

27 February 2017

Mr Allen Wicomb
Parliamentary Standing Committee on Finance
3rd Floor
90 Plein Street
Cape Town
8001

By e-mail: Allen Wicomb, SCOF (awicomb@parliament.gov.za)

Dear Sir

COMMENTS ON THE 2017 BUDGET REVIEW

We present herewith our written submission on the 2017 Budget Review on behalf of the South African Institute of Chartered Accountants (SAICA) National Tax Committee.

Our submission includes a discussion of various matters but our presentation will be limited to the matters we believe require the Committee's most urgent attention. We have deliberately tried to keep the content of our submission as concise as possible. Should you require further clarification you are more than welcome to contact us in this regard.

We would like to extend a hand of collaboration to the Minister of Finance (the Minister) where he believes SAICA could serve in dealing with the challenges that affect us all.

As always, we thank the Standing Committee on Finance (SCoF) for the on-going opportunity to participate in the development of South Africa.

Yours sincerely

Tracy Brophy
CHAIRPERSON: National Tax Committee

Pieter Faber
SENIOR EXECUTIVE: Tax
legislation and practitioners

Attachments:

Annexure A – Detailed submission



ANNEXURE A

MATTERS TO BE PRESENTED TO THE SCoF

Table of Contents

GENERAL	3
A. Radical Policy vs. Radical Budget	3
B. Prudent funding for the state	3
C. Regressive taxes – Fuel levy	5
CHALLENGES	6
D. Fiscal morality	6
E. South African Revenue Service – Operating model	8
UNCERTAINTY	10
F. Policy certainty	10
G. SA Customs Union	11

GENERAL

A. Radical Policy vs. Radical Budget

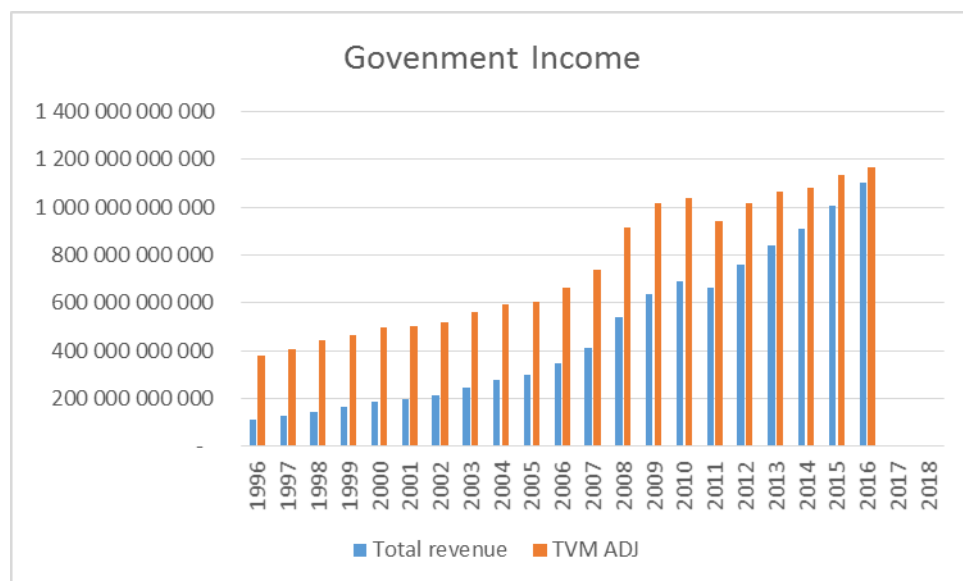
1. The Budget Review of 2017 seeks to achieve funding and appropriation of such funding, to enable the implementation of the policies of the government. This is a collective process by Cabinet¹, under the direction of the President as the highest office holder in the Executive to whom the Minister reports.
2. It is therefore unclear why stakeholders or public groups expect a radical budget, if the programmes it seeks to fund, which are managed by the other relevant Ministers, are themselves not radical in seeking solutions for appropriation. Furthermore, it remains unclear what exactly is meant by a radical budget?
3. Submission: In our view, if the Budget is lacking in this regard, it is submitted that it is as a result of the underlying policies and implementation programmes, which it merely funds, also lacking in effectiveness.
4. We agree that the Budget should be radical in the sense of substantially moving away from the spending approaches of the past, such as debt funding for operating costs and continually increasing both debt and staff costs to the detriment of the fiscal stability of the country. In our view, over indebtedness just makes us more subservient to the debt market as our political priorities become subject to the approval of our creditors, a common challenge that the government shares with our over indebted society.

