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2021
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ASSESSING THE FEASIBILITY OF REPLACING THE CURRENT INCOME-BASED TAX SYSTEM WITH A CONSUMPTION-BASED TAX SYSTEM FOR INDIVIDUALS IN SOUTH AFRICA

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A research report submitted to the Faculty of Commerce, Law and Management, University of Witwatersrand, Johannesburg, in partial fulfilment of the requirements for the degree of Master of Commerce (Specialising in Taxation).

Tshwane, 2021

Abstract

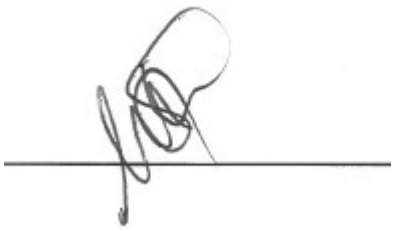
In South Africa, a small and continuously declining individual taxpayer base is a significant issue. For the 2018 tax year-end, 4,337,923 taxpayers were assessed.[1] Relative to an estimated population of 59,620,000[2], a small portion bears a disproportionate tax burden. Unfortunately, South Africans have gained notoriety for spending while saving very little.[3] Therefore, this research examines the feasibility of replacing the tax system from income-based to consumption-based. The current income-based tax system is assessed regarding its equity, the costs to comply, and the extent to which tax evasion is prevalent. Against this, a consumption-based tax system is assessed to understand its ability to sustain existing tax revenue and positively impact tax evasion while addressing its most significant critique (i.e., being regressive). The outcomes of this research suggest that this proposed change will exacerbate South Africa's disproportionate distribution of wealth, and the current political climate in South Africa will probably prevent any meaningful support.

Keywords: Tax burden, Spending, Equity, Costs to comply, Tax evasion, Sustain, Regressive, Disproportionate distribution of wealth, Political climate.

[1] South African Revenue Service., *2020 Tax Statistics*, viewed 23 September 2020 from https://www.sars.gov.za/wp-content/uploads/Docs/TaxStats/2020/Tax-Statistics-2020.pdf
[2] Stats SA., *2020 Mid-year population estimates*, viewed 21 January 2021 from http://www.statssa.gov.za/?p=13453#:~:text=South%20Africa's%20mid%20year%20population,released%20by%20Statistics%20South%20Africa.&text=The%20report%20indicates%20that%20approximately,of%20the%20population%20is%20female
[3] Trading economics., *South Africa Household Saving Ratio*, viewed 27 September 2020 from https://tradingeconomics.com/south-africa/personal-savings

Declaration

I declare that this research report is my own unaided work. It is submitted for the degree of Master of Commerce at the University of Witwatersrand, Johannesburg. It has not been submitted before for any other degree or examination in any other university.



Mohsin Khan
29 April 2021

Acknowledgements

I want to thank Professor Alwyn de Koker, my supervisor, for his guidance and support to complete this research report. Additionally, Professor Robert Vivian contributed immensely towards steering my research to a credible and value-adding report.

Finally, I want to thank my wife and family for their understanding and patience throughout this period.

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Abbreviations and acronyms

Act	Income Tax Act No. 58 of 1962
AFFT	Americans for Fair Taxation
ANC	African National Congress
COSATU	Congress of South African Trade Unions
COVID-19	Corona Virus Disease
DTC	Davis Tax Committee
GDP	Gross Domestic Product
GST	General Sales Tax
HNWIs	High Net Worth Individuals
IMF	International Monetary Fund
IRS	Internal Revenue Service
NEHAWU	National Education, Health and Allied Workers' Union
OECD	Organization for Economic Co-operation and Development
PAYE	Pay-As-You-Earn
SARS	South African Revenue Service
Stats SA	Statistics South Africa
TBOR	Taxpayer's Bill of Rights
USA	United States of America
VAT	Value-Added Tax
VAT Act	Value-Added Tax Act, No. 89 of 1991

1. INTRODUCTION

1.1. A brief overview of income tax

Fundamentally, income tax is territorial. A state has the sovereign power to declare its tax base. However, it is constrained by the practical difficulties of enforcement and collection if it were to attempt to extend the tax base beyond its geographical boundaries.[4] South African individuals are subject to tax on income, earned locally and abroad. Income tax was first enacted in South Africa in 1914. Globally, income tax is the most common and widely used basis of taxation for individuals. There are, however, some countries that do not impose income taxes.[5] Income tax was first introduced by British Prime Minister William Pitt, the Younger in 1799.[6] There was an earlier attempt to introduce income tax in England in 1404, though it was thought that this form of tax was so evil that all records had to be destroyed.[7]

In recent years, SARS has not met tax revenue collection targets set by National Treasury.[8] A primary cause for this has been depressed economic conditions. South Africa's individual taxpayer base has been shrinking over the past few years,[1] highlighting the reliance on tax collection from a small proportion of the South African population. There is a clear need for improved economic conditions.

1.2. The research problem

Taxing individuals on income impedes the ability to save, and this can be regarded as a taxation on savings (i.e., capital).[9] South African individuals currently achieve a deficient level of savings,[3] with a concomitant tendency for high consumption levels. It is nothing short of astounding when confronted with such dire economic conditions. According to the Gini index, South Africa ranks as one of the most unequal societies globally

[4] De Koker, A., 'Introduction', *Silke on International Tax*, pp. 1 – 20, LexisNexis South Africa.
[5] Trading economics., *List of Countries by Personal Income Tax Rate*, viewed 27 September 2020, from https://tradingeconomics.com/country-list/personal-income-tax-rate
[6] UK Government., *History of government*, viewed 27 September 2020, from https://history.blog.gov.uk/2015/09/16/william-pitt-the-younger-whigtory-1783-1801-1804-1806/
[7] Adams, C., 1993, *For Good and Evil – the impact of taxes on the course of civilization*, Madison Books
[8] Times Live., *SARS misses revenue collection target for fifth year in a row*, viewed 23 September 2020, from https://www.timeslive.co.za/news/south-africa/2019-04-01-sars-misses-revenue-collection-target-for-fifth-year-in-a-row/
[9] Ricardo, D., 1817, *On the Principles of Political Economy and* Taxation, John Murray

concerning wealth.[10] The wealthiest 10% of the population held around 71% of net wealth in 2015, while the bottom 60% held 7% of the net wealth.[11] A low level of savings may also be linked to low-income levels by a large proportion of the population. Considerations of covering the necessities of life take precedence over savings. Nevertheless, it does pose a fundamental question as to whether the current basis of taxation for individuals (i.e., income tax) is an appropriate basis of taxation in South Africa.

High levels of consumption by South Africans suggests that a consumption-based tax system may have merit by expanding on the existing tax base, maintaining current levels of income for the Government of the Republic of South Africa, and encouraging investments and savings.

1.3. The FairTax, a consumption-based tax system

Consumption taxes are generally viewed as a regressive form of taxation. The impact of this type of taxation reverberates throughout society, with the poor impacted significantly due to having a lower amount of disposable income on hand. Currently, there is no country with a consumption-based tax system as its primary basis of taxation, though there has been strong support for this, most notably in the USA. The system touted for in the USA is commonly referred to as the FairTax.[12]

FairTax

The idea of a consumption tax first originated in Houston, Texas, where a group of successful businessmen was lamenting that many of their business decisions focused an undue amount of time and effort on the tax implications. The AFFT was formed as a result of this. Research conducted by the AFFT gave birth to the proposed introduction of a national sales tax on new goods and services sold at a retail level. It has evolved to a commonly referred to term, known as the 'FairTax'.

[10] OECD., *Income inequality*, viewed 27 September 2020, from https://data.oecd.org/inequality/income-inequality.htm
[11] The World Bank., *The World Bank in South Africa Overview*, viewed 27 September 2020, from https://www.worldbank.org/en/country/southafrica/overview
[12] Fair Tax Act of 2019 (H.R. 25)

FairTax is a 133-page tax reform bill proposed in the USA, which aims to replace all direct and indirect taxes (e.g., corporate income tax, capital gains tax, personal income tax) with one consumption tax. FairTax was introduced in July 1999.[13] The most prominent advocates for FairTax are Congressman John Linder and Neal Boortz.

It proposes a fixed sales tax of 23%, levied on all new local goods and services sold at a retail level. It argues that the sales tax of 23%, often cited as a high increase for the price already paid by consumers, will be compensated for by a decrease in the price of new local goods and services due to the elimination of the 'embedded tax'.

The 'embedded tax' is a concept which notes the inclusion of taxes currently included as part of the cost of producing goods and supplying services. Therefore, the end consumer indirectly pays for the associated tax costs included in the cost of a good or service. An example of this is labour costs, which includes a portion paid over to the revenue collection authority as a direct tax on earnings. Studies have noted that the embedded tax of goods and services included in the USA amounts to a rate of 22%. It is argued that the introduction of FairTax will introduce a sales tax rate of 23% that is compensated for, by a reduction of embedded taxes of 22%. The embedded tax is expected to be no longer included due to eliminating all other forms of direct and indirect tax (e.g., taxes on income earned through remuneration).

FairTax does not advocate for an increase or decrease in taxes. Its primary purpose is to introduce a fair means for collecting tax revenue.

FairTax aims to introduce a primary rebate paid to all of the country's legal citizens every month to allow for necessities to be covered. It is referred to as a prebate, as it will be paid in advance. It is to counter against arguments that the proposed FairTax and the general issue around consumption tax are regressive. In the context of a flat consumption tax, a poor individual would pay a disproportionately higher amount for goods and services relative to their disposable income than a wealthy individual would.

FairTax also aims at tax evasion in the current system, specifically regarding the informal or so-called 'underground' economy. Cash flows within this sector are known to be under-declared or not declared at all. The introduction of FairTax would allow this sector

[13] FairTax Act of 1999 (H.R. 25)

to be brought into the tax revenue collection as purchases by individuals would be taxed at a retail level without the need to rely on the declaration of income, as is the current *modus operandi*.

The introduction of FairTax is expected to increase the disposable income of individuals and therefore promote savings and investments within the economy.

The simplified nature of FairTax aims to force the closure of the IRS, the tax revenue collection authority within the USA. The simplified manner of FairTax will reduce the complexity of tax compliance and enforcement, for that matter. It will negate the need for the IRS regarding enforcement on many individuals and corporations for under-declared or undeclared income and the challenging interpretation of complex tax legislation. The alleged administrative, operational, and technical inefficiencies of the IRS are also highlighted as a critical factor for introducing FairTax. It will allow for funds previously used for administering the IRS instead to be used in other areas that add value.

FairTax is not without its critics. Numerous publications have been released, citing fatal flaws in the proposal. To name a few, these are:

- Arguments that the proposed sales tax of 23% is too low to maintain current tax revenue collection and that it needs to be at a much higher and subsequently unsustainable rate
- The uncertainty of the sales tax rate of 23% in future and whether or not this may be increased at the government's whim
- The fact that no other country in the world has implemented such a system to date
- The transitional costs of changing over to a consumption-based system of tax
- Income already earned by taxpayers for which direct tax was paid will lose a significant amount of value by introducing FairTax
- The wealthy benefit more from not being able to sustainably spend and consume at a level similar to what is currently raised under direct taxes
- The wealthy can spend and consume outside of the USA, with no sales tax being paid
- The ethically questionable principle of not providing prebates to illegal citizens within the USA. These groups are usually amongst the poorest of society
- The risk for increased tax evasion when counterparties do not impose sales taxes for trade
- The closure of the IRS would result in the need for a new authority to be established to administer the new consumption-based tax system.

Further detail on FairTax will be unpacked in this research report and the chapters outlined below, with specific reference and application in a South African context.

1.4. Structure of the research report

This research report is structured as follows:

Chapter 2 analyses the full extent of taxes borne by individuals through direct and indirect taxes within South Africa. The fundamental principles of a sound tax system are then overlaid against these findings. A determination on whether individuals are subject to a tax system that aligns with these principles is then ascertained.

Chapter 3 seeks to understand the full extent of costs associated with the current tax system within South Africa. It will include the cost of administration by the Government of the Republic of South Africa and the cost to comply by taxpayers. The legislative history of tax within South Africa and its ever-growing complexity will be analysed to understand its impact on costs to the Government of the Republic of South Africa and taxpayers.

Chapter 4 seeks to identify if, at a basic level, government revenue collections can be sustained through a consumption-based tax system based on past and projected consumption patterns.

Chapter 5 analyses historical and current estimates on tax evasion within the current income-based tax system. An understanding will be sought on the potential for increased tax evasion under a consumption-based tax system.

Chapter 6 aims to assess the most extensive critique of a consumption-based tax system. Its perception as being regressive (i.e., unfairly discriminating against the poor whilst improperly benefiting the wealthy).

Chapter 7 assesses the current economic and political environment within South Africa to understand its potential impact on a proposed fundamental change to taxation. It will be considered relative to the Great Excise Crisis of 1733.

Chapter 8 concludes the appropriateness for a fundamental change of the current income-based tax system to a consumption-based tax system. Additionally, aspects for further research will be identified and recommended.

2. THE TRUE EXTENT OF TAX BORNE BY INDIVIDUALS; ITS EQUITY AND MEASURE

2.1. Introduction

Individuals are subject to direct and indirect taxes. It is fairly simple for an individual taxpayer to identify the tax rate they are subject to for direct taxes. Indirect taxes, on the other hand, poses a different challenge altogether. Significant challenges with tracking indirect taxes incurred by individuals are:

- Taxes included in the price of goods and services, with very little information shared with the public regarding these taxes.
- A significant number of transactions entered into by individuals, which are difficult to track; and
- The lack of general public awareness and education with regard to various forms of indirect taxes

2.2. Direct taxes

Individuals are taxed according to a progressive system (i.e., the tax burden increases proportionately to income). Depicted below are the latest tax rates applicable to individuals, based on their levels of income:[14]

Taxable income (R)	Rates of tax (R)
1 – 195 850	18% of taxable income
195 851 – 305 850	35 253 + 26% of taxable income above 195 850
305 851 – 423 300	63 853 + 31% of taxable income above 305 850
423 301 – 555 600	100 263 + 36% of taxable income above 423 300
555 601 – 708 310	147 891 + 39% of taxable income above 555 600
708 311 – 1 500 000	207 448 + 41% of taxable income above 708 310
1 500 001 and above	532 041 + 45% of taxable income above 1 500 000

Individual taxpayers settle their taxes due to SARS either through monthly payments or bi-annual payments.

[14] South African Revenue Service, *Rates of tax for individuals*, viewed 28 January 2021, from https://www.sars.gov.za/tax-rates/income-tax/rates-of-tax-for-individuals/

Monthly payments to SARS are made by employed individuals whose remuneration is subject to PAYE.[15] The PAYE of an individual is calculated by employers and withheld from employees' monthly remuneration payments. The employer then pays over the PAYE due to SARS on behalf of the respective employee. An employer is liable for the failure to pay over PAYE of an employee to SARS timeously.[16]

Bi-annual payments to SARS are made by individuals who earn income through means other than a salary or remuneration.[17] These payments are due and payable by the end of September and February of each tax year-end. It is referred to as a provisional tax.

Therefore, the assessment and payment of direct taxes are low in volume (monthly and bi-annually) and are certain in terms of how much tax an individual is liable for, according to their respective taxable income.

2.3. Indirect taxes

2.3.1. The concept of 'embedded tax'

Taxes included in the price of goods and services are noted as a significant challenge and relatively unknown to the layman. FairTax introduced a term for this, known as the 'embedded tax'.

The embedded tax is the associated tax included as part of the cost of producing goods and providing services. All input costs included in producing goods and providing services for sale or consumption include a tax component.

It is because all individuals and companies involved in the supply chain of specific goods or services have an intention to earn a profit from their trade. Earning a profit is likely to result in the liability to pay over direct taxes. An individual or company subject to such direct taxes needs to also factor in the associated tax they incur as part of producing goods and providing services. It includes the profit they indirectly pay over to an individual or company who has sold the said good or service for a profit. Additionally, the cost of labour includes a component of tax (i.e., PAYE). The end-user of the good or

[15] Fourth Schedule to the Act
[16] Paragraph 2 of the Fourth Schedule to the Act
[17] Paragraph 21 of the Fourth Schedule to the Act

service is the consumer, who ultimately bears the final tax burden, albeit inadvertently and without noting it specifically as a tax.

