B

Tax expenditure statement

Introduction

Tax expenditures are estimates of tax revenue that government forgoes as a result of legislative provisions that deviate from standard tax treatment. This includes deductions, exemptions and rebates. Transparent reporting of tax expenditures is international best practice and encourages accountability. This annexure presents government's estimates of the fiscal cost of tax expenditures, and the methodology used to produce these estimates.

Government estimates that tax expenditures in 2014/15 – the latest year for which data is available – amounted to R139.1 billion, equivalent to 3.6 per cent of GDP. The four largest tax expenditures were deductions for pension and retirement annuity contributions, credits for medical contributions and qualifying expenses, value-added tax (VAT) relief for basic food items, and car manufacturer incentives.

Main types of tax expenditures

Type of tax expenditure	Description	Examples
Tax credits, rebates and refunds	An amount of money a taxpayer is able to subtract from taxes owed	Medical tax credits, secondary rebate (65 years and older), diesel refund
Exclusions	Excluded from the amount that a taxpayer reports as gross income on which the tax liability is calculated	Donations tax exclusion (R100 000), capital gains tax (annual exclusion)
Tax deduction	A reduction of taxable income, commonly due to deductible expenses, particularly those incurred to produce additional income	Pensions and retirement annuity contributions
Additional tax deduction	Deductions over and above costs incurred	Learnership allowance, research & development
Accelerated capital cost allowance	Accelerated depreciation allowing for a faster write-off of assets compared to their economic useful life	Urban development zones, film tax incentive
Special rate regime	Preferential tax rates	Small business reduced headline rate
Zero-rating of goods or services	Zero-rating results in lower total purchase price for designated goods	19 basic food items, petrol, diesel, paraffin

Tax expenditures can advance specific policy goals. Tax incentives, for example, provide favourable tax treatment to individuals and businesses to encourage certain behaviour. Well-targeted incentives can promote investment and growth, but they also erode the tax base. Recent work by the International Monetary Fund, the Organisation for Economic Cooperation and Development, the United Nations and the World Bank shows that investors do not consider tax incentives to be a decisive factor when considering investments in developing countries. Incentives were often found to be redundant, meaning that investment would have taken place without them. This suggests that even well-designed incentives may not be an effective way to address underlying problems that are not tax related. Tax expenditures can also undermine the principles of equity and simplicity, given that they target specific taxpayers and often require complicated rules to prevent abuse.

Spending decisions presented in the Budget are subject to extensive scrutiny and democratic oversight. In many jurisdictions, tax expenditures are subject to fewer controls and reviews. Good governance and regular, transparent evaluations are necessary to justify the existence and continuation of incentives.

Tax expenditure estimates

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

The estimates should be interpreted with caution. The amounts depend on the estimation methodology and data used, as well as the underlying assumptions. A critical assumption made in the revenue foregone approach is that taxpayers do not change their behaviour in response to the tax expenditure. In reality, behaviour is likely to change if an incentive is withdrawn. This implies that the value of the tax base would change, and the revenue intake from the measure’s withdrawal might be less than projected in the total tax expenditure estimate. For example, consumers might respond to a withdrawal of zero-rated fuel by reducing their fuel consumption, thereby reducing the expected increase in tax revenue. However, it is exceedingly difficult to fully anticipate behavioural changes, as this would require a more detailed evaluation of the impact of the measure. In this context, the revenue foregone method has the advantage of providing a simple, broad and standardised indicator.

Data from the South African Revenue Service (SARS) is the primary source on which the estimates are based. Other data sources include the Financial Services Board, the Council for Medical Schemes, Statistics South Africa, the Department of Energy and the Reserve Bank. SARS, which accumulates data mainly on a cash accounting basis, aims to provide data on an accrual basis for tax expenditures over the medium term. Progress has been made in this regard, with SARS tax administrative data being made available to the National Treasury for policy analysis. Most of the personal income tax and corporate income tax expenditure estimates are calculated using this data, meaning expenditures are accounted for on an accrual basis.