B. Prudent funding for the state

5. Government is funded from taxes, borrowings and other income.
6. How much funding is appropriate is a matter to be determined by each government though various methods are employed as guidance.
7. One such method is the **Tax to Gross Domestic Product** ratio i.e. how much tax is government extracting from the economy to invest on our collective behalf.
8. This rate has continued to progressively increase, with no clear policy direction as to when it should stabilise and at what ratio, if any.
9. The Katz commission recommended that a ratio of 25% represents the upper limit. However, the Davis Tax Committee and National Treasury have disputed this without although providing no alternative.

¹ <http://www.treasury.gov.za/publications/guidelines/2017%20MTEF%20Guidelines.pdf>

10. Submission: National Treasury should provide a clear statement as to whether they believe there is a limit to taxing an already over tax burdened society before economic harm results and if so, what is the appropriate level, if not the Katz commission's 25% tax to GDP ratio.
11. We concur with Judge Dennis Davis that the wealthy are less inclined to be acrimonious to carry such a huge burden if there is proper administration and application of such resources.
12. It should be noted that, as acknowledged by the Minister, South Africa has become a high tax country, though benefits from state spending remain limited.
13. However, continual tax increases, especially when a marginal rate is increased by 4% together with the addition of new taxes e.g. acid mine drainage tax, tax on sugar sweetened beverages, carbon tax, gambling tax, etc. makes it questionable whether this is sustainable.
14. The government's insatiable need to spend outside of its means is also reflected in the ever growing debt burden, which now exceeds 50% of GDP and with the addition of SOE's debt, exceeds 60%. This is nearly double the level it was in 2008.
15. Government's ever growing need to fund itself seems to merely increase, rather than stabilise, as presented by the Minister.
16. As seen in the graph below, the government's income has exponentially increased in the last 22 years and even when adjusted for inflation has grown nearly 400%. Even on a per person basis, adjusted for inflation (i.e. in today's money), the amount to be spent by the government increased from about R9 000 to R21 000 per person.



17. This begs the question as to whether government really has a funding rather than a spending problem, as it is seemingly the latter.

- | |
|---|
| <p>18. <u>Submission</u>: The Minister of Finance should clearly indicate what the long and medium term funding goals of the state are given the current economic conditions as it cannot be that the state expects the current funding increases to continue unabated.</p> <p>19. The continual upward adjustment in medium term borrowings and spending indicates the state's inability to keep to its spending plans, which provide little certainty to the public and stakeholders such as rating agencies.</p> |
|---|