After extensive research, advocates of FairTax indicated that consumers within the USA bear approximately 22% as an embedded tax for goods and services.

2.3.2. South Africa's embedded tax

Comprehensive studies on quantifying the embedded tax rate within South Africa have not been done, and information from a South African perspective is not available.

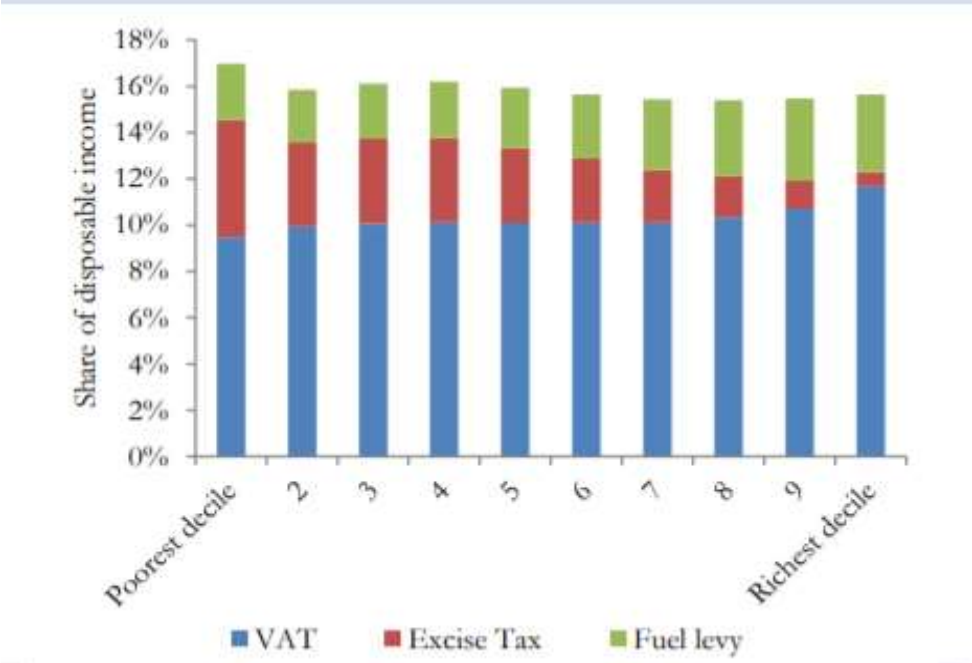
The purpose of quantifying the embedded tax rate is to understand the impact of indirect taxes on an individual.

Significant indirect taxes within South Africa are VAT, excise duties and the fuel levy. In the absence of detailed studies on the embedded tax, these three primary sources of indirect tax will be analysed and considered in their impact on individuals within South Africa.

VAT accounts for 25.6% of total tax revenue collection, with excise duties and the fuel levy accounting for 4.1% and 5.9%, respectively.[1] Together with the personal income tax contribution of 39.0%, these all contribute towards a total of 74.6% of total tax revenue collection.[1]

The graph below[18] indicates a detailed report undertaken to understand the significant indirect taxes such as VAT, excise duty and the fuel levy in proportion to the disposable income of individuals within South Africa.

[18] Inchauste, G., Lustig, N., Maboshe, M., Purfield, C. & Woolard, I., 2015, *The Distributional Impact of Fiscal Policy in South Africa*, Policy Research Working Paper Series 7194, The World Bank



This graph highlights the following:

- The proportion of an individual's share of disposable income relative to VAT and the fuel levy is progressive. It is indicated by the increased share of VAT and the fuel levy in the upper deciles.
- Excise tax is regressive. This can be attributed to the fact that the treatment of excise taxes is the same across the board.
- Combined with progressive rates levied for direct taxes,[14] the average total tax borne by an individual, is illustrated below.

Taxable income	Direct tax	Average share of disposable income for VAT, excise tax and the fuel levy	Average Total tax borne by an individual
1 – 195 850	18%	19.5%	37.5%
195 851 – 305 850	26%	19.5%	45.5%
305 851 – 423 300	31%	19.5%	50.5%
423 301 – 555 600	36%	19.5%	55.5%
555 601 – 708 310	39%	19.5%	58.5%
708 311 – 1 500 000	41%	19.5%	60.5%
1 500 001 and above	45%	19.5%	64.5%

Such an exorbitant amount of tax levied on individuals, regardless of the level of disposable income, raises many questions. First and foremost is whether this represents an equitable and fair means of collecting tax from South African individuals.

The focus then shifts to the current tax system for individuals in South Africa. Though progressive, such a high burden of taxes borne by an individual raises doubt on the equity of such a system.

2.3.3. Principles of a sound tax system

The four principles of a sound tax system are equity, efficiency, certainty, and simplicity.[19]

Equity is well-captured in Adam Smith's first canon of taxation, being equality.

'The subjects of every state ought to contribute towards the support of government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the state. In the observation or neglect of this maxim consists, what is called the equality or inequality of taxation.'[20]

The following extracts from Adam Smith's first canon of taxation, as elaborated on by John Stuart Mill, will be analysed further to clarify its relevance, relative to equity in particular:

In proportion to their respective abilities

It refers to a taxpayer's ability to bear the burden of taxation. The taxpayer's ability to bear relates to the taxation of income and not capital. It is important to note that this refers to a taxpayer's ability to bear the burden of taxation instead of the state's desire for taxation. It was well documented and understood by classical economists, with Montesquieu stating, '*To fix these [state] revenues in a proper manner, regard should be had both of the necessities of the state and those [i.e., necessities] of the subject. Nothing requires more wisdom and prudence than the regulation of that portion of which the subject is deprived [by taxation] and that which he suffered [permitted] to retain*'.[21] It is captured as part of the modern tax theory as the 'ability-to-pay' principle.

[19] Hattingh, J., Roeleveld, J. & West, C., 2016, *Income Tax in South Africa: The first 100 years (1914 – 2014)*, Juta and Company Ltd.
[20] Smith, A., 1776, *An Inquiry into the Nature and Causes of the Wealth of Nations*, W. Strahan and T. Cadell, London.
[21] Montesquieu, C.S., 1748, *The Spirit of Laws*

The phrase 'their respective abilities' indicates that those who have limited or no ability to pay tax must not be subject to tax. It introduces the concept of the necessities of life by Jeremy Bentham. It is one of the oldest fundamental principles of tax. This concept supports the view that a taxpayer should first cover all costs of living along with his or her dependants before any tax is levied.[22] John Stuart Mill proposed a fixed amount for determining the necessities of life. He did not suggest for discretion to be given to a taxpayer to determine their necessities-of-life amount. This assists in achieving a balance between what a taxpayer can bear and what the state desires.

The 'ability-to-pay' principle has been incorrectly interpreted as a motivation and support for a progressive tax system. Classical economists were against progressive tax systems. John Stuart Mill, in particular, rejected a progressive tax system and argued for a flat tax. A flat tax system is in direct contrast to a progressive tax system that increases the tax rate at higher income levels. A flat tax rather levies the same proportion of taxes at any level of income. It is thus a fixed rate.

Interestingly, the following points are noted from a South African context:

- A progressive direct tax on income is not in line with the classical economists' view.
- The current rates at which income is taxed, on a progressive basis, is primarily driven by the needs of the state.[23]

Tax revenue increases such as the increase of the VAT rate from 14% to 15% (1 April 2018) and increasing the highest marginal income tax rate for individuals from 41% to 45% (2018 tax year-end) are just some examples of measures taken by the Government of the Republic of South Africa based on the desire to increase tax revenue.

The ability of an individual taxpayer to bear this increased burden is not fairly and appropriately considered.

[22] Mill, J.S., 1848, *Principles of Political Economy*, John W. Parker
[23] National Treasury, *Budget Review 2018*, viewed 15 January 2021, from http://www.treasury.gov.za/documents/national%20budget/2018/review/FullBR.pdf

South Africa accounts for one-third of Africa's HNWIs and slightly less than one-third of Africa's total private wealth.[24] The number of wealthy South Africans looking to emigrate is increasing day by day. Approximately 4 000 HNWIs emigrated from South Africa over the last ten years.[25] High taxes are noted as one of the factors contributing to investment migration. It indicates a tax system driven by the needs of the state without the due balance being considered from a taxpayer's perspective.

A fixed rebate on tax payable is granted,[14] though the amount provided raises doubt about whether this would cover the necessities of life.

Fixed rebates provided for the 2019/20 tax year-end are structured as follows:

Type of fixed rebate	Applicable to	Rebate (R)
Primary	Below 65 years of age	14 220
Secondary	65 years and older	7 794
Tertiary	75 years and older	2 601

The average living cost in South Africa amounts to R102,000 per annum.[26] Compared to a simple gross-up of the primary rebate, relative to the various progressive individual income tax rates, it is evident that this does not cover the necessities of life. See analysis below.

Average cost of living in South Africa	
12-month average	R102 000

Tax bracket	Primary rebate	Taxable income of primary rebate	Sufficient to cover average cost of living in South Africa?
18%	R14 220	R79 000	No
26%	R14 220	R54 692	No
31%	R14 220	R45 871	No
36%	R14 220	R39 500	No
39%	R14 220	R36 462	No
41%	R14 220	R34 683	No
45%	R14 220	R31 600	No

[24] Investment Migration Insider, *The South Africa Investment Migration Report* 2020, viewed 15 January 2021, from https://www.imidaily.com/wp-content/uploads/2020/07/PREVIEW-THE-SOUTH-AFRICA-INVESTMENT-MIGRATION-REPORT-2020.pdf
[25] Capgemini Research Institute, *World Wealth Report* 2020, viewed 27 January 2021, from https://worldwealthreport.com/resources/world-wealth-report-2020/
[26] University of Witwatersrand, *Average Living Costs*, viewed 15 January 2021, from https://www.wits.ac.za/internationalstudents/financial-information/average-living-costs/

It provides an indicative view that the South African income tax system does not fully align with this first aspect of Adam Smith's first canon of taxation. With specific reference to direct taxes, the current system of taxing individuals does not allow for the necessities of life to be covered by fixed rebates. Additionally, it places an unfair tax burden on individuals without much consideration for their ability to pay these taxes.

In proportion to revenue

It is commonly understood that the taxation of capital is excluded. It was implicitly implied by Adam Smith's specific reference to the word 'revenue'. Revenue refers to income, which is derived from capital. David Ricardo also noted that a country's capital will be reduced through excessive taxation and will consequently diminish annual reproduction, allowing for the ultimate demise of a state.[9]

Applying this to a South African context raises an important aspect:

- capital and revenue are both taxed.

Though this is in contradiction to this aspect of Adam Smith's first canon of taxation, it is common across the globe for taxes to be levied on both revenue and capital.

Horizontal and vertical equity are common arguments raised in favour of taxing capital.[27] Horizontal equity refers to the taxing of individuals who realise equal profits, though different in nature (i.e., through the realisation of capital and income earned).

Vertical equity refers to the aim of a progressive tax system, where HNWIs settle most capital gain taxes. This assists in setting a highly redistributive tax system. It is crucial to South Africa as the wealthiest 10% of the population held around 71% of net wealth in 2015, while the bottom 60% held 7% of the net wealth.[11]

[27] Parliamentary Monitoring Group, *Taxing Capital Gains is Good for the Tax System, the Economy and Tax Administration*, viewed 15 January 2021, from https://static.pmg.org.za/docs/2001/appendices/010126Brooks.htm

South Africa's highest marginal income tax rate levied on individuals is 45%.[14] This places South Africa at number 20, of countries with the highest individual marginal income tax rate.[28]

The inefficient use of tax revenue

Governments, in general, are less efficient than the private sector in terms of the use of resources, including money. A high burden of taxes, utilised by an inefficient government, can also impede economic growth.

The tax-to-GDP ratio is commonly used as an indicator to measure a country's efficiency in collecting tax revenues. It is often compared to the quality of public services that a taxpayer receives, measuring the effective use of a taxpayer's revenue that has been collected. It is also referred to as a measure of a tax burden that a country's taxpayers bear.

The tax-to-GDP ratio increased marginally to 26.3% for the 2019/20 tax year-end.[1] The average OECD tax-to-GDP ratio for 2019 is 33.8%. Relative to OECD countries, South Africa ranks 32nd in terms of its tax-to-GDP ratio.[29]

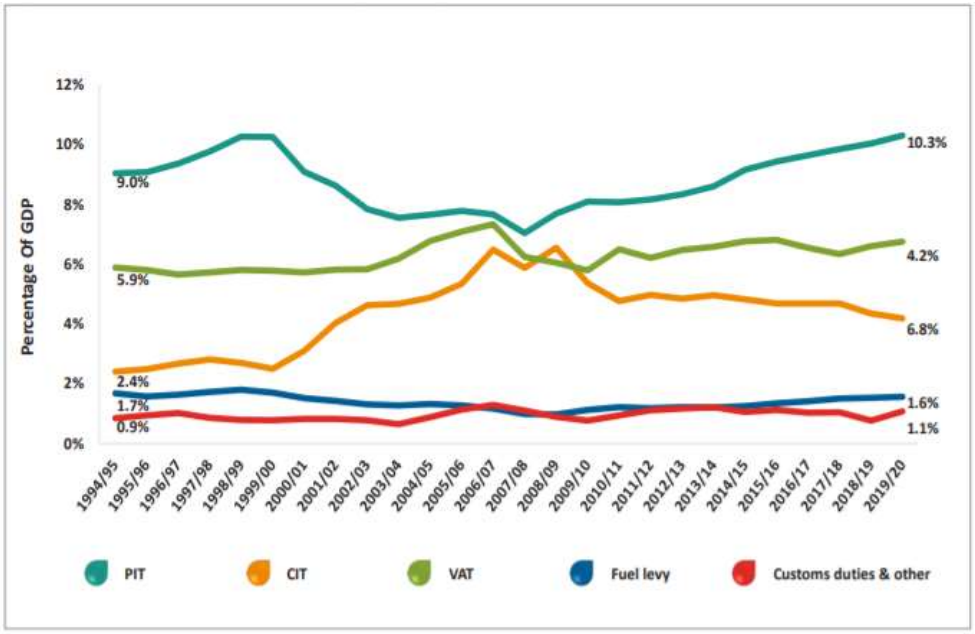
South Africa has shown a relatively constant growth trajectory in terms of its tax-to-GDP ratio. It is depicted in the table below reflecting data from 1994/95 to 2019/20,[1] reflecting South Africa's performance during its democracy.

[28] Trading Economics, *List of Countries by Personal Income Tax Rate*, viewed 7 January 2021, from https://tradingeconomics.com/country-list/personal-income-tax-rate
[29] OECD, *Revenue Statistics 2020*, viewed 9 January 2021, from https://www.oecd.org/ctp/revenue-statistics-2522770x.htm

R million	Tax revenue	Nominal GPD[1]	Tax revenue as % of GDP
1994/95	113 775	511 561	22.2%
1995/96	127 278	580 155	21.9%
1996/97	147 332	652 065	22.6%
1997/98	165 327	717 535	23.0%
1998/99	184 786	776 801	23.8%
1999/00	201 266	858 945	23.4%
2000/01	220 119	976 573	22.5%
2001/02	252 295	1 079 625	23.4%
2002/03	281 939	1 251 137	22.5%
2003/04	302 443	1 357 971	22.3%
2004/05	354 979	1 510 452	23.5%
2005/06	417 196	1 682 271	24.8%
2006/07	495 549	1 911 151	25.9%
2007/08	572 815	2 171 014	26.4%
2008/09	625 100	2 408 661	26.0%
2009/10	598 705	2 551 440	23.5%
2010/11	674 183	2 825 042	23.9%
2011/12	742 650	3 078 417	24.1%
2012/13	813 826	3 320 754	24.5%
2013/14	900 015	3 614 459	24.9%
2014/15	986 295	3 865 119	25.5%
2015/16	1 069 983	4 124 704	25.9%
2016/17	1 144 081	4 419 437	25.9%
2017/18	1 216 464	4 698 724	25.9%
2018/19	1 287 690	4 921 494	26.2%
2019/20	1 355 766	5 148 302	26.3%

1 Source: Statistics South Africa; Gross Domestic Product (GDP), Quarter 2-2020. Statistical release contains revised estimates for Gross Domestic Product (GDP) for select historical periods.

