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Raising VAT:
Between the Devil and the Deep Blue Sea?

"At the end of the day for the faith community with its fundamental option for the poor, the Budget must be evaluated not in the first place by the reactions of the markets but by its impact on the poor."
Fr Peter-John Pearson

1. Introduction

According to a March 2018 World Bank report,[1] South Africa is 'one of the most unequal countries in the world, and that inequality has increased since the end of Apartheid in 1994'. In 2017 Statistics South Africa released a report[2] which revealed that 'almost 14 million people live below the food poverty line [R531 per month]; almost 30 million below the lower-bound poverty line [R758 per month] and 30.4 million below the upper-bound poverty line [R1 138 per month]. That is – one out of four South Africans is considered food poor'.[3]

The 2018 Budget will significantly alter the statistics that were revealed in the World Bank and SSA reports. This briefing paper will focus on what effect the increase in the taxes, especially the increase in value-added tax (VAT), will have on these 'one in four' South Africans that are food poor and thus most vulnerable to increases in the costs of basic necessities.

2. What Does the Church Say?

The Church has often pointed out that it is not within its ambit to recommend specific political or economic theories. However, the Church does have a responsibility and duty to speak out, prophetically, where economic policies or practices have an adverse effect on people.[4] In Catholic Social Teaching (CST) terms, 'a tax system is evaluated in terms of its impact on the poor'. This aspect of CST was summed by the US Bishops' Conference in their 1986 pastoral letter, *Economic Justice for All*, when they emphasised that:

> "First, the tax system should raise adequate revenues to pay for the public needs of society, especially to meet the basic needs of the poor. Secondly, the tax system should be structured according to the principle of progressivity, so that those with relatively greater financial resources pay a higher rate of taxation. The inclusion of such a principle in tax policies is an important means of reducing the severe inequalities of income and wealth in the nation."

The Southern African Catholic Bishops' Conference applied similar thinking when they wrote in their 1999 pastoral letter, *Economic Justice in South Africa:*

> "Regarding personal taxation, we propose that the tax-burden on lower and middle-income earners be further reduced, and balanced by an increase in estate duties and an increase in the top marginal rate applicable to the wealthiest sectors of the population. Those South Africans fortunate enough to enjoy a high standard of living, and whose material needs are assured, must be encouraged to consider their wealth in the context of widespread poverty. The fact that a relatively small number of taxpayers contribute a high percentage of income tax revenue is not an indictment of the tax system. On the contrary, it is an illustration of the

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imbalances in our economy, since it shows that the great majority of wage-earners earn too little to have to pay significant amounts of income tax. The rich have an opportunity – and a moral duty – to assist in redressing these imbalances by willingly accepting higher levels of taxation, especially when such increases do not threaten to deny them a comfortable standard of living. By embracing such a 'solidarity' tax they would contribute further to economic justice and at the same time demonstrate a profound commitment to national reconciliation and the common good."

3. Between the Devil and the Deep Blue Sea

A national budget is a political statement: it is an opportunity for the government to articulate its policy goals into an actionable programme. It is also a high-wire act that requires balancing fiscal priorities with the Constitutional obligation to 'improve the quality of life of all citizens and free the potential of each person.'[5] Thus, the 2018 budget presented the Treasury with a conundrum: how to raise the fiscal revenue requirements (Government's income) without over-burdening the small base of personal tax payers. Revenue requirements ballooned after Government was forced to find R56 billion to fund free tertiary education after former President Jacob Zuma made a sudden announcement in this regard in December 2017.

According to the National Treasury's Director for VAT, Mr Mpho Legote,[6] the decision to raise VAT by one percentage point was a difficult one to make. Treasury examined which of the current tax instruments, such as personal income tax, corporate tax and value-added tax, could be raised to fill the coffers. He argued that while personal taxes have been raised over the last four years, the revenue raised from the increase was far from sufficient to deal with fiscal revenue requirements. The other option was to raise corporate tax, but it seems the Treasury did not have the appetite for it. Mr Legote stated that the corporate tax rate could not be raised from its current 28% because South Africa must 'attract investment and make an environment conducive for growth.'[7] In the United States of America the corporate tax rate has been reduced from 35% to 21%; in the United Kingdom the rate was reduced from 30% to 19%, and in China, the rate is at 25%.[8]