C. Regressive taxes – Fuel levy

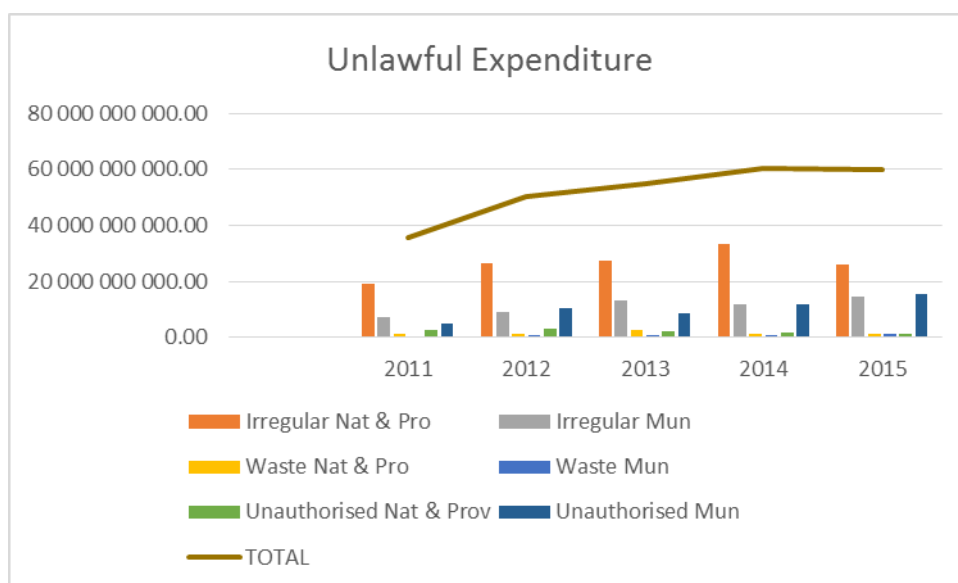
20. The introduction of tax increases and a myriad of newly proposed taxes was done on the basis that it would not be prudent to raise VAT, which even the Davis Tax Committee has acknowledged, as has the Minister, is the most efficient means to raise additional revenue.
21. The reasons provided as to why the VAT rate was not increased was on the basis that VAT is regressive and will be reloked at in future.
22. Ironically, over the last three years the government has used the fuel levy to generate nearly R63bn of which nearly R20bn was used as general revenue collection.
23. This tax is far more regressive than VAT, as its pro rata impact on the poor (who arguably spend more on transport as a percentage of their monthly income) is far greater. It also means that transactions that would otherwise have been covered by a VAT increase, such as financial services' fees, and which would arguably not have impacted the poor to a large degree are now excluded from this increase altogether, which makes the decision not to raise the VAT rate but rather increase fuel levies 'anti the poor' rather than being 'pro the poor'.

- | |
|---|
| <p>24. <u>Submission</u>: An increase in VAT still remains the most prudent mechanism to fund the current shortfall. However, the generation of such a shortfall is a problem which would not have occurred in the first place had there been a prudent use of public funds (See below on Fiscal Morality). Ultimately, the use of even more regressive taxes, but ones which are seen as more politically acceptable, only harms the poor more and further exacerbates their plight.</p> |
|---|

CHALLENGES

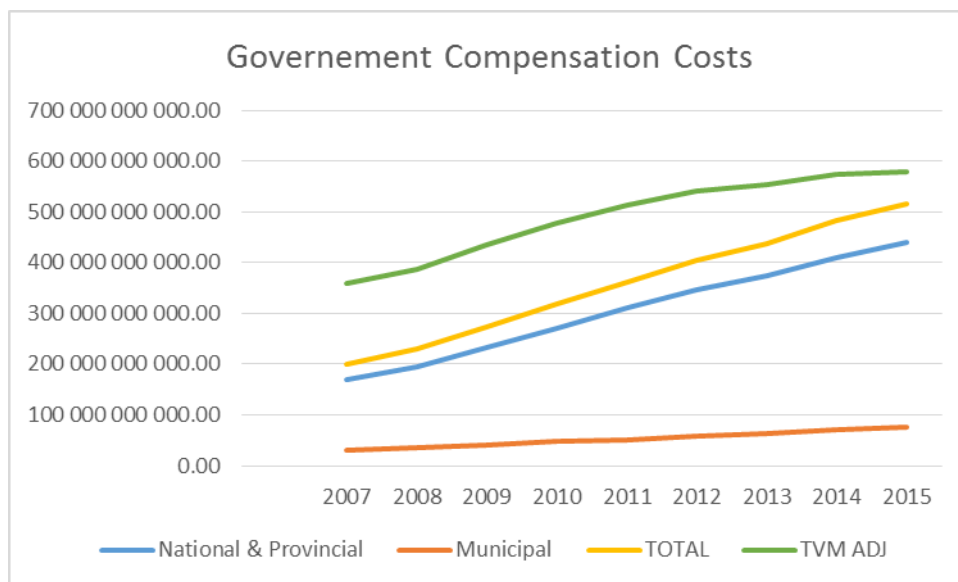
D. Fiscal morality

25. The question of fiscal morality has in our view become 'a blame game' rather than one of robust engagement. This begs the question whether, as a country, the various representatives of society can 'put away' their indifferences to ensure that we effectively collaborate in the furtherance of our country's long term prosperity.
26. Much has been said of the private sector acting against the 'spirit of the law' in seeking narrow and short term financial gains or colluding to the detriment of society. However, 'doing the right thing' should first start with the duly elected representatives of our country who are responsible for spending our nation's revenue in a responsible manner.
27. Though citizens contribute to fiscal morality, the level of their monetary contribution is imposed by government as the custodians of our collective wealth.
28. In this regard we have to reflect on whether fiscal morality is practiced and preached.
29. Below is a table of the unlawful expenditure (irregular, unapproved and wasteful expenditure) incurred over the last 6 years.