The contribution of personal income taxes to total tax revenue has shown consistent growth relative to GDP throughout the past few years. It is in direct contrast to other taxes, such as corporate income tax. Thus, additional revenue is generated by the Government of the Republic of South Africa through personal income taxes.

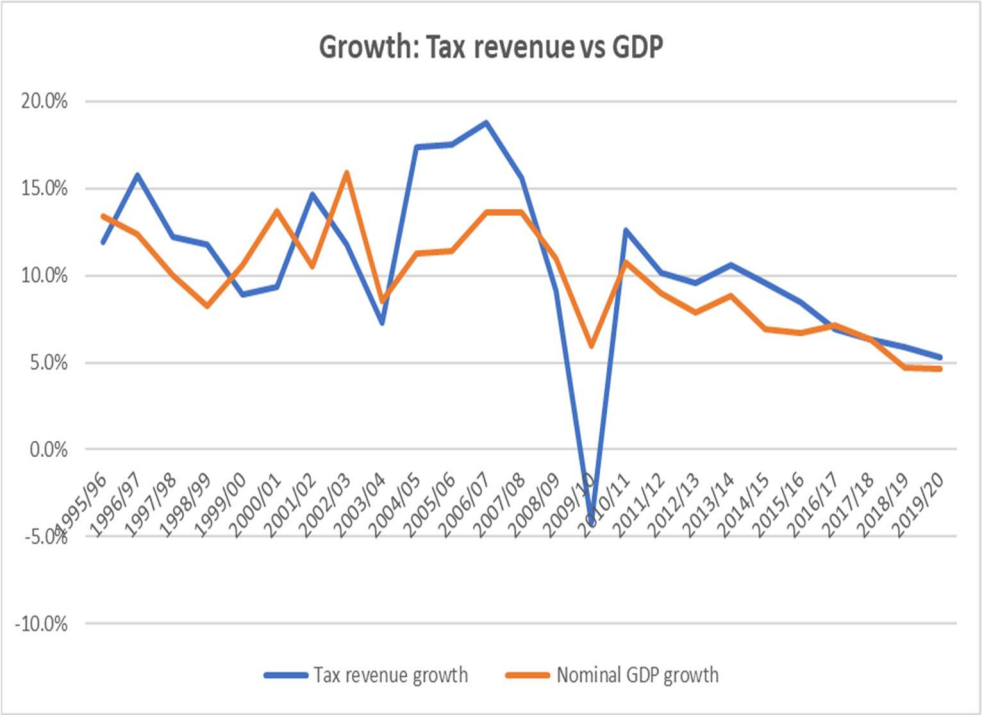


1

The lack of growth in South Africa's GDP in the past few years[30] raises questions and uncertainty regarding the efficient use of tax revenue, which ultimately impedes economic growth.

Context is always of paramount importance. South Africa's weak economic performance needs to be factored into this analysis. The graph depicted below shows an analysis of South Africa's tax revenue growth relative to nominal GDP growth.

[30] The World Bank, *GDP Growth (annual %) – South Africa*, viewed 7 January 2021, from https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?locations=ZA



[1]

Growth in tax revenue has exceeded growth in nominal GDP. It is indicative of an increased tax burden. The contribution from personal income tax has increased by 2.6% from 2015/16 to 2019/20, with all other significant streams of tax revenue such as VAT and corporate income taxes decreasing in the same period. The tax-to-GDP ratio is placing enormous reliance and strain on individuals in South Africa.

under protection of the state

The critical role of governments within taxation is emphasized through the in-depth analysis by John Stuart Mill and Adam Smith in their respective books, ‘Principles of Political Economy’ and ‘An Inquiry into the Nature and Causes of the Wealth of Nations’.

The predominant role of governments, at the time, was to protect life and property. Taxation by the state was viewed to cover costs to protect life and property. The role of government in the modern era has become very complex, with taxes not only stated to cover for the protection of life and property.

With globalisation expanding at a frenetic pace, many countries are employing a dual residence-based and source-based form of taxation. South Africa employs a dual framework, though its primary basis remains a residence-based form of taxation. The

residence-based form of taxation subscribes to the 'ability-to-pay' principle as it justifies worldwide taxation without regards to actual benefits received by the taxpayer.[31]

Survey

A survey has also been conducted to ascertain the views of taxpaying South African individuals regarding the four principles of a sound tax system.

Survey overview

The survey was broken down into four parts, with each one addressing a specific principle. To reiterate, these are equity, efficiency, certainty, and simplicity. Questions posed for each of these principles are:

Equity

- In my view, legislation in South Africa, specific to income tax as an individual, is fair and impartial.
- I pay my fair share of income tax as an individual.
- Currently, the highest marginal tax rate for an individual to pay income tax is 45%. How much would you consider increasing or decreasing this rate by?
- Income tax which I pay for as an individual, is adequately compensated for by public services I receive from the Government of the Republic of South Africa.
- Which services do you believe are not adequately provided to you by the Government of the Republic of South Africa?
- Which services do you believe are adequately provided to you by the Government of the Republic of South Africa?
- As an individual, I am liable for income tax that is in accordance with my ability to pay the income tax.
- Would you support a flat rate of tax charged on incomes for an individual, regardless of how much an individual earns?
- At what rate would you propose for a flat tax to be charged at?

[31] Barker, W.B., 2002, Optimal International Taxation and Tax Competition: Overcoming the Contradictions, *Northwestern Journal of International Law & Business*, Winter 2002, 187

Efficiency

- Income tax, which I pay as an individual, has influenced an economic decision I have made?

Certainty

- The costs for me to comply with income tax legislation is onerous and exorbitant.
- On average, I spend the following amount on tax compliance costs annually.

Simplicity

- South Africa's income tax legislation for an individual is clear and unambiguous.
- South Africa's income tax legislation for an individual is easy to comply with.
- In my experience, the South African Revenue Service satisfactorily administers and processes my income tax obligations as an individual.

Survey results

The survey and related results can be accessed through the link below:
https://www.surveymonkey.com/results/SM-J5C3JM9L9/

The survey was conducted primarily through online social media platforms, which included the use of LinkedIn, Instagram, and WhatsApp. The target audience was individuals who were potentially personally liable for income tax in South Africa. A total of 224 responses have been received up to the date of this research report.

Results of the survey conducted are outlined below:

Equity

- 55% of respondents indicated that, in their view, legislation in South Africa specific to income tax for individuals is not fair and impartial.
- 71% of respondents indicated that they would support a reduction of the highest marginal income tax rate by 5%.

The above two points indicate the needs of the state taking precedence, without considering taxpayers and their ability to pay.

- Just over 89% of respondents indicated that the income tax they pay as an individual is not adequately compensated for by services received from the Government of the Republic of South Africa.
- Electricity, healthcare, and security were noted as the top three services which are not adequately provided by the Government of the Republic of South Africa.

It fits in line with the current residence-based system of tax adopted by South Africa. These statistics are hardly surprising, considering that South Africa maintains a highly redistributive tax system, with most taxes being paid by the wealthy and a significant portion of public services spent and provided to the poor.

- 64% of respondents indicated that they were unlikely to support a flat rate of tax for individuals, regardless of the income level.

It is not in line with the classical economists view. It is interesting to note that support for a progressive income tax system, which is currently skewed towards taxing a minority portion of the population within South Africa, is against a flat tax rate.

- In any case, just over 57% of respondents indicated support for a hypothetical flat tax rate of up to 20%.

The result of this will be extended to analysing the potential consumption tax rate that can be levied if a change from an income-based system of tax is made to a consumption-based system of tax. Please refer to Chapter 4 of this research report.

Efficiency

- Just over 75% of respondents indicated that income tax had played a role in influencing an economic decision they have made.

An efficient tax does not distort economic decision making.[32] The influence of tax on an individual in South Africa certainly questions whether the current method of taxing individuals is efficient.

[32] Musgrave, R.A. & Musgrave, P.B., 1989, *Public Finance in Theory and Practice*, McGraw-Hill Education.

Certainty

- 43% of respondents indicated that compliance with tax legislation applicable to individuals was onerous and exorbitant.
- 55% of respondents indicated that they spend less than R10,000 per annum on tax compliance costs.

It is interesting to note a significant portion of respondents indicating against the fact that tax compliance is onerous and exorbitant, with the majority of respondents indicating low costs for compliance.

Simplicity

- Over 39% of respondents indicated that South Africa's income tax legislation for individuals is clear and unambiguous. Additionally, just over 48% of respondents indicated that income tax legislation for individuals in South Africa is easy to comply with.

It certainly indicates a need for simplified tax legislation, which has grown more complex over the years. The impact of this will be analysed further in Chapter 3.

- Just over 54% of respondents indicated that SARS satisfactorily administers and processes their income tax obligations as an individual.

With all of the issues plaguing SARS over the past few years, it is interesting to note that most respondents were satisfied with the level of service and efficiency they received. Challenges, though, do remain and will be further analysed in Chapter 3.

2.4. Conclusion

It is evident that individual taxpayers are subject to extremely high taxes, directly and indirectly. On average, this ranges between a combined rate of 37.5% to 64.5%, depending on the level of income an individual earns for direct taxes. Individuals are not always fully aware of the extent to which they incur indirect taxes. It is attributed to a lack of awareness, detailed knowledge on specific taxes included in the cost of goods and services, and the high level of volume an individual encounters from a transactional perspective.

The high amount of taxes incurred by individuals raises a pointed question regarding its equity and, in general, whether or not it meets the four principles of a sound tax system (i.e., equity, efficiency, certainty, and simplicity).

With regards to equity, some areas of concern are:

- The current system of taxing individuals does not fully align with the classical economists' views regarding a progressive tax being levied and taxing capital.
- a view that the state's desire to tax takes precedent over a taxpayers' ability to bear the burden of tax, and
- the current structure of rebates offered to individual taxpayers does not allow for the necessities of life to be covered.

The efficiency of the current system of taxing individuals is also called into question as it is a high area of focus for individual taxpayers when making economic decisions.

The certainty of the current system of taxing individuals aligns with expectations fairly, though this will be further explored in Chapter 3 when assessing the costs of compliance.

However, the simplicity of the current tax system is questioned due to the complexity of ever-increasing tax legislation. It is encouraging to note that SARS is viewed to efficiently and effectively administer and process individual taxpayers' tax obligations.

Overall, the current system, which South African individual taxpayers are obliged to comply with, has its flaws. It certainly is not a perfect fit for the principles of a sound tax system. The unique nature of South Africa and its history of racial and certainly economic inequality adds to this.

3. THE CURRENT TAX SYSTEM WITHIN SOUTH AFRICA: TAX REVENUE COLLECTION, THE COST OF ADMINISTRATION AND COMPLIANCE

3.1. Overview

A tax system always has a cost associated with it. Tax revenue cannot be collected without any associated cost being incurred. It has a cost implication from both the administrator and taxpayer's perspective. Briefly, this relates to tax administrative costs for operating the specific tax system and tax compliance costs by the taxpayer.[33]

South Africa has a rich history of income tax, introduced and legislated for in 1914.[34] Over the years, it has evolved from a basic system to a relatively complex system. By no means is this indicative of an unnecessarily complex system. However, it does highlight the increasing complexity of the business environment, necessitating a need for the evolution of the income tax legislation. The following statement by Justice Learned Hand aptly describes this complexity:[35]

'[T]he words of such an act as the Income Tax Act. . .merely dance before my eyes in a meaningless procession: cross-reference to cross-reference, exception upon exception – couched in abstract terms that offer no handle to seize hold of – leave in my mind only a confused sense of some vitally important, but successfully concealed, purport, which it is my duty to extract, but which is within my power, if at all, only after the most inordinate expenditure of time. I know that these monsters are the result of a fabulous industry and ingenuity, plugging up this hole and casting out that net, against all possible evasion; yet at times I cannot help recalling a saying of William James about certain passages of Hegel: that they were no doubt written with a passion of rationality; but that one cannot help wondering whether to the reader they have any significance save the words are strung together with syntactical correctness. Much of the law is now as difficult to fathom, and more and more of it is likely to be so; for there is little doubt that we are entering a period of increasingly detailed regulation, and it will be the duty of judges to thread the path-for-path there is through these fantastic labyrinths.'

[33] Pope, J., 1989, The compliance costs of personal income taxation – A review of the issues, *Australian Tax Forum*, vol. 6, no. 2, 125-142.
[34] Income Tax Act No. 28 of 1914
[35] Learned Hand, Eulogy of Thomas Walter Swan, 57 Yale LJ 167, 169 (1947), quoted in *Welder v United States*, 329 F. Supp at 741-42 (SD Tex 1971).

This chapter will briefly provide an overview of the history of income tax in South Africa, its development and its complexity to date. It will be factored into the cost of administration by SARS and the cost of compliance by taxpayers.

3.2. Administrative costs for maintaining the current tax system

Administrative costs, otherwise known as the current tax system's operating costs, are used as a key measure of a tax revenue authority's efficiency worldwide.

The international benchmark for operating costs relative to tax revenue collected is 1.0%.[1] South Africa's historical five-year cost of revenue collection has been below the international benchmark, depicted as follows:[1]

R million	Tax revenue collected	Operating cost[1]	Cost of collection[2]
2015/16	1 069 983	10 245	0.96%
2016/17	1 144 081	10 696	0.93%
2017/18	1 216 464	10 795	0.89%
2018/19	1 287 690	10 792	0.84%
2019/20	1 355 766	10 841	0.80%

1 Operating cost as disclosed in the Statement of Financial Performance for the controlling entity in the SARS: Own Accounts Annual Financial Statements.

2 Operating cost as a percentage of tax revenue

SARS has, however, been plagued by mismanagement over the past few years. Therefore, it is interesting to note that international benchmarks have been adhered to whilst damning evidence has been made regarding the operational decay of SARS under the stewardship of ex-SARS Commissioner, Mr Tom Moyane. A Commission of Inquiry was established as the integrity of SARS was questioned both domestically and internationally. This view was formed by the then Minister of Finance, Mr Gigaba. Justice Robert Nugent chaired the Commission of Inquiry. The Commission of Inquiry dealt with specific issues, one of which related to revenue collection.[36] Dr Randall Carolissen, Group Executive: Research, provided a detailed written submission outlining particular matters of the efficiency of SARS' tax revenue collections.[37] Dr Carolissen's executive summary outlined the achievements SARS had been awarded from 2008 – 2016, with

[36] *Final Report of the Commission of Inquiry into Tax Administration and Governance by SARS*, 2018, Nugent Commission, Pretoria
[37] *Final Report of the Commission of Inquiry into Tax Administration and Governance by SARS*, Appendix 4, 2018, Nugent Commission, Pretoria

one notably being the average tax buoyancy ratios of 1.2, which in effect means that the tax revenue grew 20% faster than the economy over the period.

That being said, tax buoyancy regressed to 1 with outstanding debt due to SARS escalating by 50% from R85 billion in 2014/15 to approximately R135 billion in 2017/18.

Additional detail on this regression includes:

- The reduction in tax compliance regarding PAYE and VAT. PAYE returns not being filed, which increased from 16.1% in 2008/09 to 31.0% in 2017/18. VAT saw an increase from 20.9% to 38.8% in the same period.
- South Africa regressed by 47 points on the World Bank's 'Ease of Trading across Borders' index, with inspection processes taking 23 days as of 2017/18 instead of 2 days in 2013.

The above extract reflects the regression of SARS' operating efficiency, even though it still meets the international benchmark in terms of operating costs.

