PBO

PARLIAMENTARY
BUDGET OFFICE

BRIEF ON THE 2023 TAXATION AND REVENUE PROPOSALS

September 2023

The Parliamentary Budget Office (PBO) has been established in terms of the Money Bills Amendment Procedure and Related Matters Act (Act 9 of 2009). The PBO provides independent, objective and professional advice and analysis to Parliament on matters related to the budget and other money Bills. The PBO supports the implementation of the Act by undertaking research and analysis for the Finance and Appropriations Committees.

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Executive Summary

The Tax Brief provides Members of Finance Committees with an analysis of the 2023 Taxation and Revenue proposals (2023 Tax Proposals). In the 2023 Budget Review, the Minister of Finance (MoF) proposed 2023 tax and revenue measures for consideration and approval by the Parliament. Therefore, in principle, the Finance Committees report on the 2023 tax and revenue proposals – as per section 8.4 of the Money Bills Amendment Procedure and Related Matters Act (2009) ('Money Bills Act') – in the Budget Review should inform consideration of the Rates Bill.

The tax brief particularly covers proposed changes to Personal Income Tax (PIT), renewable tax incentives and indirect taxes and developments in the Base Erosion and Price Shifting (BEPS).

Proposed changes to Personal Income Tax (PIT)

The 2023 Budget tax proposals included inflationary relief through a 4.9 per cent adjustment in personal income tax brackets and rebates. The 2023 Budget inflation estimation is lower than the South African Reserve Bank (SARB) estimate of 6.2 per cent in 2023. Higher inflation rates, without adequate wage and tax relief adjustments, will lead to real declines in wages and disposable income for households, respectively. The main argument for relief has been to support middle-income earners. However, the PBO analysis revealed that the relief disproportionately benefits upper-income earners. They also disproportionately benefit males as they are disproportionately represented in higher income brackets.

The adjustment to medical tax credits will also disproportionately benefit the minority of the population (16.1% of all individuals in South Africa were members of medical aid schemes) that have medical aid, which tends to be higher-income earners. Thus the inflationary adjustment of tax brackets (tax relief) plus the medical tax rebates disproportionately fails to benefit low-income earners.

Proposed renewable energy tax incentive

The renewable energy incentives account for 69 per cent of the 2023 proposed tax relief. This incentive has been in place, as South Africa has been implementing the renewable energy tax incentive (Section 12b) since 2016. The PBO is concerned that businesses with greater access to capital will be able to take greater advantage of the incentive than small and micro businesses. The business with greater capital can make the upfront payment required to get the incentive later in the tax cycle.

The PBO would like to the attention of the committees that the expansion of this incentive will reduces the overall CIT Effective Tax Rate (ETR). In essence this means that overall actual tax paid by corporate taxpayers is getting lower than the current CIT statutory rate of 27 per cent. Corporate taxpayers have already benefited from the 1 per cent reduction in the Statutory CIT rate announced last year. In 2017, when the CIT rate was 28 per cent, the all-sector average ETR was 18.2 per cent, which was lower than many countries including advanced countries.

In terms of the literature, clean energy subsidies disproportionately go to higher-income and wealthier people. The bottom 50 per cent of the South African population has negative wealth, which the National Treasury acknowledged in its response to the public hearings.

PBO is concerned that the government is losing substantial revenue potential to persuade higher earning consumers who would have chosen to spend on renewable energy without support. The question is; how else could the government have utilised this revenue to support the majority in their pursuit of energy security? In addition, National Treasury states that the incentive cap for households is due to limited fiscal space. However, there is no limit for businesses, which is contradictory.

Levies

The non-adjustment to the fuel levy and the Road Accident Fund (RAF) provided significant relief in the context of high inflation, rising fuel prices and an exacerbated cost of living crisis. In the past the PBO has shown that fuel levy is considered to be a regressive tax instrument. The levy disproportionally impacts low-income households.

Therefore, the question that MPs may ask is, how will not increasing RAF levy support low income

household. Such measure will provide much-needed relief to low income households that will not benefit from the relief provided through the PIT relief. In the face of rising inflation, these are welcomed measures.

The PBO highlights this issue because the tax instrument must be linked to how it is spent. RAF has a direct bearing on the costs of living for all. It is also important that the levies collected from this fund serve their purpose given. The PBO has previously noted the importance of fiscal legitimacy, which is defined as the contract between taxpayers and the government. In the case of RAF, the PBO, therefore, supports SCOPA's continued efforts for transparency and oversight.