30. This amount has nearly doubled from R35bn to R60bn and the auditor general has already reported that for national government this expenditure has **increased 80% for 2016**, i.e. it alone stands at R48bn which equates to a R20bn increase. Therefore, if unlawful expenditure by government had not been incurred, the current tax increase could have been avoided altogether.

31. Thus, in a time when the Minister proposes 'spending caps' and reduced wastage, government nearly doubled its unlawful expenditure and then imposed a punitive "wealth tax".
32. In this regard we need to question whether the political will to really act in the best interest of the country actually exists, as the Minister can impose all the measure he likes, but without the support of the civil servants and the relevant Ministers, not much is going to be achieved.
33. As the private sector can rightfully be questioned for doing the lawful but not necessarily 'the right' thing, which undermines the country (e.g. BEPS), so to should the government reflect when its Ministers purchase Porches with taxpayer money on the justification that the law or Ministerial Handbook allows it.
34. It is with the same concern that we review the salary compensation budget. Again the Minister has implemented ceilings and various proposals which are admirable, but it becomes meaningless when a 6,5% increase is budgeted for and wage bills grow by more than 10% per annum, as seen over the last 3 years. At the end of the day, it is not the Minister but his co-ministers who are tasked to ensure implementation of the budget.
35. Below is a table highlighting our concern:



36. In real terms (i.e. adjusted for inflation or Time Value of Money) the government's wage bill has increased from R359bn in 2007 to R579bn in 2015, i.e. nearly an 80% increase and this does not even include the salaries of SOE's.

- | |
|---|
| <p>37. <u>Submission</u>: Government cannot expect and demand fiscal morality from its citizens if it does not abide by the same ethical standard and, in fact, continues to reduce its own fiscal morality.</p> <p>38. More support is required from Cabinet for the Minister of Finance to show citizens that government is willing to 'lead from the front' rather than just impose that which they themselves do not abide by.</p> <p>39. The current lack of fiscal morality cannot be supported and will result in a lose/lose situation for the country, irrespective of how draconian the Minister's fiscal powers are exercised, as it undermines the social construct the government has with its citizens.</p> |
|---|

E. South African Revenue Service – Operating model

Migration to accrual basis of accounting

40. An overview submission on the 2017 Budget Review would not be complete without commenting on the current status quo at SARS, as it is the cardinal implementer of the funding side of the budget.
41. The implementation in SARS of an accrual basis of accounting in line with GARP 3 as opposed to the Modified Cash Basis is welcomed, though a specific timeline for implementation is lacking.
42. Though this implementation would solve certain operational frustrations taxpayers have with SARS such as the practice of pre-collection, deferred refunds and blanket assessments, it also poses risks to National Treasury. These cash based practices have become quite problematic, as they have now started to impact on fiscal policy as noted by the Minister in the October 2016 MTBPS and again in the 2017 Budget Review.
43. As revenue estimations migrate to accounting entries rather than cash in the bank, National Treasury will face other challenges in ensuring that any discrepancy does not result in government spending exceeding available funds, rather than accounting funds available.

- | |
|--|
| <p>44. <u>Submission</u>: SAICA will continue to engage with SARS and National Treasury to assist in ensuring that collection policies and strategies do not only negatively impact taxpayers or on other government mandates.</p> |
|--|

Outstanding SARS Service Charter and Senior Officials List

45. The SARS' Service Charter, which was removed in 2005, has continued to elude publication, notwithstanding SARS' undertaking to the SCoF in October 2016 that it would be issued by the end of that year.

46. Though it is welcomed that SARS has now embarked on a consultation with stakeholders on the draft, no firm deadlines have been given and it remains unclear why a document that only details service standard principles has taken 12 years to update.

47. Submission: An implementation date should be provided towards which SARS and stakeholders can work, given the 12 year delay already.