3.3. The costs of compliance by taxpayers

The cost of compliance by a taxpayer is another area of interest as this is generally not reported by tax authorities. A taxpayer has the right to have the cost of compliance considered when tax legislation is administered.[38] It forms part of a TBOR. '*The TBOR does not create new rights but makes existing rights accessible to taxpayers and their advisers, and importantly to tax authority officials.*'[32] Unfortunately, South Africa does not have a TBOR. The closest to which South Africa came to a TBOR was introducing the Taxpayers' Charter in 1997. It followed on from the recommendation by the Katz Commission in 1995.[39] The Taxpayers' Charter was not meant to add on to existing rights afforded to taxpayers but rather to state rights that taxpayers have in dealing with SARS and having the ability to assess services levels.[40]

[38] *Report on Tax Administration*, 2017, Davis Tax Committee, Pretoria
[39] *Third Interim Report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa*, 1995, Katz Commission, Pretoria
[40] Franz Tomasek, *SARS Client Charter*, viewed 25 January 2021, from http://www.ftomasek.com/archive/m041297a.html

The amendment to the Taxpayers' Charter was concluded during 2002 when the draft SARS Client Service Charter was published. Currently, it is known as the SARS Service Charter and was released as a final version on the 19th of October 2005.[41] The SARS Service Charter included specific detail regarding the turnaround times on various contentious and painful administrative processes experienced by taxpayers.

Examples of these are:

- to attend to 95% of visitors within 15 minutes of arrival at a SARS branch/office.
- to respond to 80% of all correspondence received by post or electronically within 21 working days of receipt.
- to assess 80% of income tax returns within 90 working days from the date of receipt during peak periods and within 34 working days during off-peak periods: and
- to process a taxpayer's request for registration within ten working days.

Though these were seen as positive steps in establishing a sound and accountable relationship between the taxpayer and SARS, the Taxpayer Charter and SARS Service Charter did not allow for a significant benefit when it came to compliance costs for taxpayers. Unfortunately, focus and annual assessments against this Charter has fallen by the wayside, up to the point where the Taxpayers' Charter and the SARS Service Charter can no longer be located on the SARS website. A revised SARS Service Charter was published in draft form during 2009, though to date, it has unfortunately not been finalised. Therefore, as of today, South African taxpayers do not have a service charter to measure service levels received by SARS.

This also affects compliance costs relative to ever-increasing tax legislation, both in terms of volume and the level of complexity.

The most recent and sole research conducted for tax compliance costs of individuals in South Africa was published on the eJournal of Tax Research, titled 'Compliance costs matter – the case of South African individual taxpayers'.[42]

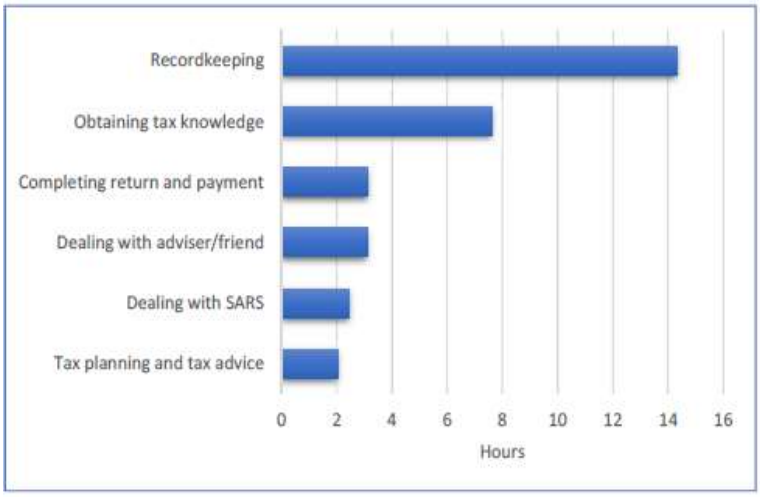
[41] Croome, B.J. & Olivier, L., 2010, *Tax Administration*, Juta and Company Ltd
[42] Stark, S. & Smulders, S., 2019, Compliance costs matter – the case of South African individual taxpayers, *eJournal of Tax* Research, vol. 16, no. 3, 801 - 823

Research noted compliance cost activities as:

- Learning and updating tax knowledge (including attending seminars and workshops)
- Tax planning and tax advice (e.g., tax opinions)
- Record-keeping (compiling information needed for tax)
- Dealing with SARS (e.g., relating to changing banking or other personal information)
- Dealing with family members/friends/tax practitioners (including providing information to them)
- Calculating tax, completing income tax returns, and paying tax, and
- Post-filing activities

The two most time-consuming activities have been noted as record-keeping and obtaining tax knowledge.[43] The findings of this research confirmed the former as the most time-consuming activity. It further identified learning and updating tax knowledge as the second most time-consuming activity, noting the possible reason for this being required to keep up to date with tax amendments continuously. This points towards the ever-increasing complexity and volume of tax legislation.

Depicted below are the results from the research, noting the average time spent annually on compliance cost activities.



The research estimated that the average compliance cost of an individual in South Africa amounted to R5,083 per annum. Once extrapolated, it was noted that the estimated total

[43] Blaufus, K., Eichfelder, S. & Hundsdoerfer, J., 2014, Income tax compliance costs of working individuals: Empirical evidence from Germany, *Public Finance Review*, vol. 42, no. 6, 128

compliance cost for individuals in South Africa for the 2016/17 tax year of assessment amounted to R32.5 billion. It amounted to 7.64% of tax revenue for personal income tax.

A brief analysis of tax compliance costs relative to personal income tax revenue has been performed, extrapolating for the study conducted for 2016/17 to the latter years, including and up to 2019/20.

Tax year	Tax compliance costs	Personal income tax (PIT) revenue	Total cost of collection for PIT
	R Million		
2016/17	32 500	425 924	7.6%
2017/18	34 262	462 903	7.4%
2018/19	36 752	493 829	7.4%
2019/20	36 814	529 172	7.0%

1 Inflation statistics March year-on-year for tax compliance costs

http://www.statssa.gov.za/publications/P0141/CPIHistory.pdf?

Though tax compliance costs relative to personal income tax revenue shows a positive trend in terms of declining rates, it still represents a high cost that taxpayers bear in terms of complying with respective tax legislation on an annual basis.

Globally, South Africa still ranks high in various studies on average tax compliance costs. It is noted from the table depicted below, which is an extract from the research concluded, 'Compliance costs matter – the case of South African individual taxpayers'.[42]

Country	Average compliance costs as a percentage of tax revenue
USA	5.0% - 8.3%
United Kingdom	3.6%
Australia	4.0% - 10.8%
Netherlands	1.4%
Spain	1.8% - 3.3%
Sweden	1.7%
Croatia	0.9%
Slovenia	2.5%
Canada	2.2% - 3.2%
Germany	3.1% - 4.7%

Source: adapted from Eichfelder and Vaillancourt (2014, p. 120)

3.4. Total compliance costs

After considering the results of tax administrative costs and tax compliance costs, an analysis has been undertaken to evaluate the total cost of compliance for the years 2016/17 to 2019/20. Assumptions in terms of the tax compliance costs for 2017/18 to 2019/20 have been made with specific key aspects relating to inflation and the number of registered taxpayers.[1] A total cost analysis solely for individual taxpayers has not been completed as tax administrative costs does not have sufficient detail to allow for costs related to individuals to be carved out and reported.

Tax year	Tax administrative costs	Number of registered taxpayers	Tax compliance costs	Total tax cost	Total tax revenue	Total cost of collection
			R Million			
2016/17	10 696	6 367 627	32 500	43 196	1 144 081	3.8%
2017/18	10 795	6 399 319	34 262	45 057	1 216 464	3.7%
2018/19	10 792	6 562 568	36 752	47 544	1 287 690	3.7%
2019/20	10 841	6 308 515	36 814	47 655	1 355 766	3.5%

1 Inflation statistics March year-on-year for tax compliance costs

http://www.statssa.gov.za/publications/P0141/CPIHistory.pdf?

To conclude, it is clear that South Africa's compliance costs (i.e., both tax administrative costs and tax compliance costs) result in a significant outlay of resources to collect the necessary tax revenues. The tax compliance costs are undoubtedly high when compared internationally. South Africa is a developing country. It should be considered when comparing to other countries, most of which are developed countries. Though much focus has been placed on the inefficient operations of SARS up to now, complex tax legislation as a significant contributor towards total costs of compliance should not be ignored.

3.5. History of income tax legislation in South Africa

The first form of income tax was introduced in the Cape in 1814 by Great Britain. It was introduced through the Cape Proclamation of 1 April 1814, of which clause 7 specifically stated '*that the ordinary assessment, instead of the general way of taxing each person, according to his apparent wealth and income, shall be taxed according to his income alone, either arising from office, profession, trade, commerce, slave hire, and other sources of a life interest, or other temporary nature, or from houses, mortgages, debts, etc., of a permanent and transmissible nature.'* Tax, in general, was primarily introduced

to fund wars around the globe. Examples of this include military expenditure by Great Britain for the Crimean War (1853 – 1856) and the Opium War (1856 – 1860). The matter of income tax for South Africa was considered from 1910, well before the outbreak of the First World War in 1914. At the time, South Africa was still considered to be a colony of Great Britain. It is widely accepted that British and other allied political leaders did not anticipate the effects of events leading to the First World War.[44] Therefore, it is widely accepted and understood that the aim of introducing income tax in South Africa was to establish a central manner of raising revenue for the Union of South Africa instead of funding a war.

The Income tax Act was first legislated for in South Africa in 1914.[34] Its enactment was significantly influenced by General JC Smuts, the then Minister of Finance and Defence of the Union of South Africa.

General JC Smuts provided data that suggested that the taxpayer base of the Union of South Africa was wealthy enough to pay for the proposed tax. A high-income threshold of 1,000 Pounds was proposed, relatively high at the time, considering the fact that England's was at 350 Pounds. Therefore, a large portion of the population would be exempt from paying taxes, avoiding a potential taxpayer revolt similar to what was experienced in 1733 by Sir Robert Walpole and his Government.[45] The proposal faced a lot of opposition, centred around the fact that it was an attack on the wealthy. On the contrary, Sir EH Walton, the then Shadow Minister of Finance from the opposition, stated the following about the high-income threshold '*A man with 1,000 pounds a year was not an object of public sympathy, but who was so optimistic to think that exemption of 1,000 pounds would last long?'*.[46] This was in response to past practice in the Cape with exemptions being introduced at 1,000 pounds, only to be lowered to 50 pounds after four to five years. Overall, the proposed introduction of the income tax was to be highly redistributive and with a small taxpayer base. Coincidentally, South Africa still retains these two traits to this day, and various other measures were introduced year on year. The contribution of personal income tax relative to total tax revenue increased from 36.4% to 39.0% for the years 2015/16 to 2019/20, respectively.[1] It is evident that the sentiments of Sir EH Walton are true to this day.

[44] Maurer, J.H., 1995, *The Outbreak of the First World War: Strategic Planning, Crisis Decision Making, and Deterrence Failure*, Praeger.
[45] Langford, P., 1975, *The Excise Crisis – Society and Politics in the Age of Walpole*, OUP Oxford
[46] Debates 1914 at 2193

The cost of administration in the first year of operation of the Income Tax Act No. 28 of 1914 equated to 2% of the tax due to the Union of South Africa.[47] Thirty-five percent of individuals were assessed for tax, with the remainder being assessed on companies.[48]

Fifty percent of income tax paid by individuals was paid by the top 8% of taxpayers, of which it stood a year later at 7.3%. During the 1920s, this rate reduced to the top 2% of registered taxpayers.[49]

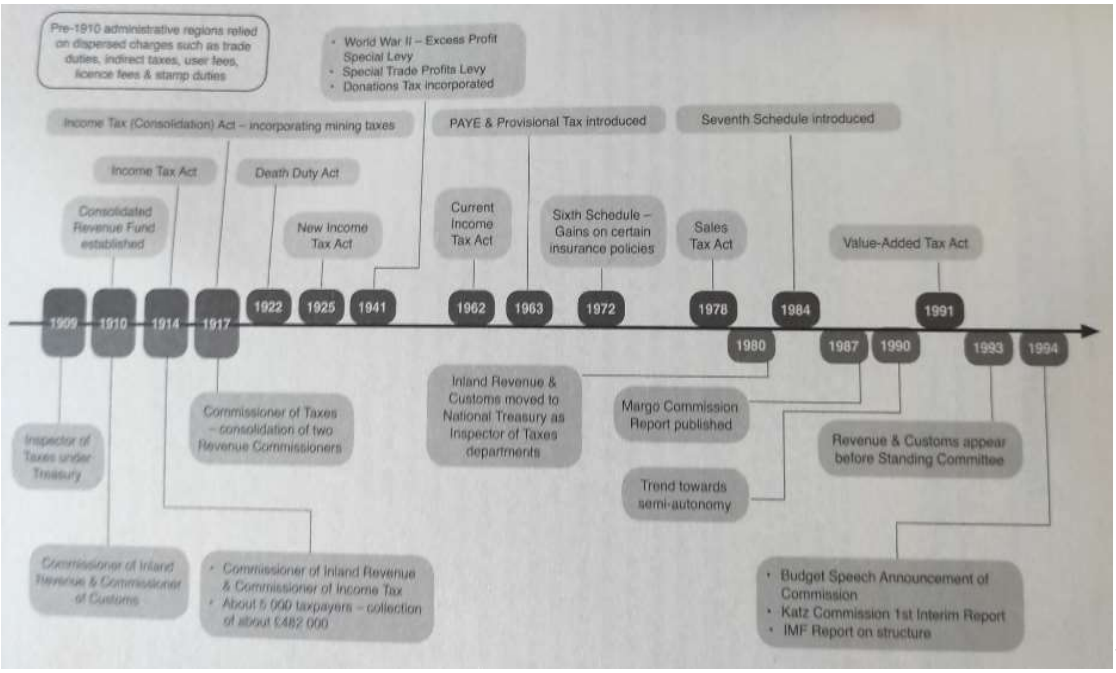
A comparison of key statistics between 1914[19] and the latest tax year-end of 2020[1] has been depicted below.

Key statistics	1914	2020
Cost of administration	2.0%	0.8%
% of tax revenue attributable to PIT	35.0%	39.0%
Percentage of taxpayers who paid at least 50% of tax	8.0%	20.5%
Number of individual taxpayers assessed	2 010	4 337 923

Though the taxpayer base has expanded significantly since 1914 (2 010 to 4 337 923 in 2020), the trend of a minority portion of the population paying the majority of income taxes for individuals continues to this day. The percentage contributed by individuals towards total tax revenue remains relatively flat, well over 100 years since the Income Tax Act No. 28 of 1914.

Amendments and the introduction of additional taxes such as sales tax (1978), VAT (1991) and donations tax (1941), to name a few, were continuously enacted throughout the period up to the present day. South Africa changed its basis of taxation from a predominantly source-based form of taxation to a residence-based form of taxation in 2001. The Act, as amended, is currently enacted.

[47] Report on the Working of the Income Tax Act, 1914. (n 111) 1.
[48] Report on the Working of the Income Tax Act, 1914. (n 111) 2, 3
[49] Lieberman E.S., 2003, *Race and regionalism in the politics of taxation in Brazil and South Africa*, Cambridge University Press



[19]

South Africa's income tax legislation has evolved considerably since its enactment in 1914. Predominant causes for this have been the desire for taxpayers to arrange their tax affairs to fall outside of the provisions enacted and the ever-increasing complexity of the business environment. The former cause certainly does not amount to tax evasion. Indeed, a taxpayer has the right to arrange his tax affairs in a manner to reduce his tax obligations.[50] The arrangements would eventually be challenged by the respective revenue authority and ultimately determined in court. Court judgments certainly added to the complexity of tax legislation, not least because it had set a precedent, which sometimes lacked sufficient rationale and logic. The evolvement of tax legislation in court judgments from 1914 to date is chronologically noted as follows:[19]

- The age of Innes sense.

It spanned a period from 1914 to 1924. Excluding capital gains was adopted in this period, whilst no guidelines were provided on the use of foreign judgments. Additionally, the courts failed to adhere to the doctrine of *stare decisis*. Practically, *stare decisis* is a principle whereby historical court cases bind courts, noting that it includes the need to also adhere to rulings by higher courts.

[50] IRC v Duke of Westminster [1936] A.C.1.

Innes CJ infamously presided over many cases during this period. Unfortunately, Innes CJ's judgments were inconsistent, whereby United Kingdom cases were expressly relied on for some cases but deemed inapplicable in other cases. Examples of such cases are *Sub-Nigel Ltd v CIR*[51] and *Natal Estates Ltd v SIR*.[52] These conflicting decisions naturally added to an increasingly complex interpretation of tax legislation.

- The great reductionist.

