will focus on both tax and non-tax financial incentives, such as subsidies.

In addition, the Department of Trade and Industry and the National Treasury are reviewing the tax incentive for industrial policy projects in terms of section 12I of the Income Tax Act. The window period for the incentive was extended to 31 March 2020 to allow sufficient time for the review process to inform a decision on the future of the incentive.

Expenditure related to the Automotive Production Development Programme is currently the largest tax expenditure item. More broadly, the programme is being reviewed by the Department of Trade and Industry as part of the South African Automotive Masterplan project. The review will assess to what extent the programme has met its intended objectives, and produce recommendations on how it should be amended.

Table B.1 Tax expenditure estimates

R million	2012/13	2013/14	2014/15	2015/16
Personal income tax				
Pension and retirement annuity contributions[1]	26 314	28 467	30 485	31 772
Pension contributions – employees	*9 684*	*10 457*	*11 116*	*11 561*
Pension contributions – employers	*11 234*	*12 131*	*12 895*	*13 411*
Retirement annuity	*5 395*	*5 879*	*6 474*	*6 799*
Medical	20 272	21 883	19 750	20 442
Medical contributions & deductions	*3 801*	*4 313*	–	–
Medical tax credits [2]	*16 471*	*17 570*	*19 750*	*20 442*
Interest exemptions	2 067	2 191	2 418	2 592
Secondary rebate (65 years and older)	1 533	1 711	2 087	2 186
Tertiary rebate (75 years and older)	119	132	177	185
Donations	620	826	963	633
Capital gains tax (annual exclusion)	309	393	458	446
Total personal income tax	**51 233**	**55 603**	**56 338**	**58 256**
Corporate income tax[3]				
Small business corporation tax savings	1 939	2 318	2 414	2 356
Reduced headline rate	*1 912*	*2 286*	*2 383*	*2 317*
Section 12E depreciation allowance	*27*	*31*	*31*	*39*
Research and development	197	199	104	216
Learnership allowances	857	830	511	728
Strategic industrial projects[4]	455	210	30	18
Film incentive[5]	354	36	13	2
Urban development zones	252	290	283	182
Employment tax incentive[6]	–	143	2 420	4 063
Total corporate income tax	**4 053**	**4 026**	**5 776**	**7 566**
Value-added tax				
Zero-rated supplies	46 139	49 611	51 123	55 013
19 basic food items [7]	*18 628*	*20 107*	*21 503*	*22 793*
Petrol [8]	*15 343*	*16 276*	*16 065*	*15 901*
Diesel [8]	*1 759*	*2 101*	*2 146*	*1 911*
Paraffin [8]	*611*	*702*	*659*	*536*
Municipal property rates	*9 598*	*10 209*	*10 522*	*13 639*
Reduced inclusion rate for commercial accommodation	*199*	*216*	*228*	*233*
Exempt supplies (public transport and education)	1 088	1 175	1 256	1 332
Total value-added tax	**47 228**	**50 786**	**52 379**	**56 345**
Customs duties and excise				
Motor vehicles (MIDP/APDP, including IRCCs)[9]	15 823	18 415	23 467	26 936
Textile and clothing (duty credits – DCCs)[9]	652	468	539	788
Furniture and fixtures	163	156	180	217
Other customs[10]	678	665	911	1 040
Diesel refund[11]	3 276	4 955	5 870	8 175
Total customs and excise	**20 592**	**24 659**	**30 967**	**37 156**
Total tax expenditure	**123 106**	**135 075**	**145 460**	**159 323**
Tax expenditure as % of total gross tax revenue	**15.1%**	**15.0%**	**14.7%**	**14.9%**
Total gross tax revenue	**813 826**	**900 015**	**986 295**	**1 069 983**
Tax expenditure as % of GDP	**3.7%**	**3.7%**	**3.8%**	**3.9%**

1. Some of this tax expenditure is recouped when amounts are withdrawn as either a lump sum or an annuity
2. Medical credits were introduced in 2012/13 to replace income tax deductions for medical scheme contributions
3. Tax and fiscal year alignment as in the annual Tax Statistics publication, e.g. 2015/16 corporate tax expenditure estimates relate to the 2016 tax year
4.Tax expenditure for all years is attributable to allowances under sections 12G and 12I
5.Tax expenditure for all years is attributable to allowances under section 24F and exemptions under section 12O
6. Reflected as corporate tax expenditures as employers claim the incentive – credited against their PAYE liability
7. VAT relief in respect of basic food items based on 2010/11 Income and Expenditure Survey data
8. Based on fuel volumes and average retail selling prices
9. Motor Industry Development Programme (MIDP), replaced in 2013 by the Automative Production Development Programme (APDP); import rebate credit certificate (IRCC); duty credit certificates (DCC)
10. Goods manufactured exclusively for exports, television monitors and agricultural goods exempted
11. Diesel refund previously offset against domestic VAT has been added
Source: National Treasury