Changes to estimating methods since the 2016 Budget

Previous calculations of corporate income tax expenditures were based on SARS cash collections data. The estimates in Table B.1 are now based on SARS administrative data, yielding improved estimates.

To enhance alignment between SARS and the National Treasury on the tax year and fiscal year allocation of tax payments, estimates of corporate tax expenditures will be reported in line with the methodology used in the annual Tax Statistics publication produced jointly by the two institutions. For example, 2014/15 tax expenditure estimates relate to the 2015 tax year. Tax and fiscal year alignment is complicated by the tax year being based on the choice of company financial year-end. Detail on this is provided in Chapter 2 of the 2016 Tax Statistics publication. VAT expenditure estimates for commercial accommodation have been revised upwards after correcting a calculation error in the 2016 Budget.

Tax expenditure estimates are subject to revision as more accurate data and estimation methodologies are implemented. In future, government also aims to expand its tax expenditure reporting by adding estimates of environmentally related tax expenditures and tax-free savings accounts.

Calculation of tax expenditure estimates

Personal income tax expenditures

Tax expenditures for personal income taxes are intended to promote savings for retirement, help individuals manage large and unexpected medical expenses, and provide relief for the elderly. Retirement fund, medical tax credit, and secondary and tertiary rebate tax expenditures are estimated based on anonymised individual tax returns. To estimate the tax expenditure, the relevant marginal tax rates are applied. The tax expenditures for medical tax credits and rebates are estimated using models based on SARS data by calculating the expected tax liability with and without each particular rebate.

The tax expenditure for retirement fund contributions should be interpreted with care, as the estimate represents only the reduction in tax liabilities in the tax year in which the contributions were made, and ignores that tax is paid on income received in retirement.

Corporate income tax expenditures

Government uses corporate income tax expenditures to promote small businesses development, stimulate investment and encourage job creation. Generally, corporate income tax expenditure estimates are calculated by multiplying the relevant tax measure by the headline corporate income tax rate (currently 28 per cent).

VAT expenditures

Concessions on taxpayers' VAT liability provide relief to low-income households and ease the administrative burden on specific economic sectors. The zero-rating of 19 basic food items assists low-income households that spend a higher proportion of income on these items. Tax-exempt food items include brown bread, rice, milk, eggs, vegetables and samp. The tax expenditure on these basic food products represents a revenue loss that is calculated by applying 14 per cent on the estimated household spending on these items.

Tax-exempt supplies include public road and rail transport, and educational services provided by approved institutions.

VAT relief on fuel sales

Petrol, diesel and illuminating paraffin are zero rated for VAT. The difference to the standard rate is recorded as tax expenditure when these items are sold to final consumers. The main assumption used to calculate this item is that 20 per cent of petrol sales and 90 per cent of diesel sales were for business purposes (by VAT vendors) and would have qualified as an input VAT claim.

Customs duties and excise expenditures

Customs and excise expenditures aim to promote industrial development in the motor vehicle and textiles and clothing sectors. Expenditure reported in this category represents revenue lost on customs duties rebates on industry development programmes and excise duty refunds on diesel used in primary sectors of the economy.

Evaluation of tax expenditures

At 3.6 per cent of GDP in 2014/15, tax expenditures represent a significant reduction in the tax base. Government must get value for money for the revenue it foregoes through tax expenditures. This requires detailed approval of each expenditure.

Government assesses the overall effectiveness of the tax expenditures shown in Table B.1 to determine whether their design should be altered or they should be discontinued. At a high level, evaluations should assess whether the incentive promoted an activity that would not have occurred in its absence, such as stimulating investment or creating additional jobs. An increase in employment while the incentive is in place is not sufficient to show that the incentive was successful, as that employment might have been created without the incentive. Economic efficiency, sustainability in terms of revenue foregone and administrative complexity should be key elements of the evaluation.

Evaluations of tax expenditures need to be completed before they are considered for renewal at the end of their stipulated window periods. For example, both the employment tax incentive and learnership tax incentive were reviewed and evaluated in 2016 before being extended.