It spanned a period from 1922 to 1949. Watermeyer CJ is one of the most influential figures in South African judicial history. Watermeyer CJ is well-known for his reductionist approach. This approach is to understand complex issues by analysing them in simple parts. Watermeyer CJ took this approach a step further, to such an extent that taxpayers and the Commissioner would win parts of a case. It resulted in numerous split decisions which did not always have economic sense. For example, *Port Elizabeth Electric Tramway Co Ltd v CIR*,[53] Watermeyer CJ held that compensation that a taxpayer had to pay under a court order qualified as deductible expenditure, though legal costs incurred to defend that action did not qualify as deductible expenditure.

- The middle sages.

It spanned a period from 1950 to 1969 and represented a period in which fundamental concepts were refined. To name a few court cases for further reference, these are *CIR v Allied Building Society*,[54] *CIR v African Oxygen Ltd*[55] and *African Life Investment Corporation (Pty) Ltd v SIR.*[56]

CIR v Allied Building Society

Interest payable on borrowings was deductible, noting that a portion of the funds may have been used to finance the acquisition of non-productive properties. Non-productive properties were incidental to the business of borrowing money and as such, was not the 'true criterion of deductibility'.

[51] 1948 (4) SA 580 (A)
[52] 1975 (4) SA 177 (A)
[53] 1936 CPD 241 (CPD)
[54] 1963 (4) SA 1.
[55] 1963 (1) SA 681 (A).
[56] 1969 (4) SA 259 (A).

CIR v African Oxygen Ltd

A cost incurred to create an enduring benefit for trade is of a capital nature.

African Life Investment Corporation (Pty) Ltd v SIR

It was held that the taxpayer has two distinct purposes and that the secondary purpose was not merely incidental. Profit realised from the secondary purpose was deemed to be revenue in nature.

- The meme merchants.

It spanned a period from 1969 to 1987 and represented a period of coining words and phrases which have assumed the status of legal principles. To name a few court cases for further reference, these are *Berea West Estates (Pty) Ltd v SIR*[57] and *Barnato Holdings Ltd v SIR.*[58]

Berea West Estates (Pty) Ltd v SIR

Holmes JA noted that the process of realising a capital asset at the most advantageous point may 'need the hand of time'.

Barnato Holdings Ltd v SIR

Trollip JA noted the characteristics of shares held as a capital asset to be 'acquired for better or for worse, or, relatively speaking, for "keeps"'.

- The Empire strikes back; and

It spanned a period from 1983 to 1996. The appointment of Chief Justice Corbett CJ saw a turn in fortunes for the State, with specific reference to outcomes in tax avoidance cases. To name a few court cases for further reference, these are *CIR v King*,[59] *SIR v Geustyn, Forsyth and Joubert*[60] and *CIR v People's Stores (Walvis Bay) (Pty) Ltd.*[61]

[57] 1976 (2) SA 614 (A).
[58] 1978 (2) SA 440 (A).
[59] 1947 (2) SA 196 (A).
[60] 1971 (3) SA 567 (A).
[61] 1990 (2) SA 353 (A).

- The era of error.

It spanned a period from 1997 to date. It is where precedents have been misread and where long-standing principles have been controversially overturned. One of the most prominent court cases for further reference is *C: SARS v Brummeria Renaissance (Pty) Ltd*.[62] Cloete JA rejected the taxpayer's argument that where an amount accrues to the taxpayer, other than in cash, it must be capable of being turned into money, or else cannot be defined as income. This rejection did not concur with previously well-thought cases regarding this subject matter.

Throughout all of these periods, amendments would then be introduced to counter any loss to the fiscus. It is an aspect of tax that is likely never to end.[19]

3.6. Conclusion

When benchmarked internationally, South Africa's total compliance costs are noted as high.

While information concerning the cost of collection relative to tax revenues collected for individuals is not available, the statistics mentioned above certainly provide a compelling indicative overview of how South Africa's revenue collection costs stand worldwide.

Nevertheless, the operational inefficiencies of SARS and complex tax legislation that continues to grow in volume certainly contributes to this. Individuals are constantly navigating through this complex and fast-changing environment, notably being required to maintain extensive records, keeping abreast of tax developments and receiving extensive tax planning and advice.

Unfortunately, no country in the world solely operates on a consumption-based tax system. Thus, there is no adequate comparison for the cost of revenue collection from South Africa's current income-based tax system.

[62] 2007 (6) SA 601 (SCA).

4. MAINTAINING SUSTAINABLE REVENUE COLLECTION BY THE GOVERNMENT OF THE REPUBLIC OF SOUTH AFRICA

4.1. Tax revenue overview for South Africa

The collection of tax is the focal point for funding government expenditure. SARS accounts for approximately 90% of all revenue collected by the Government of the Republic of South Africa.[1] Tax revenue is therefore critical for maintaining committed government expenditure. Recent historical tax revenue collection is depicted below:[1]

R million	Direct				Indirect					
	Personal Income Tax (PIT)[1]	Company Income Tax (CIT)[1]	Dividends Tax (DT)/Secondary Tax on Companies (STC)[2]	Other	Value-Added Tax (VAT)	Fuel levy	Customs duties[3]	Specific excise duties	Other	Total tax revenue
2015/16	389 280	193 385	23 934	17 558	281 111	55 607	46 250	35 077	27 779	1 069 983
2016/17	425 924	207 027	31 130	17 660	289 167	62 779	45 579	35 774	29 042	1 144 081
2017/18	462 903	220 239	27 894	19 704	297 998	70 949	49 152	37 356	30 271	1 216 464
2018/19	493 829	214 388	29 898	19 662	324 766	75 372	37 902	40 830	51 043	1 287 690
2019/20	529 172	214 986	27 930	19 083	346 761	80 175	55 428	55 428	26 802	1 355 766
Percentage of total										
2015/16	36.4%	18.1%	2.2%	1.6%	26.3%	5.2%	4.3%	3.3%	2.6%	100.0%
2016/17	37.2%	18.1%	2.7%	1.5%	25.3%	5.5%	4.0%	3.1%	2.5%	100.0%
2017/18	38.1%	18.1%	2.3%	1.6%	24.5%	5.8%	4.0%	3.1%	2.5%	100.0%
2018/19	38.3%	16.6%	2.3%	1.5%	25.2%	5.9%	2.9%	3.2%	4.0%	100.0%
2019/20	39.0%	15.9%	2.1%	1.4%	25.6%	5.9%	4.1%	4.1%	2.0%	100.0%

1 Includes interest on overdue income tax.

2 Dividends tax (DT) replaced Secondary Tax on Companies (STC) on 1 April 2012

3 Excludes Miscellaneous customs and excise receipts.

The introduction of a consumption-based tax system would eliminate the company income tax, dividends tax, fuel levies, customs duties, excise duties, and other forms of direct taxes. The only tax to remain would be VAT. VAT accounts for 25.6% of total tax revenue collected.[1] Removing all other tax forms would see a large gap of approximately 74.4%, which a newly introduced consumption-based tax system would have to bridge. South Africa currently taxes consumption through VAT at a rate of 15%.[63] The consumption of most goods and services provided in South Africa is currently taxed at 15%. Some goods and services are exempt or in respect of which VAT is levied at 0% (i.e., zero-rated).[64] The majority of these goods and services apply to essential goods and services generally consumed by the poor. It is a measure introduced to address the regressive nature and impact of VAT.

Bridging the gap of taxes that would no longer be collected in a consumption-based tax system would require a combination of increasing the rate charged for VAT as well as no longer zero-rating and exempting certain goods and services.

[63] Section 7(1) of the VAT Act
[64] Section 11 and Section 12 of the VAT Act

South Africa's consumption statistics will be analysed to understand and identify:

- The quantum of consumption in its entirety, historically and forecasted
- The quantum of consumption concerning essential goods and services, historically and forecasted.

The statistics outlined above will assist in understanding the gap that currently resides regarding zero-rated and exempt goods and services, and then accordingly a potential increase in the rate charged for VAT to increase VAT collected to a level on par with current total tax revenue.

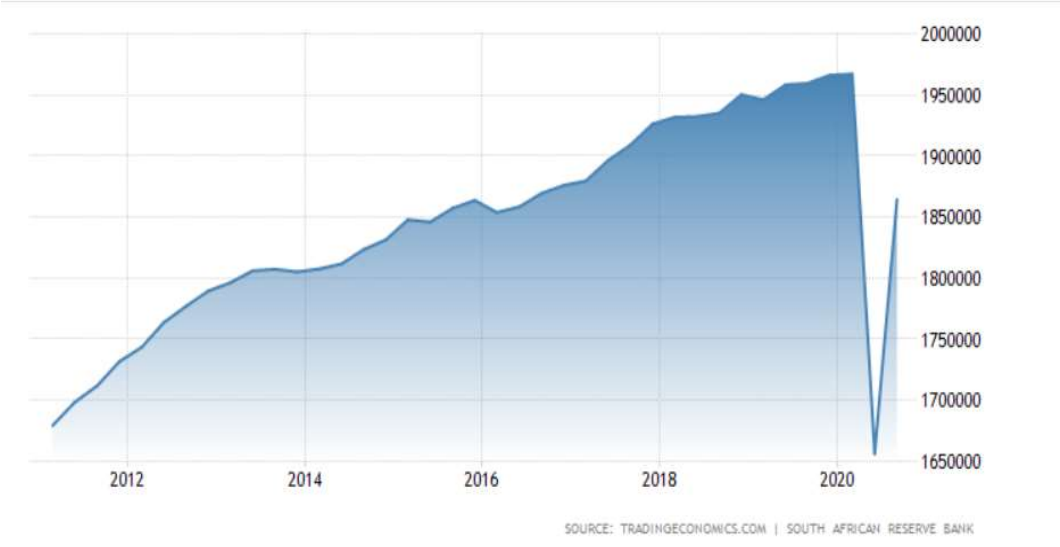
4.2. Total historical consumption for South Africa

South Africa's consumption over ten years has consistently increased at an alarming rate. Before the impact of COVID-19 during the second quarter of 2020, consumer spending for the first quarter of 2020 stood at R1.97 trillion. Before 2015, consumer spending accounted for less than R1.85 trillion every quarter. It represents a 6.5% increase in consumer spending over five years (Refer to graph a. illustrated below).

Relative to a negative household savings ratio for the majority of the past five years, as depicted below in graph b., it is evident that South Africans continue to increase consumption whilst neglecting savings. The lack of savings has been cited as a major concern for South Africa. The latest data from the World Bank indicates that South Africa's gross savings relative to GDP amounts to 15%, well behind the global average of 24.6%.[65] Additionally, the GDP growth rate has regressed over the past ten years, with consumer spend actively growing year-on-year. See graph c. depicted below, showing the historical 10-year consumption and GDP growth rate.

[65] The World Bank, *Gross Savings (% of GDP)*, viewed 30 January 2021, from https://data.worldbank.org/indicator/NY.GNS.ICTR.ZS

a. Historical 10-year consumption



[66]

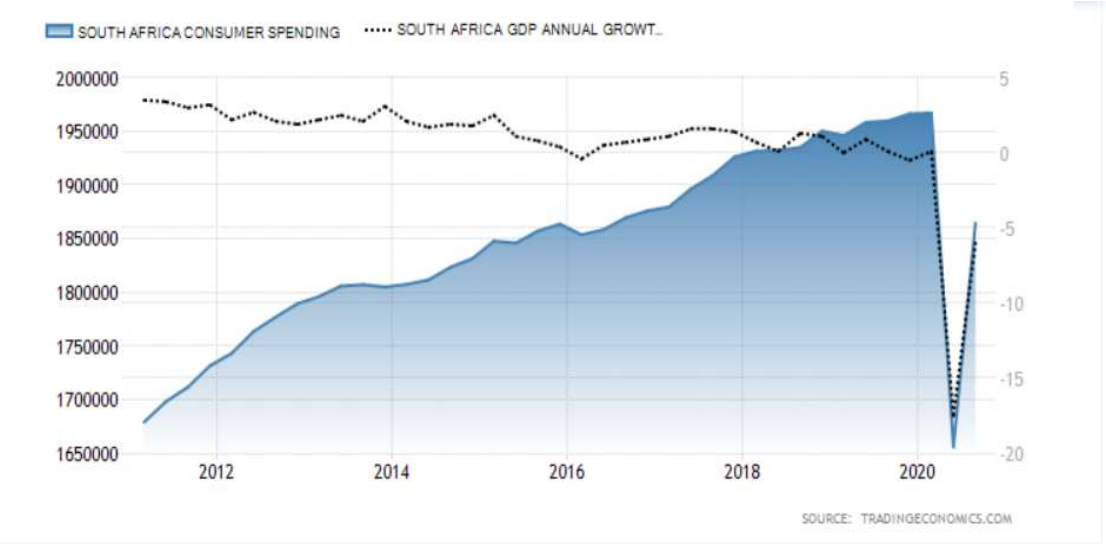
b. Historical 10-year household savings ratio



3

[66] Trading Economics, *South Africa Consumer Spending*, viewed 15 January 2021, from https://tradingeconomics.com/south-africa/consumer-spending

c. Historical 10-year consumption and GDP growth rate



66

4.3. Forecasted consumption for South Africa



66

The impact of COVID-19 during 2020 is depicted as an outlier in the above graph. Forecasted consumption is expected to recover and eventually exceed the R2 trillion mark, closely approximating the R2.1 trillion mark towards the end of 2022.

The graph above clearly illustrates the sensitivity of tax revenue collection based on consumption. It creates a risk for sustainable revenue collection on an annual basis for funding government expenditure. A significant decline in consumption for unforeseen

catastrophic events may render the government unable to collect sufficient tax revenues in a short timeframe in order to fund expenditure.

4.4. Consumption spend analysis

It is crucial to identify detail regarding consumption spend, specifically to identify goods and services currently exempt or levied at a rate of 0% (i.e., zero-rated) for VAT. It will allow for identifying current consumption to be charged with VAT before considering any increase in the current VAT rate.

4.4.1. Plugging the gap – VAT generated from existing consumption.

There are specific goods and services which are either zero-rated or exempt from VAT being levied. It is detailed within section 11 and 12 of the VAT Act. To summarise, though not exhaustive, these are:

Section 11 (zero-rated)

- Essential food items (e.g., brown bread, maize meal)
- Fuel
- Business operating as a going concern
- Agricultural and pastoral goods to registered farmers
- Goods and services exported
- International transport
- Municipal property rates
- Housing subsidies to beneficiaries
- Grants paid by public authorities

Section 12 (exempt)

- Financial services
- Residential accommodation
- Passenger transport by taxi, bus, or train
- Educational services
- Childcare services

The latest Living Conditions Survey by Stats SA for 2014/15 outlines detailed information regarding household consumption. This survey focused on income, consumption and spending patterns of households at a national and provincial level.

Extracted from the Living Conditions Survey is detail related to goods and services identifiable to a great degree regarding the list of exempt and zero-rated supplies already reflected.

Percentage distribution of annual household consumption expenditure	
Expenditure group	**%**
Bread and cereals	3.1%
Milk, cheese, and eggs	1.3%
Oils and fats	0.5%
Fruits	0.3%
Vegetables	1.2%
Rentals paid by tenants	5.1%
Gas	0.1%
Liquid fuels	0.1%
Passenger transport by railway	0.1%
Passenger transport by road	3.2%
Education	2.5%
Financial Services	0.6%
	18.1%

In summary, household consumption that is not subject to VAT amounts to 18.1% of household consumption. Extrapolating an average quarterly spend of R1.91 trillion between 2015 and 2020, the total consumption expected to add to existing VAT revenue for a year, amounts to R1.38 trillion (R1.91 trillion X 4 quarters X 18.1%). Taking South Africa's VAT rate of 15% into account, this would raise revenue of R207.4 billion. Considering the tax gap of 74.4% noted above, additional tax revenue of 15.3% will be generated.

It is important to note that terms such as excise duties and the fuel levy will fall away, but their impact and effect on taxation are unlikely to follow. It is because excise duties and the fuel levy are effectively taxes on consumption, albeit at often higher rates. For purposes of this research report, their impact within a consumption-based tax system is assumed to be neutral. These will therefore account for R217.8 billion of taxes on consumption.[1]

The remaining gap of 43% of total tax revenue (i.e., R583.4 billion) is thus required, at a minimum, to maintain total tax revenue collections for 2019/20.

