B

2023 BUDGET REVIEW

TAX EXPENDITURE STATEMENT

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

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. Since the 2022 Budget, selected corporate tax expenditures are presented on a sectoral basis.

In 2020/21 – the latest year for which data is available – tax expenditures were estimated at R252 billion or 4.5 per cent of GDP. For that year, 35 tax expenditures were calculated, as in 2017/18, and the five largest expenditures accounted for nearly 60 per cent of the total. These relate to deductions for pension contributions, value-added tax (VAT) relief for basic items, medical tax credits on contributions to medical schemes, and vehicle manufacturer incentives.

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revenue foregone approach assumes that taxpayers do not change their behaviour in response to a tax expenditure being withdrawn. In reality, behaviour is likely to change if an incentive is withdrawn, so the additional revenue collected may be less than estimated.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 2022 Budget

Small business corporations – section 12E of the Income Tax Act (1962) depreciation allowance

Section 12E deductions are differentiated by claims from manufacturing and other corporations. For small manufacturing businesses, the difference between immediate expensing (what is reported) and the baseline (what any business not eligible for section 12E can deduct) is multiplied by the corporate tax rate to estimate the revenue forgone. For other sectors, the methodology remains the same. As a result, the tax expenditure estimates presented in the 2023 Budget have increased relative to prior years.

Urban development zones (UDZ)

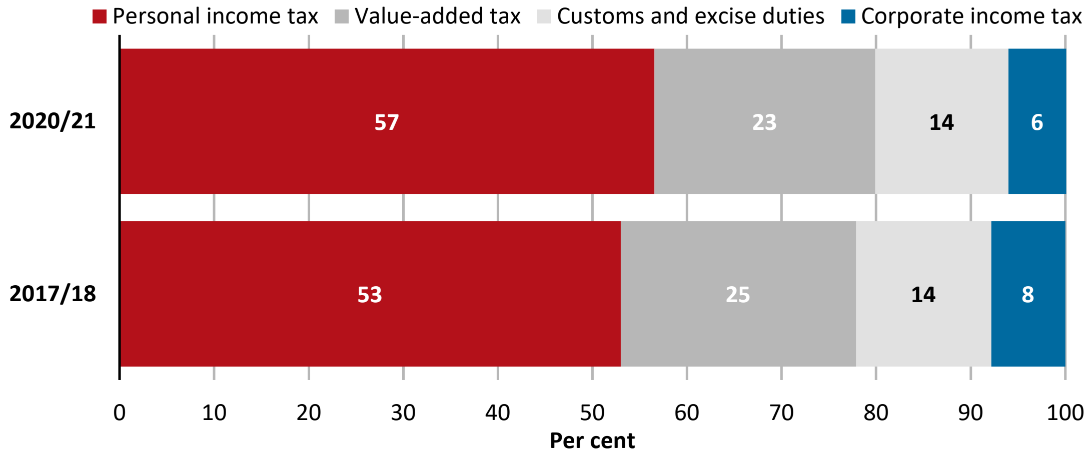
Previously, the allowances reported for the erection of new buildings and improvements to existing buildings were multiplied by the corporate tax rate to estimate the tax expenditure. No baseline was included in the calculation. Sections 13*sex* and 13*quin* allow for building allowances of 5 per cent annually over 20 years for residential and commercial buildings, respectively. This constitutes the most likely baseline against which to measure the UDZ allowance and has been factored into the tax expenditure calculation for the 2023 Budget. As a result, the UDZ tax expenditure estimates decrease over the reporting period.

More accurate data and estimation methodologies have prompted revisions to the historical tax expenditure estimates in tables B.1 and B.2.

Trends in tax expenditure: 2017/18 – 2020/21

This section uses historical data to analyse trends in tax expenditure at an aggregate level between 2017/18 and 2020/21. The total value of tax expenditures grew by R17.1 billion or 2.4 per cent over the period, which is below nominal GDP growth of 3.0 per cent. As a result, tax expenditures decreased as a share of nominal GDP, reaching 4.5 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: 2017/18 – 2020/21

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	2017/18	2018/19	2019/20	2020/21
Research and development	**270**	**257**	**213**	**165**
Manufacturing	118	132	86	55
Financial intermediation, insurance, real estate and business services	65	39	52	77
Agriculture, hunting, forestry and fishing	32	25	19	11
Community, social and personal services	26	20	18	9
Mining and quarrying	21	27	18	1
Other	9	14	19	14
Participation exemption	**8 423**	**16 311**	**12 569**	**4 930**
Financial intermediation, insurance, real estate and business services	3 728	11 932	8 204	3 530
Mining and quarrying	1 431	1 354	1 765	230
Transport, storage and communication	2 298	1 557	1 554	11
Community, social and personal services	107	168	369	292
Manufacturing	470	522	312	252
Other	389	777	365	614

Source: National Treasury

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

The R&D tax incentive aims to encourage more private-sector companies to invest in R&D by providing a 150 per cent deduction for expenditure on eligible scientific or technological R&D carried out in South Africa. This incentive was recently reviewed and Chapter 4 contains proposals in this regard.

