

NATIONAL ASSEMBLY
QUESTION FOR WRITTEN REPLY

QUESTION No 943 NW1061E

18 MARCH 2011

Dr D T George (DA) to ask the Minister of Finance:

- 1) Whether, with regard to the impact of value-added tax (VAT) on the poor, the National Treasury has conducted a study on the impact of extending the zero-rate to additional basic necessities; if not, why not; if so, what are the relevant details;
- 2) Whether the National Treasury has conducted a study on the redistributive impact of the taxation; if not, why not; if so, what are the relevant details?

REPLY

- 1) Yes. The National Treasury commissioned a study in 2007 into the most appropriate VAT treatment of merit goods and services. The aim of the study was to determine whether current VAT concessions should be retained, whether the policy considerations that applied when VAT was introduced are still relevant, or whether changed circumstances would justify the introduction of further concessions for other merit goods and services. Additional merit goods and services considered included medical goods and services, books and other reading matter, funeral or cremation services, electricity and water. A copy of this study, which was also made available to members of the Standing Committee on Finance on 23 March 2011, is attached, and is available on the National Treasury website.

Detailed analysis suggests that existing VAT zero-ratings and exemptions in almost all cases confer substantially more benefits to higher income groups than to lower income groups. With the exception of maize meal,

bread flour and maize rice, the savings derived by higher income expenditure groups from current zero-ratings are generally substantially higher than those enjoyed by lower income groups.

Targeted assistance in the form of focused expenditure and / or grants seem more appropriate to reach low income households.

It should also be noted that a VAT system cannot and should not be administratively too complex, and that generates revenue efficiently, will tend to better fund social and redistributive expenditure programmes and hence higher levels of income growth over time.

- 2) Yes, the 2007 study did consider the impact of VAT on different income groups. It is not clear what the Honourable means by the “redistributive impact of the taxation”, but it should be noted that the actual redistributive impact is done through the expenditure side of the Budget, as the taxation system does not by itself redistribute income. . The perception that VAT is regressive is based on the fact that lower income households pay a higher proportion of their disposable income in a given period on VAT. This arises because higher income households tend to save greater portions of their income. However, these savings are used in subsequent periods (e.g. during retirement), at which stage they attract VAT. The proportion of disposable income paid on VAT by different income groups over their respective lifetimes therefore tend to converge. Hence, the full life cycle VAT burden is less regressive and might be more or less proportional.

Concessions that cannot be targeted exclusively to the poor distort equity in the economy as the affluent tends to benefit more in absolute terms. VAT concession has a negative effect on other tax policy considerations such as neutrality, efficiency and simplicity. The resultant distortion of consumer and producer choices and preferences often leads to requests for even more VAT concessions.