4.4.2. Plugging the gap - VAT rate increase

A tax gap of R583.4 billion, relative to an average consumption of R7.64 trillion (R1.91 trillion X 4 quarters), requires an increase in the VAT rate of 7.6%.

The proposed VAT rate would therefore stand at 22.6%. It would place South Africa 12th on the list of countries with the highest rate for indirect taxes.[67] It would place South Africa, on average, well above the 15.79% for Africa, 15.51% globally and 19.23% for the OECD.

4.5. Conclusion

The risk, though, remains with regards to significant incidents such as the 2008 global financial crisis and COVID-19 during 2020. Significant declines in consumption put sustainable tax revenue collection at risk, thus impacting a government's ability to continue its committed projects.

The increase of any tax rate should always consider Adam Smith's first canon of taxation (Chapter 2). Specific focus within the first canon of taxation should be on the ability-to-pay principle. Analysis on increasing the VAT rate within this chapter has only been considered from the Government's point of view, without assessing the taxpayer's ability to bear this burden of tax. Results from the survey conducted on the principles of a sound tax system (Chapter 2), from a South African context, has noted that in general, individuals would prefer a flat tax to be levied at no more than 20%. Though this question was posed to direct taxes, it is interesting to note that the increased rate required for VAT (i.e., 22.6%) would exceed this tolerable threshold identified by respondents of the survey.

Setting aside discussions on VAT that will be collected from goods and services no longer zero-rated and exempt from VAT along with an increase in the rate of VAT, it

[67] KPMG, *Indirect Tax Rates Table*, viewed 15 January 2021, from https://home.kpmg/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online/indirect-tax-rates-table.html

should also be borne in mind that a tax gap exists as well. The ability of South Africa to reduce this gap will undoubtedly assist in reducing the significant gap that has been identified for purposes of changing over to a consumption-based system of tax. Further detail on this is discussed within this research report in Chapter 5 – Tax evasion.

5. TAX EVASION

5.1. Overview

A taxpayer has the right to arrange his tax affairs in a manner to reduce his tax obligations.[50] It is not uncommon for taxpayers to do as such. It is otherwise known as 'tax avoidance', a legal manner of reducing tax obligations and liabilities. The differentiation between permissible and impermissible tax avoidance is another challenging aspect, which is not discussed in detail within this research report. 'Tax evasion', on the other hand, involves the misrepresentation or concealment of a taxpayer's actual state of affairs to the relevant tax authority. It leads to the reduction of a taxpayer's tax liability through illegal means.

There is a fine line to maintain in tax collections which may entice taxpayers to consider tax evasion. The higher the tax burden, the more likely it is that taxpayers will consider evading tax. Often, it is referred to as 'tax morality'. The word 'moral' refers to 'adhering to conventionally accepted standards of conduct, based on a sense of right and wrong according to conscience'.[68] Tax morality refers to the willingness of individuals to pay their taxes and comply with tax laws. Tax morality is driven by several factors that work to define whether people feel inclined or disinclined to contribute to the tax revenue of South Africa.[69] The following factors are identified to contribute towards a breakdown in tax morality:

- The use of taxpayer money by the Government of the Republic of South Africa
- What the taxpayer receives in return for paying over taxes; and
- How taxes are collected and the faith and trust placed on SARS to assist in resolving any issues.

Like any other country globally, South Africa is no different when it comes to tax evasion. The DTC was established by the Minister of Finance in 2013, with its primary objective to assess South Africa's tax policy framework and its role in supporting the objectives of inclusive growth, employment, development, and fiscal sustainability.[70]

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[68] Collins English Dictionary
[69] Du Chenne, S., 2018, Tax morality: The morals and ethics of tax, *Tax Professional*, Issue 32, 4 - 6
[70] The Davis Tax Committee, *About Us*, viewed 16 January 2021, from https://www.taxcom.org.za/aboutus.html

The Minister of Finance extended the DTC's term of office during his budget speech in February 2019. It was to allow the DTC sufficient time to investigate the tax gap.

The DTC conservatively estimated that South Africa lost an estimated R50 billion per annum due to customs, VAT, base-erosion, profit shifting, and tax non-payment by wealthy individuals.[71] VAT fraud and tax evasion by HNWIs had not yet been quantified, with customs and base-erosion and profit shifting studies indicating a loss of $3.4 billion[72] and R7 billion,[73] respectively. Therefore, the impact of tax evasion is significantly higher than the conservatively estimated R50 billion lost in tax evasion.

5.2. Tax evasion - Personal income tax

This research report aims to primarily understand the merit of completely removing personal income taxes (along with all other forms of taxation, excluding VAT), favouring a consumption-based tax system. It is therefore imperative to understand the potential for tax evasion from personal income taxes. It will allow a meaningful comparison and analysis relative to a consumption-based system of tax.

Depicted below is the disaggregation by type within personal income taxes.

R million	Pay-as-you-earn (PAYE)	Provisional tax	Assessment payments	Employment Tax Incentive (ETI)	Refunds	Subtotal	Interest on overdue income tax	Total
2015/16	376 164	26 101	10 647	-4 063	-20 747	388 102	1 177	389 280
2016/17	410 807	28 641	12 719	-4 656	-22 965	424 545	1 379	425 924
2017/18	446 274	29 796	16 001	-4 317	-26 801	460 953	1 950	462 903
2018/19	477 503	34 935	14 668	-4 512	-30 511	492 083	1 746	493 829
2019/20	518 243	31 339	14 168	-4 754	-31 364	527 633	1 540	529 172
Percentage of total								
2015/16	96.6%	6.7%	2.7%		-5.3%	99.7%	0.3%	100.0%
2016/17	96.5%	6.7%	3.0%		-5.4%	99.7%	0.3%	100.0%
2017/18	96.4%	6.4%	3.5%		-5.8%	99.6%	0.4%	100.0%
2018/19	96.7%	7.1%	3.0%		-6.2%	99.6%	0.4%	100.0%
2019/20	97.9%	5.9%	2.7%		-5.9%	99.7%	0.3%	100.0%

1

From the above, it is evident that PAYE forms a significant component of personal income taxes. It can be linked directly to the fact that legislation requires employers to

[71] Sowetan Live, *Tax fraud and evasion cost R50bn a year, says Dennis Davis*, viewed 16 January 2021, from https://www.sowetanlive.co.za/news/south-africa/2019-12-28-tax-fraud-and-evasion-cost-r50bn-a-year-says-dennis-davis/

[72] Global Financial Integrity, 2018, *South Africa: Potential Revenue Losses Associated with Trade Misinvoicing*

[73] Wier, L. & Reynolds, H., 2018, *Big and 'unprofitable': how 10% of multinational firms do 98% of profit sharing*, SA-TIED

pay over an employee's appropriate personal income tax due for a specific month. An employer and an employee will both need to collude and this minimises the risk of tax evasion through non-payment or the understatement of taxable income. Provisional taxes are likely to contain the yet to be quantified tax evasion amount by HNWIs. HNWIs tend to earn a significant amount of their income through passive income. This form of income is collected through provisional taxes.

Recent research has been published, estimating the extent and nature of South Africa's personal income tax gap, disaggregating the gap by the type of income (salaried and non-salaried).[74]

A bottom-up approach has been used to estimate South Africa's personal income tax gap. This study used data from the Income and Expenditure Survey of 2005/06 and 2010/11.[75] The findings of this study, relevant to this research report are as follows:

R billion	2005/06				2010/11			
	Potential collection	Actual collection	Tax gap	Compliance rate	Potential collection	Actual collection	Tax gap	Compliance rate
PIT revenue	276.4	216.3	60.1	78.3%	316.6	290.4	26.2	91.7%
PAYE revenue	218.2	201.0	17.2	92.1%	265.1	264.8	0.3	99.9%
Provisional tax revenue	58.2	15.3	42.9	26.3%	51.5	25.6	25.9	49.7%

Compliance with regards to provisional taxes is a major issue. High levels of compliance and major progression from 2005/06 to 2010/11, regarding PAYE revenue, has been attributed to the following:

- The introduction of an electronic management queue system, reducing average queue times by 57%
- The introduction of an electronic filing facility, resulting in the efficient submission and processing of tax returns; and
- The rollout of an Individuals Taxpayer Policy Registration required all formal employees to register as taxpayers.

[74] Dare, C., Du Plessis, S. & Jansen, A., 2019, Tax revenue mobilisation: Estimates of South Africa's personal income tax gap, *South African Journal of Economic and Management Sciences*, 22(1), a2817
[75] Stats SA, 2017, *Income and expenditure Survey 2005/06 and 2010/11*

SARS has experienced tax revenue shortfalls since 2014/15.[76] The actual tax gap for personal income tax, together with other forms of tax gaps mentioned by the DTC, would cover the respective shortfalls identified for actual tax revenue collection, relative to revised estimates and original budgets, respectively. Depicted below is a table that adequately reflects such:

R billions	Tax revenue shortfall (Actual vs Original budget)
2014/15	R7.3
2015/16	R11.3
2016/17	R30.6
2017/18	R49.0
2018/19	R57.3
2019/20	R66.4

5.3. Tax evasion - Consumption-based tax

Tax evasion is one of the components of the so-called VAT gap. The VAT gap is the difference between the VAT, which is due under the law, and the amount of actual VAT collected.[77]

The IMF was requested to prepare a tax gap analysis for VAT in South Africa, specifically for the DTC.

The Fiscal Affairs Department of the IMF produced a final report, titled 'Revenue Administration Gap Analysis Program – The Value-Added Tax Group', during February 2015.[78]

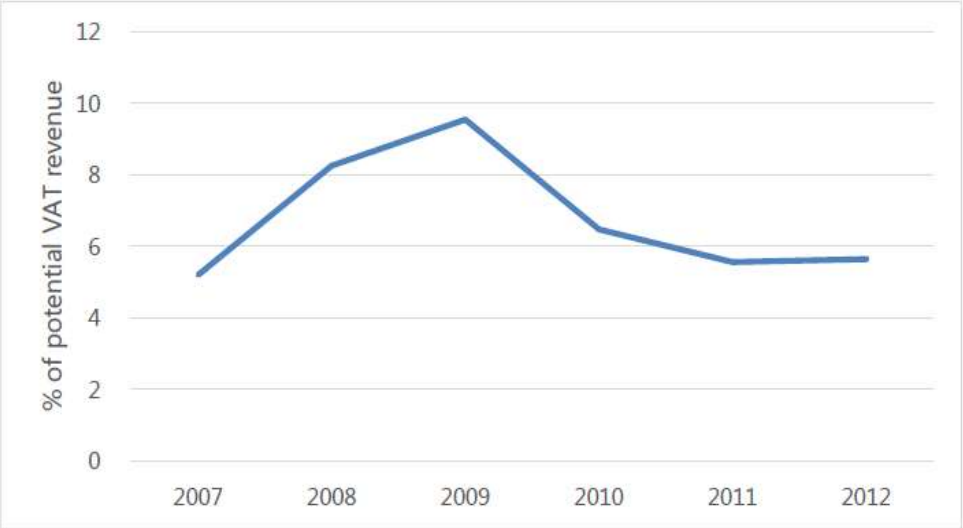
The report's methodology used a top-down approach for estimating the potential VAT base whilst using data on value-added generated in each sector.
The report produced a few key aspects that can be specifically related to tax evasion:

- That the compliance gap was estimated to be between 5% to 10% of potential revenues during 2007 – 2012

[76] Businesstech, *South Africa's tax base is shrinking*, viewed 18 January 2021, from https://businesstech.co.za/news/finance/438917/south-africas-tax-base-is-shrinking-2/#:~:text=The%20unemployment%20figures%2C%20as%20well,Who%20pays%20South%20Africa's%20taxes%3F
[77] *First Interim Report on Value-Added Tax*, 2015, Davis Tax Committee, Pretoria
[78] International Monetary Fund., 2015, *Revenue Administration Gap Analysis Program – The Value-Added Tax Group*

The compliance gap is noted as the difference between the estimated net VAT collections and the accrued net VAT collections for a specified period.

This gap is estimated to be low according to international standards, well below that of European and Latin American countries. Depicted below is a graph reflecting the VAT compliance gap over a period, from 2007 – 2012.



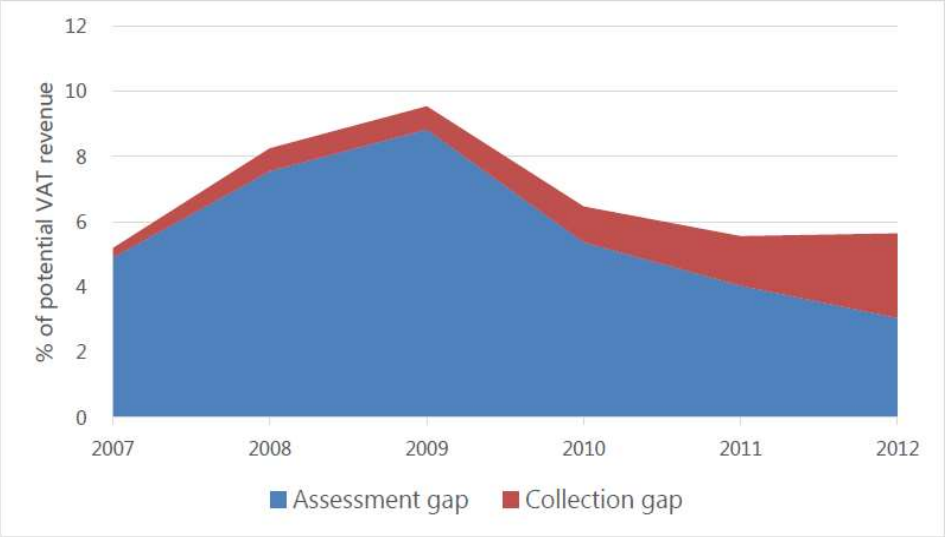
It is noted that the compliance gap is made up of identified and unidentified portions, being a collections gap and assessments gap, respectively.

The collections gap is the difference between actual VAT collections and VAT declared and assessed.

The assessment gap is the difference between VAT declared and assessed and potential VAT that could have been declared and assessed.

The collections and assessment gap could include indicative elements of tax evasion, with the intended evasion of settling VAT that is due and payable to SARS and the under-declaration of VAT due and payable to SARS.

Depicted below is the collection and assessment gap over a period from 2007 to 2012.



The collection gap has gradually increased, indicating a decline in the quality of the debtor's book of SARS. Outstanding debt due to SARS escalated by 38% from R64 billion in 2006/07 to approximately R88.6 billion in 2011/12.

• That the c-efficiency ratio was on average 63.6%

The c-efficiency is a general measure widely used to compare the overall performance of the VAT system. It presents the ratio of actual VAT collections to the amount collected under a perfectly enforced tax levied at the standard rate on overall final consumption.

This c-efficiency ratio of South Africa's is considered relatively high amongst Sub-Saharan African countries.

The high ratio can be attributed to South Africa's simple VAT structure and potentially effective revenue collections by SARS. Additionally, South Africa does not tax all consumption on an equal basis. There are specific exceptions, such as the zero-rating of certain supplies that aims to address the regressive nature of VAT.

5.4. Conclusion

From the above, it is evident that personal income tax revenue accounts for a higher tax gap when compared to VAT. Therefore, it can be deduced that a change to a consumption-based tax system is unlikely to yield a higher rate of tax evasion.

The regressive nature of VAT and the implications of the proposed change to a consumption-based tax system will be discussed further in Chapter 6.

6. FUNDAMENTAL CRITIQUE OF A CONSUMPTION-BASED TAX SYSTEM. A BENEFIT TO THE WEALTHY AT THE EXPENSE OF THE POOR

6.1. VAT – regressive by nature

VAT, the current consumption tax within South Africa, was introduced in 1991. It replaced the GST.

The initial VAT rate was at 10%, after which it was increased to 14% in 1993. It remained at that rate until 2018, increasing to 15%.

VAT accounts for 25.6% of total tax revenue.[1] It is a significant contributor towards tax revenue.