Table B.1 shows the five sectors that benefited the most from this tax incentive, which remain unchanged from the outcome reported in the 2022 *Budget Review*. Almost half of the tax expenditure has supported the manufacturing sector. The agricultural sector has also benefited, highlighting that this incentive encourages R&D within sectors that are important for job creation.

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

To qualify for the participation exemption, a resident company (or group of companies) must hold 10 per cent or more of the total equity shares and voting rights of a company declaring a foreign dividend. The exemption aims to encourage resident companies to repatriate dividends and prevent economic double taxation (if dividend withholding tax is due in the foreign country, for example). 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 exemption is calculated. Table B.1 highlights the five sectors that benefited the most between 2017/18 and 2020/21. The reported numbers relate solely to the exempt foreign dividend element, as there is insufficient information to publish the tax expenditure associated with the capital gains tax element.

On average, 1 460 taxpayers benefit from the participation exemption (limited to dividends) annually. The financial intermediation, insurance, real estate and business services sector benefits the most – both in respect of the number of taxpayers and the monetary element.

Table B.2 Tax expenditure estimates

R million	2017/18	2018/19	2019/20	2020/21
Personal income tax	**124 441**	**135 942**	**141 267**	**142 299**
Retirement fund contributions[1]	82 546	88 799	96 407	97 734
Pension contributions – employees	*18 445*	*19 933*	*21 927*	*25 220*
Pension contributions – employers	*32 186*	*34 851*	*37 206*	*37 755*
Provident contributions – employees	*4 571*	*5 209*	*6 850*	*6 594*
Provident contributions – employers	*13 325*	*14 733*	*15 827*	*14 680*
Retirement annuity	*14 018*	*14 073*	*14 597*	*13 485*
Medical	33 213	37 818	35 052	35 371
Medical tax credits on contributions	*27 081*	*31 089*	*27 478*	*27 839*
Medical tax credits on out-of-pocket expenditure	*6 131*	*6 728*	*7 574*	*7 532*
Interest exemptions	3 523	3 657	3 814	3 201
Secondary rebate (65 years and older)	3 273	3 535	3 784	3 857
Tertiary rebate (75 years and older)	261	284	306	307
Donations	377	418	477	467
Capital gains tax (annual exclusion)	697	561	601	428
Venture capital companies	551	870	827	932
Corporate income tax	**18 402**	**27 455**	**21 675**	**15 382**
Small business corporation tax savings	3 290	3 305	3 187	2 663
Reduced headline rate	*3 215*	*3 239*	*3 115*	*2 611*
Section 12E depreciation allowance	*74*	*67*	*72*	*52*
Research and development	270	257	213	165
Learnership allowances	719	587	502	273
Strategic industrial projects (12I)	563	361	16	2
Film incentive[2]	6	0	19	1
Urban development zones	203	208	253	114
Employment tax incentive	4 317	4 512	4 754	7 165
Energy-efficiency savings	611	1 913	161	68
Participation exemption[3]	8 423	16 311	12 569	4 930

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

R million	2017/18	2018/19	2019/20	2020/21
Value-added tax	**58 446**	**66 857**	**73 439**	**58 760**
Zero-rated supplies	56 926	65 255	71 752	57 236
22 basic items [4]	*26 023*	*29 390*	*31 834*	*27 960*
Petrol [5]	*17 080*	*20 259*	*20 003*	*14 730*
Diesel [5]	*6 147*	*8 089*	*8 212*	*6 592*
Paraffin [5]	*665*	*931*	*838*	*740*
Municipal property rates	*6 704*	*6 252*	*10 528*	*6 886*
Reduced inclusion rate for commercial accommodation	*307*	*334*	*336*	*328*
Exempt supplies (public transport and education)	1 520	1 603	1 687	1 525
Customs duties and excise	**33 564**	**38 608**	**44 393**	**35 534**
Motor vehicles (MIDP/APDP, including IRCCs)[6]	28 754	31 250	34 107	26 189
Textile and clothing (duty credits – DCCs)[6]	712	734	725	709
Furniture and fixtures	198	178	168	138
Other customs[7]	875	600	625	1 409
Diesel refund[8]	3 025	5 846	8 767	7 090
Total tax expenditure	**234 854**	**268 862**	**280 774**	**251 975**
Tax expenditure as % of total gross tax revenue	**19.3%**	**20.9%**	**20.7%**	**20.2%**
Total gross tax revenue	**1 216 464**	**1 287 690**	**1 355 766**	**1 249 711**
Tax expenditure as % of GDP	**4.6%**	**5.0%**	**4.9%**	**4.5%**

1. Retirement benefits are taxable once they are paid out, therefore a portion of the revenue is deferred rather than foregone, unlike most other tax expenditures. Some of the revenue foregone is also recouped through taxes on lump sum withdrawals
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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