48. In addition, the SARS' Senior Official list, which is essential for the administratively fair implementation of the Tax Administration Act of 2011, remains quite concerning, as it has been outstanding since 2011.

49. It is unclear why a document which is so critical and details what should be common information, namely who the SARS' Officials are that are empowered to exercise specific powers on behalf of SARS, has been outstanding for so long, given that even the current Commissioner of SARS has been in office for nearly 3 years.

50. Submission: This document should be finalised with the utmost haste given its importance in the fair administration of actions by SARS.

SARS' Communication challenges

51. The communication strain between the SARS' Commissioner and the Minister remains evident; clearly not to the benefit of the country and with which we express much concern.

52. However, a similar strained relationship has developed between SARS, taxpayers and stakeholders of which a large portion is attributable to the lack of communication by SARS to the public.

53. This includes not notifying the public of updates to practices, returns, interpretation and even such enormous events such as the change in the SARS' operating model (and its effect on taxpayers) and appointment of third party debt collectors.

54. The overall lack of communication has also added much frustration when system failures occur such as the Special Stoppers or electronic VAT return implementation and problems with the objections and appeals' system.

55. There is even a lack of communication on progress developments such as the necessary expansion of the Transfer Pricing team at SARS, which also seems to even lead to tension within government as to whether SARS is progressing with retaining or attracting the necessary talent.

56. Submission: SAICA will continue to engage with the SARS' Commissioner on the above though SARS will have to ensure that it does not unnecessarily strain relations

with taxpayers in already difficult and financially challenging times, as this will greatly increase tax apathy.

57. Furthermore, the SCoF is requested to encourage much more transparency and communication from SARS to ensure that greater collaboration is enabled between the various sectors of society.