Indirect taxes, including VAT, are generally regressive. National Treasury in South Africa has introduced some measures to counteract VAT's regressivity by introducing zero-rated and exempt goods and services. The poor generally spend a proportionately higher amount of their disposable income in consuming these specifically identified goods and services. Zero-rated and exempt goods and services have countered the regressive nature of VAT to a certain extent. Depicted below is a table that demonstrates the relative progressive nature of South Africa's current VAT policy and structure.

Table 4. Progressivity of indirect taxes [1/]

	Disposable income and concentration shares (in %)					Cumulative disposable income and concentration shares (in %)				
Decile	Disposable income	VAT	Excise tax	Fuel levy	Indirect taxes	Disposable income	VAT	Excise tax	Fuel levy	Indirect taxes
1	0.54%	0.47%	3.44%	0.39%	0.68%	0.54%	0.47%	3.44%	0.39%	0.68%
2	1.00%	0.88%	3.52%	0.75%	1.05%	1.54%	1.35%	6.97%	1.14%	1.73%
3	1.38%	1.22%	3.76%	1.04%	1.38%	2.92%	2.57%	10.73%	2.19%	3.11%
4	1.86%	1.67%	4.65%	1.41%	1.84%	4.78%	4.24%	15.38%	3.60%	4.95%
5	2.54%	2.31%	5.83%	1.88%	2.49%	7.32%	6.55%	21.20%	5.48%	7.44%
6	3.62%	3.28%	7.79%	3.04%	3.57%	10.94%	9.83%	29.00%	8.52%	11.01%
7	5.45%	4.99%	10.15%	5.10%	5.40%	16.39%	14.82%	39.15%	13.63%	16.42%
8	9.09%	8.42%	13.30%	9.15%	8.94%	25.49%	23.24%	52.46%	22.77%	25.36%
9	17.86%	17.20%	18.34%	19.24%	17.72%	43.34%	40.44%	70.79%	42.02%	43.08%
10	56.66%	59.56%	29.21%	57.98%	56.92%	100.00%	100.00%	100.00%	100.00%	100.00%

Source: Own calculations based on IES 2010/11.

1/ The distribution of disposable income and tax concentration shares for the population are ordered by disposable income deciles. 18

The bottom four deciles accounted for 4.78% of disposable income yet accounted for 4.24% of the total VAT incurred.

On the contrary, the top decile accounted for 56.66% of disposable income, with 59.56% being incurred in VAT.

It is important to note that any increase in the VAT rate still has a negative impact on the poor. Concerning the poor, the impact of an introduction or an increase of VAT is lower than that which the wealthy bore. It is important to note that the wealthy also benefits from zero-rated and exempt goods and services afforded to all residents of South Africa. However, the poor generally consume a higher proportion of essential goods and services than the wealthy. Though the measures of zero-rating and exempting goods and services counters the regressive nature of VAT to a certain extent, a more definitive and highly redistributive method of benefiting the poor would be to potentially collect VAT on all goods and services and distributing these collections to targeted initiatives meant to benefit the poor. The reason being, that it is the wealthy who also benefit from the zero-rating and exemption of essential goods and services.

6.2. Elimination of capital gains tax and progressive income tax

Capital gains tax is viewed as a wealth tax. From a South African context, it is a tax levied on a minority proportion of the population, as can be seen from the most recent statistics of wealth distribution across the country. The wealthiest 10% of the population held around 71% of net wealth in 2015, while the bottom 60% held 7% of the net wealth.[11] However, capital gains tax is not a significant contributor towards total tax revenue collected. It accounted for 0.6% of total tax revenue for the 2019/20 tax year.[1]

The introduction of a consumption-based tax system will result in the rescinding of capital gains tax. Though South Africa retains an unequal balance in wealth distribution, the related revenue derived from capital gains tax is minute (0.6% of total tax revenue for the 2019/20 tax year) and does not warrant further investigation and analysis.

A major critique of a consumption-based tax system will be the rescinding of progressive income taxes. Statistics from personal income tax revenue collected indicates that 72.7% of personal income tax revenue is assessed against 20.5% of taxpayers.[1] This represents 888 832 taxpayers out of a total of 4 337 923. These taxpayers contributed R261.7 billion of total tax revenue. On average, this represents a tax payment of R294 442 per taxpayer.

The rescinding of progressive income taxes will benefit these high-income earners.

Practically though, the collection of tax revenue from high-income earners on a sustainable basis annually will require a substantial amount of consumption.

Mathematically, collecting an equivalent of R261.7 billion of taxes will require the consumption of goods and services equating to R1.74 trillion. It represents 23% of South Africa's entire average annual consumption (R7.64 trillion)[66] between 2015 and 2020. On average, this would amount to R2.0 million of consumption per taxpayer. This represents a significant amount of consumption relative to consumption of the top decile identified as part of the Living Conditions Survey conducted by Stats SA.[79] The upper decile indicates an average annual expenditure of R485 222, less than 25% of what is theoretically required to maintain tax revenue currently under progressive income taxes. Therefore, this is unsustainable and cannot be relied upon to collect the equivalent amount of taxes under the current progressive income taxes.

Therefore, it is clear that the elimination of capital gains tax and progressive income taxes will benefit the wealthy, the latter more specifically. Addressing the inequality within South Africa is unlikely to be affected in this manner.

6.3. Consumption outside of South Africa

The proposal of FairTax, on which this research report has been based, does not include the taxation of expenditure and consumption outside of a specific country.

Validly so, as imposing taxes on consumption in another country would prove extremely difficult due to the following key factors:

- The specific country where consumption takes place is likely to tax and collect for their benefit; and
- Tracking the consumption of individuals across the globe is likely to prove an extremely challenging and ultimately futile exercise.

[79] Stats SA, 2017, *Living Conditions Survey 2014/15*

On average, the total number of passengers departing from airports in South Africa from 2015 to 2020 amounted to 5.6 million.[80] International travel is expensive and can be considered a luxury. Only the wealthy are likely to benefit from travel and thus consume outside of the borders of South Africa, free of any form of consumption tax. Tracking the movement and consumption of 5.6 million individuals worldwide would prove to be an administrative nightmare. The scale and reach of SARS would therefore be required to expand significantly. The challenge with this is amplified by the infamous leak of the so-called 'Panama papers', which identified numerous wealthy South Africans to have benefited from offshore tax structuring.

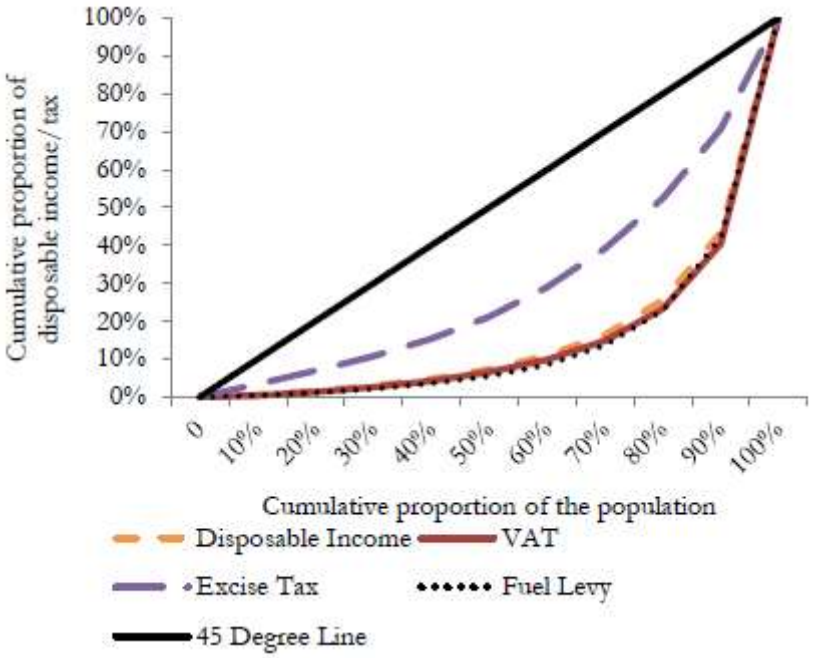
Additionally, as per the Nugent Commission report, SARS has lost a significant amount of capability due to mismanagement under the former SARS Commissioner, Mr Tom Moyane. In the short to medium-term, it would be unwise to consider implementing a consumption-based tax system along with specific measures to militate against non-payment of taxes by South Africans for consumption outside of South African borders.

6.4. Will a consumption-based system of tax retain its nature of being regressive?

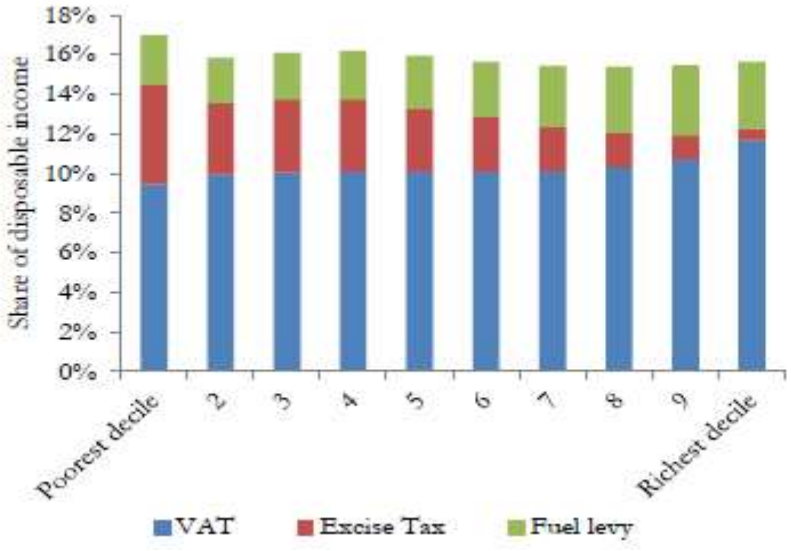
A significant criticism of VAT is that it is regressive and disproportionately affects the poor. Individuals with low-income levels spend a higher proportion of their disposable income than individuals with high-income levels. It is the nature of a broadly applied tax across the population group at a flat, fixed rate.

In basic terms, South Africa has sought to counter this by levying VAT at a rate of 0% for certain goods and services which are deemed to be necessities. The extent to which these zero-rated items contributed towards a progressive or balanced form of tax from VAT has been analysed through various studies, one of which is depicted below:[18]

[80] Statista, *Total number of departing passengers from airports in South Africa from 2014/15 to 2018/19, by type*, viewed 21 January 2021, from https://www.statista.com/statistics/1119345/number-of-departing-passengers-in-south-africa-by type/#:~:text=As%20of%20financial%20year%202018,thousand%20from%20the%20previous%20year



The above study notes that zero-rating for VAT has had a relatively positive and progressive influence. The poorest decile would pay 9.5% of disposable income on VAT, whilst the wealthiest decile would pay approximately 12%. It is depicted below.



Furthermore, it was identified that if these very same essential goods and services were levied with the standard rate of VAT, the nature of VAT would then be regressive. The bottom 60% would pay a higher share of VAT relative to their disposable income.[18] Poverty and inequality would increase due to this.

No longer zero-rating these essential goods and services would result in an exacerbated regression system in a country that already ranks as the most unequal society in the world.[10]

Various measures to counter this would therefore be needed. Chief amongst this would be the lowering of the costs of goods and services through the reduction or removal of the embedded tax and an additional grant provided by the Government of South Africa to all legal citizens of this country to cater for the necessities of life.

Detailed research on the embedded tax is unfortunately not available, as outlined in Chapter 2 of this research report.

Countering the regressive nature – The introduction of a prebate

The South African government already provides a wide range of social benefits to citizens of the country. Known as social protection, this includes welfare grants that account for the 4th largest line item on the National Budget for the Republic of South Africa.[81] Social protection was budgeted for at R221.5 billion for the 2020/21 fiscal year-end. This budget supports approximately 17,996,000 beneficiaries.[81] This accounts for 30% of the total population, relative to an estimated population of 59,620,000.[2] These beneficiaries receive various grants such as child support, old age, disability, foster care, and care dependency. Compared to 2015/16,[82] this represents a 6.3% increase in beneficiaries under the social protection program. Even more concerning was the Minister of Finance's comment, Mr Tito Mboweni, during February 2020, indicating that social grant beneficiaries are likely to increase to almost 19,000,000 by 2022/23.[83]

Over and above this, a grant would need to be provided to all legal citizens of South Africa to cover for the necessities-of-life. It was a concept first introduced by Jeremy Bentham. It is one of the oldest fundamental principles of tax. It links up with Adam Smith's first canon of taxation, and more specifically within that first canon of taxation,

[81] National Treasury, 2020, *Budget review 2020*
[82] National Treasury, 2016, *Budget review 2016*
[83] South African Government News Agency, *Social grants increased*, viewed 31 January 2021, from https://www.sanews.gov.za/south-africa/social-grants-increased#:~:text=The%20Budget%20delivered%20by%20the,19%20million%20by%202022%2F23

which refers to a taxpayer's ability to pay or bear the tax burden. It essentially amounts to the minimum a person would need to sustain themselves.

John Stuart Mill proposed a fixed amount for determining the necessities-of-life. He did not suggest for discretion to be given to a taxpayer to determine their necessities-of-life amount. This assists in achieving a balance between what a taxpayer can bear and what the state desires. There would be various responses received from individuals in the current environment if a question regarding the necessities of life were to be posed to them, as every individual maintains a particular lifestyle.

Thankfully, various studies are performed on an annual basis with regards to basic costs of living. The monthly average living cost in South Africa amounts to R8 500.[26] It equates to R102 000 per annum for an individual, specifically representative of an adult. On the other hand, children have different needs, and it would be misleading to equate their cost of living to that of an adult. Research indicates that raising a child costs approximately R90 000 per annum.[84]

South Africa conducts a population census every ten years, the last of which was conducted in 2011. However, utilising statistics from 2011 would be misleading as it is close to 9 years since then and represents potentially outdated data. 2020 mid-year population estimates by Stats SA indicates that South Africa's population stands at 59,620,000. Approximately 28.6% of the population are younger than 15 years of age.[2] Depicted below is a brief analysis of a potential prebate that would be required to be provided by the Government of the Republic of South Africa before any considerations of current social protection grants.

	Average annual cost of living	Population	Total cost
Adult	R102 000	42 568 680	R4.3 trillion
Child	R90 000	17 051 320	R1.5 trillion
		59 620 000	**R5.8 trillion**

Reducing the above figures with social protection grants totalling R221.5 billion does not reduce the extraordinary amount that would be required to provide for South Africa's

[84] Financial Planning Institute of Southern Africa., *How much does it really cost to raise a child?*, viewed 31 January, from https://www.fpi.co.za/fpi/News/How_much_does_it_really_cost_to_raise_a_child_.aspx#:~:text=On%20a%20serious%20note%2C%20several,child%20reaches%2023%20years%20old

entire population. These social protection grants include child support, old age, disability, foster care, care dependency, grant-in-aid.

Additionally, providing a prebate to wealthy individuals will increase the disproportionate wealth in South Africa.

6.5. Conclusion

It is evident that wealth inequality, which currently exists in South Africa, is likely to increase by introducing a consumption-based tax system. Though there are some mitigating factors for this, the potential for the wealthy to benefit disproportionately is highly likely. The elimination of capital gains tax is likely to see significant retention and the probable increase in the capital already held by the wealthy. Additionally, the wealthy are unlikely to incur a sustained level of spending to compensate for the loss of direct taxes that would have been paid under the income-based system of tax. Factoring in the ease of international travel, with the wealthy having the means to do so, monitoring consumption outside of the borders of South Africa is likely to be a challenging and futile exercise. The ever-increasing number of beneficiaries on South Africa's social protection programs is also a cause for concern. South Africans' are already on several social protection programs to cover the necessities of life. An additional prebate for a change to a consumption-based tax system is not financially feasible, as can be seen from the respective amounts computed.

7. SOUTH AFRICA'S APPETITE FOR A CHANGE TO A CONSUMPTION-BASED TAX SYSTEM IN TODAY'S POLITICAL AND ECONOMIC CLIMATE

7.1. Overview

The general narrative within society concerning VAT is that it is regressive. Even though studies, as noted in this research report, indicate otherwise, it is the consensus to a certain extent. With South Africa noted as the country with the highest inequality,[10] any form of legislation viewed to oppress the poor is likely to attract a lot of attention and interrogation.