Thus, according to Mr Legote, an increase in VAT was the only other option available because it is a 'broad-based tax instrument' and 'less destructive in terms of attracting investment.'[9] In its Budget Review 2018 document, the Treasury asserts that an increase in the VAT has been estimated to 'have the least detrimental effects on economic growth and employment over the medium term.'[10] Finance Minister Malusi Gigaba stated in his budget speech that the negative effects of the VAT rate increase would be mitigated by the 19 zero-rated food items. These items include brown bread; maize meal; samp; mealie rice; dried mealies; dried beans; lentils; pilchards/sardines in tins; milk powder; diary powder blend; rice; vegetables; fruit; vegetable oil; milk; cultured milk; brown wheat meal; eggs; edible legumes and pulses of leguminous plants. Treasury is optimistic that the 1 percentage point VAT increase will contribute about R23bn of the R36bn that Treasury hopes to raise through taxes to reduce the budget deficit and fund fee-free higher education.

While the Treasury claims that its hand was forced regarding the VAT rate, civil society, organised labour, the faith-community and many others have disagreed, arguing that the 1 percentage point increase was not the only option. They also note that VAT is a regressive tax because it is levied irrespective of how much the consumer earns. In a recent *Huffpost* article,[11] Minister Gigaba was quoted saying the wealthiest 30% of South Africans pay 85% of revenue received through VAT of revenue; therefore, the article continues, the impact on the poor will not be all that detrimental, especially if the 19 zero-rated food items are taken into account.

However, while the wealthy may contribute more in absolute terms to VAT revenue, it is the poor who spend the higher proportion of their income on VAT. For example, Dr Gilad Isaacs has argued that 'the lowest-earning 10% spend 13.8% of their disposable income on these taxes, compared to 12.6% for the highest-earning 10% in the country.'[12] Furthermore, in their joint submission[13] to Parliament on the proposed 2018 National Budget, a group of civil society organisations[14] asserted that the existing 19 zero-rated food items will not significantly mitigate the negative effects of the VAT increase on the poor. In the submission, they argued that:

- Low-income earners consume more than just the 19 zero-rated items. According to

PACSA, which tracks the prices of a basket of goods commonly consumed by the poor, the basket of 36 food items includes only 17 VAT exempted items.

- The current 19 zero-rated food items exclude a number of items, as PACSA has indicated, that are consumed by the poor. These include margarine, chicken, polony, candles, white flour, canned beans and soap.

- In addition, the increase in the fuel levy will push up food prices, which will force poor families to substitute some nutritious food items (which are zero-rated) with relatively cheaper fats, salts and sugars that are not zero-rated. According to PACSA, because some zero-rated food items, like dried beans, take longer to cook, a rise in the fuel price can shift consumption away from these.

What emerged from the broader opposition to the VAT rate increase was opposite to what the Treasury's been arguing: that their hand was forced in raising the VAT rate. For example, the Catholic Parliamentary Liaison Office (CPLO) argued in its submission[15] that an alternative revenue source is the growth in land values (an alternative also mentioned by others):

> 'Any increase in the value of a piece of land accrues to the owner, and is unearned by him or her. That is, nothing that he or she does can increase the value of the land (we are not referring to buildings, earthworks, etc.) Land values rise because of the location of the land, and because of public inputs such as the building of roads, railways, etc. Land values near the Gautrain stations, for example, rose considerably because of the envisaged economic benefits, and these values ended up not in the public purse (which paid for the Gautrain) but in the pockets of the lucky landowners. A land value tax would also be highly redistributive (progressive) as it would tend to impact most on the richest people and corporations, who own the most land and the most valuable land, and least on the poorest people, who own the least land.'