Table B.1 Tax expenditure estimates

R million	2011/12	2012/13	2013/14	2014/15
Personal income tax				
Pension and retirement annuity contributions[1]	23 346	26 038	27 773	25 915
Pension contributions – employees	*8 728*	*9 598*	*10 236*	*9 571*
Pension contributions – employers	*9 980*	*10 975*	*11 705*	*10 944*
Retirement annuity	*4 639*	*5 464*	*5 832*	*5 399*
Medical	16 413	19 887	21 297	18 493
Medical contributions & deductions	*16 413*	*3 849*	*4 284*	*–*
Medical tax credits [2]	*–*	*16 038*	*17 013*	*18 493*
Interest exemptions	1 939	1 965	2 160	2 106
Secondary rebate (65 years and older)	1 891	2 035	2 256	2 522
Tertiary rebate (75 years and older)	165	155	177	203
Donations	528	632	879	931
Capital gains tax (annual exclusion)	147	305	381	414
Total personal income tax	**44 429**	**51 018**	**54 923**	**50 584**
Corporate income tax[3]				
Small business corporation tax savings	1 561	1 953	2 515	2 294
Reduced headline rate	*1 539*	*1 926*	*2 484*	*2 266*
Section 12E depreciation allowance	*22*	*27*	*31*	*28*
Research and development	361	340	163	34
Learnership allowances	825	815	774	320
Strategic industrial projects[4]	130	169	438	7
Film incentive	228	353	13	1
Urban development zones	300	240	157	115
Employment tax incentive[5]	–	–	143	2 420
Total corporate income tax	**3 404**	**3 869**	**4 204**	**5 192**
Value-added tax				
Zero-rated supplies	40 763	46 139	49 611	51 123
19 basic food items [6]	*17 106*	*18 628*	*20 107*	*21 503*
Petrol [7]	*13 797*	*15 343*	*16 276*	*16 065*
Diesel [7]	*1 532*	*1 759*	*2 101*	*2 146*
Paraffin [7]	*585*	*611*	*702*	*659*
Municipal property rates	*7 568*	*9 598*	*10 209*	*10 522*
Reduced inclusion rate for commercial accommodation	*174*	*199*	*216*	*228*
Exempt supplies (public transport and education)	999	1 088	1 175	1 256
Total value-added tax	**41 763**	**47 228**	**50 786**	**52 379**
Customs duties and excise				
Motor vehicles (MIDP/APDP, including IRCCs)[8]	16 306	15 823	18 415	23 467
Textile and clothing (duty credits – DCCs)[8]	860	652	468	539
Furniture and fixtures	150	163	156	180
Other customs[9]	847	678	665	911
Diesel refund[10]	1 756	3 276	4 955	5 870
Total customs and excise	**19 919**	**20 592**	**24 659**	**30 967**
Total tax expenditure	**109 514**	**122 706**	**134 573**	**139 122**
Tax expenditure as % of total gross tax revenue	**14.7%**	**15.1%**	**15.0%**	**14.1%**
Total gross tax revenue	**742 650**	**813 826**	**900 015**	**986 295**
Tax expenditure as % of GDP	**3.6%**	**3.7%**	**3.7%**	**3.6%**

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. 2014/15 corporate tax expenditure estimates relate to the 2015 tax year
4.Tax expenditure for all years is attributable to allowances under sections 12G and 12I
5. Reflected as corporate tax expenditures as employers claim the incentive – credited against their PAYE liability
6. VAT relief in respect of basic food items based on 2010/11 Income and Expenditure Survey data
7. Based on fuel volumes and average retail selling prices
8. Motor Industry Development Programme (MIDP), replaced in 2013 by the Automative Production Development Programme (APDP); import rebate credit certificate (IRCC); duty credit certificates (DCC)
9. Goods manufactured exclusively for exports, television monitors and agricultural goods exempted
10. Diesel refund previously offset against domestic VAT has been added
Source: National Treasury