The introduction of a new or increased tax rate is likely to cause much controversy, especially in South Africa, which has such a skewed tax distribution. Less than 10% of the population accounted for all personal income tax revenue in 2019/20,[1] whilst approximately 30% of South Africa's population are beneficiaries of social protection programs. Expenditure by Government generally tends to aspects that assist the poor and needy. Tax in South Africa is therefore highly redistributive.

As a result of the above, a change from an income-based tax system to a consumption-based tax system needs careful consideration. It would represent a drastic change in the tax system, whilst potentially being seen as a reprieve to the wealthy (i.e., high-income earners who currently pay the majority of personal income taxes) at the expense of the poor with an increased rate of VAT and the elimination of zero-rated and exempt goods and services.

It could lead to a tax revolt. In other words, this could see taxpayers abstaining from their duties to pay over their respective tax obligations.

7.2. The Great Excise Crisis

One of the most infamous instances of a tax revolt occurred during 1733 in Great Britain. At the time, Sir Robert Walpole was the Prime Minister of Great Britain.[45]

Sir Robert Walpole sought to introduce excise and customs taxes on wine and tobacco while reducing land taxes. He cited the main reason as '*it was the frequent advices I had*

of the shameful frauds committed in these two branches, and the complaints of the merchants themselves, that induced me to turn my attention to discover a remedy for this growing evil'.[85]

At the time, this would have resulted in consumers bearing the burden of tax, whilst wealthy landowners saw their tax obligations reduce significantly.

The most significant criticism waged against Sir Robert Walpole was his timing of introducing such a proposal, specifically from a political point of view. He had failed to understand the sensitive political climate, both within and outside of Parliament. '*For once Sir Robert had allowed his desire for financial efficiency to get the better of his political judgement'*.[86]

Still, the revolt against the proposed excise tax on wine and tobacco could not have been predicted at the time. Other excise taxes had been introduced before, without much opposition compared to this. It is likely to have influenced Sir Robert Walpole's decision in pursuing the implementation of the excise tax on wine and tobacco. Wine and tobacco were widely traded goods at the time, almost regarded as essential commodities. The introduction of a tax on these goods was likely to displease a significant portion of the population. It was evidently quoted as follows '*To sum up the whole, there are no Persons who oppose an Excise, except Jacobites and Tories, and Whigs, and Dissenters, and Revolutioners, and Murmurers, and Grumblers, and Portugal and Virginia Merchants, and the Deluded and Disaffected, …. and the Rash and the Heady, and the Clamorous, and the Noisy (especially noisy Sheep) and Factious Writers, and those who write Letters to Members of Parliament, and Party Politicians, and Bugbears, and Scarecrows, and wooden Grenadiers, and Men of Sense, and Men of Honour, and the Fair Traders and Retailers, and the unfair Traders, and the Deceivers and Deceived, and the Crasftsman, and Fog; who, if you take them altogether, will not amount to many more than 99 in 100'.*[87]

In the years leading up to the Great Excise crisis, there was growing sentiment that corruption was getting out of hand. It was portrayed and reported through the media, well in advance of the formal proposal for the excise taxes. The media was a critical weapon

[85] *Parl. Hist.*, viii. 1270: 14 Mar. 1733.
[86] Marshall, D., *Eighteenth Century England* (London, 1962), p. 150.
[87] Fog's Weekly Journal, 17 Feb. 1733

utilised by both Sir Robert Walpole's Government and the opposition to the Great Excise crisis. Propaganda material was widely distributed across the Kingdom, with individuals in the countryside and those with less interest in politics heavily influenced by such, ahead of elections.

Additionally, the importance of significant centres of support took prevalence. London was a stronghold for the Government of Sir Robert Walpole. However, the Great Excise Crisis laid bare the growing discontent within London, which significantly influenced other areas of the country.

There was strong support and arguments for and against the proposed excise tax, which created a lot of pressure on Members of Parliament at the time. Not least because an election was close (1734), and any drastic measure supported or opposed by them concerning the proposed excise tax could have dire political consequences for them in their local constituencies.

Sir Robert Walpole won the general election of 1734 but indeed lost many votes due to the fallout from the proposed excise tax. He was eventually unseated from power at the next general election, and the lasting impact of the Great Excise Crisis is credited with this. Included below is an extract tabulating the effect that the excise tax had on the political future of Members of Parliament.[45]

The effect of the General Election of 1734 on M.P.s who had voted against the excise in 1733

Categories of constituencies	Before 1734	After 1734	Reduction as percentage
Over 1,000 votes:	88	77	12½%
500–1,000 votes:	30	21	30 %
100–500 votes:	66	36	36 %
Under 100 votes:	40	26	35 %

The effect of the General Election of 1734 on M.P.s who had voted for the excise in 1733

Categories of constituencies	Before 1734	After 1734	Reduction as percentage
Over 1,000 votes:	37	19	49%
500–1,000 votes:	27	16	41%
100–500 votes:	71	60	13%
Under 100 votes:	121	92	24%

7.3. A repeat of the Great Excise Crisis? A South African perspective

South Africa is no different from any other country globally in that politics play a significant role. A drastic change from an income-based tax system to a consumption-based tax system needs to factor in the potential political impact. The ruling political party of South Africa, the ANC, has been in power since the dawn of democracy in 1994. Its power and influence amongst voters have, however, declined since 1994. It won over 60% of national votes in 1994,[88] whilst 2019 saw a significant decline to 57.5%.[89] Corruption and the mismanagement of education and the economy have been cited as one of the main reasons for the ANC's decline in support.[90] The tax revolt experienced by Sir Robert Walpole's government also has similar features concerning corruption and an increasing decline in tolerance levels for corruption.

Additional reasons for its decline up to 2019 also relates to the fact that the ANC can no longer count on loyalty from its traditional base of supporters. It has, however, strived to ensure that significant forms of government expenditure seek to address injustices of the past through education and training, health, social protection, and community development. Collectively, these account for 53.6% of the 2020/21 National budget. Its traditional support base accounts for a significant proportion of beneficiaries who benefit from these forms of expenditure made by the Government.

Introducing a system of tax that may pose a higher tax burden to these individuals who form part of the traditional supporter base may prove to be a significant stumbling block for the ANC. Wine and tobacco were considered staple products of trade during Sir Robert Walpole's proposed excise tax, drawing the ire of many people from the public, media and government. The rescinding of zero-rated goods and services, for which the poor and needy rely significantly upon, may also pose a similar issue for the current ruling political party of South Africa. The highly redistributive nature of the current tax system plays a significant role, with the general sentiment being a pro-poor policy.

[88] Electoral Commission of South Africa, *1994 National and Provincial Elections*, viewed 24 January 2021, from https://www.elections.org.za/content/uploadedfiles/NPE%201994.pdf
[89] Electoral Commission of South Africa, *2019 National and Provincial Elections*, viewed 24 January 2021, from https://www.elections.org.za/NPEDashboard/app/dashboard.html
[90] The Guardian, *ANC corruption is a major cause of South Africa's failure – and the polls will show it*, viewed 24 January 2021, from https://www.theguardian.com/commentisfree/2019/may/08/anc-corruption-south-africa-failure-polls

Careful consideration needs to be applied as the ANC likely holds on to power due to this solid traditional support base.

Sir Robert Walpole's declining support in the general election of 1734 also stemmed from constituencies with a large population. The risks posed to the ANC, therefore, also bears a marked resemblance to this.

Votes which political parties vie for are now coming from a younger base, commonly referred to as the generation of those born after the abolition of Apartheid. To remain in power, the ANC needs to improve its performance to validate its position as the governing political party.

In such a highly politicised environment, the merits of such a drastic change to a system of tax may not be based solely on the financial benefits. Sir Robert Walpole was often criticised for not considering the political impact of the proposed excise tax.

At the moment, the ANC finds itself in a period of rebuilding trust and integrity. The timing of such a drastic change to the system of tax is critical. The ANC's declining support cannot likely afford a significant change such as this.

A highly contentious matter related to a recent change in tax legislation, specifically related to the increase of the VAT rate, from 14% to 15% as of 1 April 2018. With VAT being noted as a regressive form of tax by the general public, it was a change to tax that largely affected the poor disproportionately.

Notable remarks from major trade unions are as follows:

COSATU

'The Congress of South African Trade Unions (COSATU) sympathises with government on the need to stabilise and fix its budget crisis. However, we are deeply disappointed that it is doing this upon the backs of the struggling working and middle classes.'[91]

[91] News24, *Cosatu rejects budget as anti-poor*, viewed 27 January 2021, from https://www.news24.com/fin24/budget/budget-and-economy/cosatu-rejects-budget-as-anti-poor-20180221

NEHAWU

'NEHAWU, rejects these tax measures because they are a frontal attack to workers and the poor and are an attempt to shift the burden of adjustment to the already poverty-stricken workers and their families.'[92]

It may not be a pure coincidence that the ANC experienced its most significant decline in national votes won in a general election since 1994, a year after introducing an increase in the VAT rate. Depicted below is the percentage change of national votes received by the ANC in democratically contested elections since 1994:

Election year	ANC national votes	% increase/(decrease)
1994	62.6%	
1999	66.4%	6.0%
2004	69.7%	5.0%
2009	65.9%	(5.4%)
2014	62.2%	(5.7%)
2019	57.5%	(7.5%)

[93]

Conclusion

The ANC finds itself at a tipping point regarding a hold onto power as the ruling political party of South Africa. The impact of such a drastic change explored within this research report may prove to be a step too far, costing the ANC its political future and long-standing dominance as the ruling political party in South Africa. It is improbable that the ANC or any ruling political party within South Africa, for that matter, would support a change to the consumption-based system of tax in the current political and economic climate.

[92] Grocott's Mail, *Historic VAT hike will hit poor*, viewed 27 January 2021, from https://www.grocotts.co.za/2018/02/26/historic-vat-hike-will-hit-poor/

[93] Electoral Commission of South Africa, *Results dashboard*, viewed 24 January 2021, from *https://www.elections.org.za/NPEDashboard/app/dashboard.html*

8. CONCLUSION

A change from the current income-based tax system to a consumption-based system of tax certainly presents a drastic change to how tax revenue is collected.

South Africa's current income-based system of tax is highly redistributive. The majority of personal income taxes are paid for by the wealthy, with significant government expenditure targeted at programs for the benefit of the poor. As noble as it may be, this has unfortunately not assisted in South Africa's aim to reduce the wealth inequality gap. South Africa still ranks as the most unequal society in the world. With a shrinking individual taxpayer base, more strain is being placed on a minority portion of the population of South Africa.

Assessing the current system of taxing individuals against the fundamental principles of a sound tax system has generated interesting points for discussion.

Without repeating, the equity of the current income-based system of tax is called into question as a result of the conflicting views from classical economists and the view that the Government of the Republic of South Africa sets tax legislation based on its need for tax revenue without much consideration from a taxpayer perspective. Additionally, the tax rebates offered are not adequate. Results from a survey conducted noted that individuals are fairly aligned in terms of expectation to the current system of taxing individuals.

Individuals have also noted that tax plays a role in making informed economic decisions. It is in contrast to what an efficient system of tax is expected to fulfil.

The ease of doing business across the globe and the rather complex business environment has resulted in complex tax legislation being developed to date. It naturally affects the simplicity of tax legislation and its cost and ease of administration. Although SARS consistently meets international benchmarks for cost-to-tax revenue collections, it is evident that there has been a steady decline in the organisation's operational efficiencies, particularly under the stewardship of former SARS Commissioner Mr Tom Moyane. However, it is encouraging to note survey respondents' views that they have recently had positive and efficient engagements with SARS. The complexity of tax

legislation and its onerous reporting requirements have also been noted through the significantly high costs for compliance by taxpayers, a statistic not officially tracked and reported within South Africa.

The current income-based system of taxing individuals certainly has its flaws. In the context of South Africa's controversial political past, its relevance cannot be ignored. The proposal to therefore change to a consumption-based system of tax needs to be carefully considered.

Additionally, South Africa has struggled to meet tax revenue targets over the past few years. It has naturally placed much pressure on the fiscus. To change the current tax system to one that purely relies on consumption would require a substantial degree of economic stability year-on-year. The impact of the recent COVID-19 pandemic has undoubtedly highlighted this risk, with consumer spend significantly stifled during this period. It highlights a vulnerable core weakness in the consumption-based system of tax. By setting aside the impact of the variability of consumption on an annual basis, it is essential to note that a gap will arise on personal income taxes that were previously collected, primarily through direct taxes. Closing this gap would be to rescind all zero-rated and exempt supplies and consider a potential increase in the rate of VAT, which is currently at 15%.

As proposed in this research report, an increased VAT rate of 22.6% will undoubtedly create much debate within South Africa. It is evident, considering the level of scrutiny which accompanied a 1% increase in the VAT rate on the 1st of April 2018.

One of the most fundamental points of discussion that is likely to arise out of this would be related to the regressive nature of VAT. The regressivity of this tax has been countered to a certain extent by introducing zero-rated and exempt goods and services. The poor spend a disproportionately higher amount of disposable income on these essential goods and services. Rescinding zero-rated and exempt goods and services along with an increase in VAT from 15% to 22.6% may likely be seen as a direct attack on the poor. The comments raised by various Trade Unions when VAT was increased by 1% on 1 April 2018 certainly lends credence to this assumption.

The view is that the wealthy will be the primary beneficiaries if such a change is applied to the current system of taxing individuals. It is undoubtedly true. South Africa's distribution of wealth, income and payments of taxes is heavily skewed towards a minority portion of the population. Rescinding personal income taxes will be a significant benefit to this minority. Whilst the taxpayer base is likely to be expanded, it will come at a cost to the poor, who will now pay taxes on par with the wealthy. A proposal to address this is through a prebate, offered upfront to all legal citizens of South Africa for the sole purpose of covering the necessities of life. Again, a flaw in this would be to provide a prebate to the wealthy, offering benefits on par with poor individuals.

South Africa also provides a high degree of financial relief through its social protection programs. The beneficiary base has constantly increased over the past few years and is forecasted to continue in the short term. With the South African economy and general finances under significant pressure, there is minimal leeway in introducing additional financial relief forms to citizens. Introducing a prebate to all legal citizens of South Africa has been quantified to be an exorbitant amount. Unfortunately, it is not feasible.

The ANC is the current ruling political party in South Africa, with the majority of its policies being pro-poor. Since the dawn of democracy in 1994, its national electoral support base has decreased to date. Introducing a system of tax that benefits the wealthy at the expense of the poor is likely to have significant political ramifications for the ruling political party of South Africa. The Great Excise Crisis of 1733, experienced by Sir Robert Walpole and his Government, is a timely reminder of the potential impact such a change could have on the political future of the ruling political party in South Africa. Considering this, it is therefore unlikely that such a system would be adopted by the ruling political party of South Africa.

South Africa faces a significant issue with regards to corruption. In recent years, a few Commission of Inquiries have been established, most notably the Zondo Commission of Inquiry and the Nugent Commission of Inquiry. Addressing corruption and mismanagement within the Government of the Republic of South Africa will undoubtedly assist significantly in ensuring that funds are effectively and efficiently spent. It would ease the pressure placed on tax revenue collections.

Additionally, South Africa has tax gaps that exist in the current system. Addressing these tax gaps will also assist in alleviating the pressure to raise additional tax revenue.
In a South African context, adopting a consumption-based tax system such as FairTax is not feasible. A concept such as this would only be feasible in a society with an equal distribution of income and wealth. Unfortunately, no such society or country like this currently exists. It is evident that South Africa certainly does not fit into this concept, being noted as a country that ranks the highest in the world in terms of wealth inequality and with such a highly skewed income distribution.

Research into the following aspects needs to be considered:

- Embedded taxes

Understanding the hidden cost of indirect and direct taxes included in the cost and pricing of goods and services.

- The efficient use of tax revenue, impeding economic growth

Understanding whether Governments efficiently utilize tax revenue. Do they inadvertently impede economic growth?

- Operational inefficiencies of SARS

Understanding the full extent of operational inefficiencies within SARS and its economic impact.

- The tax gap between personal income tax and VAT

Analysing the extent to which the tax gap for personal income tax and VAT differs and the core reasons.

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