4. Mitigations and Alternatives

There is no doubt that zero-rated goods contribute positively towards reducing inequality and poverty, but that positive contribution will be pegged back if the current list of 19 food items is not expanded in order to mitigate the impact of the VAT rate increase. This much was acknowledged when new Finance Minister Nhlanhla Nene announced the appointment of Professor Ingrid Woolard to chair a 'panel of independent experts to review the current list of zero-rated items and consider the most effective way to mitigate the impact of the increase in the VAT rate on poor and low-income households.'[16] Other members include development economist Ayabonga Cawe, associate professor in economics at Stellenbosch University Ada Jansen, economist Dr Thabi Leoka, senior economist Dr Neva Makgetla, chief director for health promotion, nutrition and oral health Lynn Moeng, independent analyst and consultant Cecil Morden, senior manager at SARS in the legal counsel unit Prenesh Ramphal, and Professor Imraan Valodia, the dean of the faculty of commerce, law and management at Wits University.[17]

An argument has been advanced by civil society that calls for an expanded zero-rated list to target those goods commonly consumed by the poor. For example, the CPLO submission on the 2018 Budget called for such items as basic toiletries, sanitary items, and school uniforms to be included in the basket of zero-rated items. A report[18] by Wits University's Corporate Strategy and Industrial Development (CSID) research unit stated that the expanded basket of zero-rated items should include bread, poultry, flour, candles, soap, basic medicines and pay-as-you-go airtime. The report acknowledged that higher-income earners would also benefit, but the poor would benefit more since they spend a higher percentage of their income on these goods.

It may also be that some of the items currently zero-rated are no longer regularly purchased by poor people; consumption habits change, and it is some 24 years since the list was originally determined. There is also the question of whether all fresh fruit and vegetables should be exempted. It is one thing to exempt potatoes and bananas, which are relatively cheap and widely consumed, but what about exotic, often imported, items like kiwi-fruit, avocados, 'artisan' vegetables, etc? It is only relatively affluent people who buy these.

Treasury routinely argues that further exemptions would weaken the tax base and detract from the administrative simplicity of VAT. This is true, but the same argument could be advanced in order to scrap zero-rating altogether. The point is, surely, that if Government (rightly) acknowledges that the impact of VAT on poor people should be mitigated by a system of targeted exemptions, it ought to make sure that the list of zero-rated items is wide enough to make a real difference to their standard of living, and that it is regularly re-evaluated and updated.

Similar to the CPLO's suggestion of a land tax as an alternative revenue source, the CSID report proposes a number of alternatives the Treasury could have pursued instead of raising the VAT rate. These included:

- Repairing the administrative capacity of SARS, especially its ability to tackle tax avoidance and evasion by corporates and the wealthy.

- Raising personal income tax, particularly on the highest earners. For example, in 2015, an effective tax rate of 40% on those earning between R500 000 and R1 million, and 45% on those earning above R1 million, would have raised additional revenue of R5.4 billion and R5.3 billion respectively.

- Increasing corporate tax. In 2015, effective tax rates of 30%, 32% and 35% would have raised an additional R13 billion, R26 billion and R45 billion respectively.

- Instituting an annual net wealth tax. International comparisons suggest this could potentially raise anywhere between R22 billion and R154 billion.

- Increasing other taxes on property or income from property, such as capital gains tax, estate duty and a securities transaction tax. For example, levying capital gains tax in line with a top marginal tax bracket of 45% could raise at additional R4 billion.

5. Conclusion

It is clear that Government's decision to raise VAT by one percentage point was not an easy one to make, but it was nevertheless favoured above other options. If the 2018 Budget was meant to be a political tool to address Government's constitutional obligation to 'improve the quality of life of all citizens and free the potential of each person' then Government has arguably squandered an opportunity to do so. The increase in the VAT rate will certainly not improve the quality of life for the majority of South Africans who live below the poverty line.

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[12]Gilad Isaacs (2018): *VAT will hit poor hardest as their spending power is eroded.* Available online at https://tinyurl.com/y9bkdz2q

[13] Submission to the Standing Committee and Select Committee on Finance with respect to the proposed 2018 National Budget.

[14] The group includes, amongst others, SPII, Equal Education, Pacsa, CSID, Section 27, Children's Institute, Dullah Omar Institute, PSAM, etc.

[15] CPLO (2018): *Submission to the Standing Committee and the Select Committee on Finance on the 2018 Budget.* Available online at https://tinyurl.com/yclqqvrk

[16]Timeslive (2018): *Panel to be established to review VAT zero-rated items.* Available online at https://tinyurl.com/y7dq3dcp

[17] *Ibid*

[18] Gilad Isaacs (2018): *Lifting the Lid On a VAT Increase.* Available online at https://tinyurl.com/yab5orly