UNCERTAINTY

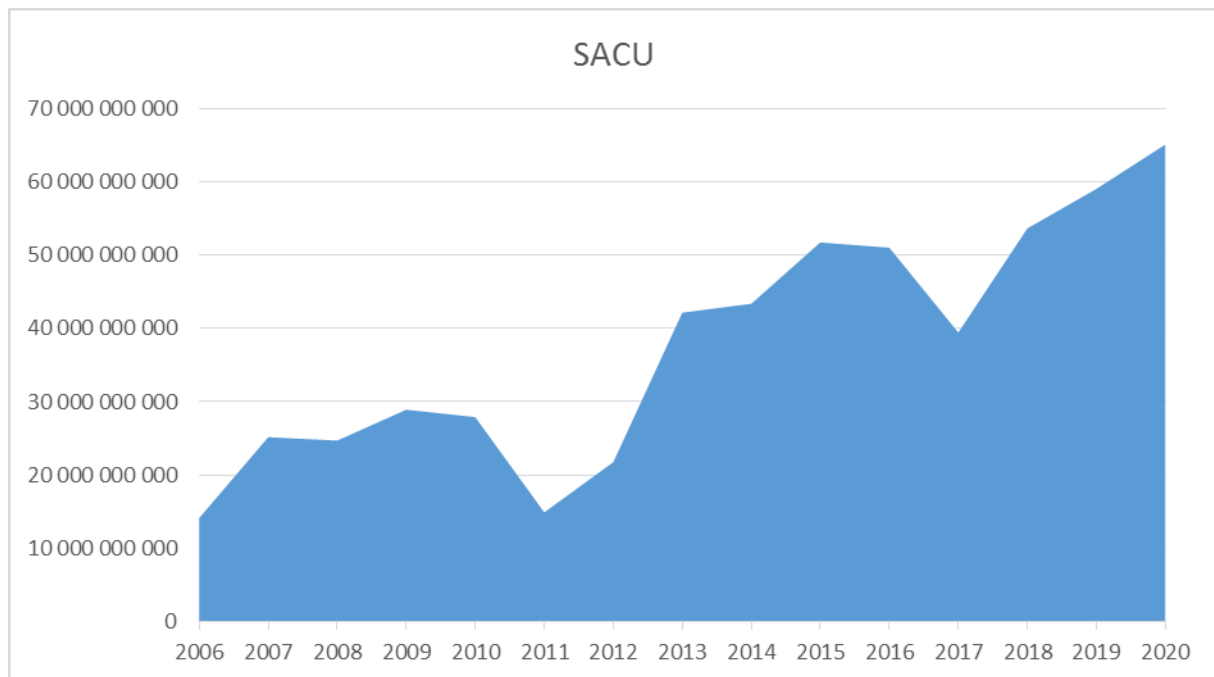
F. Policy certainty

58. Policy uncertainty continues to remain the number one contributor to lack of economic growth, as business (both foreign and local) is hesitant to invest in an economy that seems to have either no clear direction or, in fact, a landscape of contradictions in policy.
59. These include policies on the level of taxes, policies on debt levels of the state, expropriation of land, labour stability and government's proposed intervention in the economy.
60. For example, these policy contradictions include government touting small businesses as a necessary economic driver as per the NDP but doing very little to actually drive the success of small businesses.
61. The symptoms of these include no clear policy and feedback from the Ministry of Small businesses, no labour engagement to enable small businesses and no clear alignment of small business funding initiatives. In fact, small businesses are not incentivised by policies where employment and self-employment are seen as being on par, hence reward for employment should be taxed as the same levels of self-employment (i.e. dividend tax arbitrage policy) notwithstanding that self-employment is the proposed policy future (Per the NDP) though much more risky for the individual.
62. Further contradictions include that of monopoly businesses, where government proposes to decentralise the economy in the private sector, on the one hand, but on the other hand wants to create government owned big business in banks and mining and also maintain monopolies like Eskom, SAA and Telkom. The latter, which have not only prevented those industries from developing but have actually embarked in harmful practices to small businesses.
63. Submission: The Minister should reconsider the limited use of earmarked taxes which in certain instances have many more shortcomings than benefits, especially in respect of behavioural taxes such as the carbon tax and the tyre levy.

- 64. However, no clear policy statement has been made in this regard of a shift to indirect taxes as creating a future funding model and it is therefore unclear whether such a policy shift has formally been made or is merely a perception?
 - 65. The impact of indirect taxes needs to be understood by the public as these taxes are mainly hidden in upstream costs though they have downstream impacts. It furthermore also adds to the tax administration burden when multiple additional taxes are added to replace a single direct tax.
 - 66. For example, for the 2016/2017 year fuel taxes are predicted to form 45,4% of the pump price of diesel, which is up from 28,1% in 2014/2015. The impact of this on the economy and how things may change should the oil price recover to over US\$100 from its current price just above US\$30 should also be considered.
67. Submission: Clarity is sought whether National Treasury has now made a policy shift in adding more indirect taxes as part of the tax mix and what the policy thinking was in respect of this decision. Also, clarity is sought on how these specific taxes would remain effective, if not earmarked.

G. SA Customs Union

- 68. The SACU agreement, as a relic of the post 1994 democratic dispensation, was renegotiated in 2002 but it would seem that the nature of the agreement has changed.
- 69. It's pre 1994 purpose was clearly to pay-off neighbouring countries and not to develop industry in competition to South Africa rather than really to support regional trade.
- 70. This infamous agreement has however now become the proverbial milestone around South Africa's neck.



71. The Minister estimates that by 2020, R64bn will be paid to neighbouring countries, and though the Chairman of the SCoF, the Honourable Mr Carrim, probably correctly commented that this payment has become a political stability cost, it has to be questioned whether it is sustainable.
72. No proposals are being made to renegotiate the terms of this agreement to ensure that a broader participation can be allowed to the benefit of the whole region.
73. Furthermore, no comment is made as to whether South Africa can continue to subsidise neighbouring countries when no incentive exists for them to grow their own industry.
74. In 2009, Lesotho received 66% of its income from SACU, Swaziland 76% and Namibia 51%. This has grown even more since then.
75. In contrast, the SACU distribution as a % of GDP in those countries has been falling, even while their GDP's have been growing, the relevant governments continue to rely more on SA's SACU payments than on their own economies (i.e. taxes) to finance themselves. For example, in Lesotho it went down from 36% of GDP to 13% in 2010 and in Namibia from 12% to 8% in 2008².

Submission: A firm policy statement by the Minister needs to be issued on the medium and long term sustainability and plans for SACU.

² https://econrsa.org/system/files/publications/working_papers/working_paper_374.pdf