Developments in the Base Erosion and Profit Shifting (BEPS) project

The capital flight and the illicit export and concealment of wealth abroad lead to reductions in the tax bases. In 2017, the PBO highlighted concerns around the impact of trade missinvoicing on fiscus. This missinvoicing, which occurs through under-invoicing of exports and over-invoicing of imports, as being critical to solutions against Illicit Financial Flows (IFFs).

There have been developments in the global discussion on BEPS, which began in 2016, which have culminated in a number of papers published by the OECD. On 12 July 2023, at the conclusion of the 15th meeting of the OECD/G20 Inclusive Framework on BEPS, the Organisation for Economic Co-operation and Development (OECD) released a statement reflecting the agreement reached by 138 of the 143 members jurisdictions. The statement confirmed the agreements with regards to Pillar One and Two and also highlighted the current standstill agreement on imposing newly enacted digital services taxes (DSTs) and similar measures.

The African Union has stated on several occasions, that the METR should be at least 20 per cent to be effective in protecting African tax bases and stem Illicit Financial Flows (IFFs) by reducing profit shifting by multinational enterprises. The Tax Justice Network estimates that with the current 15 per cent minimum tax, South Africa could get USD 1.5 billion more in revenue, whereas at a statutory rate of 21 per cent, South Africa could get a projected revenue gain of USD 3.5 billion. In this regard, as part of the oversight the PBO is request the Committees to require the government to reconsider and assess the current provisions against the potential to raise additional revenue. Otherwise, government may provide Parliament with its analysis of the potential impact of the OECD Inclusive Framework on the fiscus.

The 2023 Budget states that "[a]minimum effective tax rate for large multinationals is expected to apply in several countries from December 2023. During the 2023 legislative cycle, the government will publish a draft position on the implementation of Pillar Two for public comment and draft legislation will be prepared for inclusion in the 2024 Taxation Laws Amendment Bill".

The government will need to prioritise meaningful public participation as highlighted by the implementation package as well as the Constitution of South Africa. There have been several institutions and individuals that have raised concerns about the BEPS and the process overall.

The government's active engagement with discussions on IFFs and oversight will remain critical as Treasury prepares and begins disseminating its proposed legislation. The government also needs to keep abreast of developments in BEPs developments as the discussions continue.

Issues raised on the 2022 Budget tax and revenue proposals

This section of the brief highlights other tax issues highlighted in the PBO's 2022 Taxation and Revenue Brief which still require attention and provides updates on issues addressed since the 2022 brief. The topics covered include Corporate Income Tax (CIT), the employment tax incentive (ETI), Carbon Taxation (Green Taxonomy), Multilateral institution tax amendments: Wealth tax, Gender dimensions of taxation policy, Tax administration and Value Added Tax (VAT).

There has been limited developments on majority of the issues raised in the 2022 Taxation and Revenue Brief except in two areas: The BEPS MLI was published in Government Gazette 47559 on 25 November 2022. The BEPS MLI was approved and ratified by Parliament. The carbon fuel levy for 2023/24 will increase by 1c to 10c/l for petrol and 11c/l for diesel from 5 April 2023.

1. Introduction

Since 2020, the approach undertaken by National Treasury (NT) and the South African Revenue Service has been to make changes to the tax system that follows with the following objectives: broaden the tax base, improve administration on revenue collection, lower tax rates and provide tax relief. The 2023 Budget proposes significant changes to give effect to the objectives/policy put forward. The proposals are summarised in the table 1.

The estimate for gross tax revenue collection for 2023/24 in the 2023 Budget is R1.79 trillion. The government proposed R13 billion in tax relief of which approximately 69 per cent is from renewable energy incentives.

It is important to note that with the ongoing domestic and global macroeconomic developments, tax revenue is likely to be negatively impacted. Recent domestic growth forecasts show weakened growth expectations for 2023 given much uncertainty in both

the global and domestic economy. Economic activity is expected to be constrained by fiscal consolidation, load-shedding, a deceleration in commodity prices, higher interest rates, bottlenecks at Transnet's ports and lower global demand and growth in some of the country's major export markets. Analysis of the local and global macroeconomic developments is discussed in the PBO's Quarterly Economic Brief.

Table 1 Impact of tax proposals on 2023/24 revenues

R million		Effect on tax proposals
Gross tax revenue (before tax proposals)		**1 800 456**
Budget 2023/24 proposals		**-13 000**
Direct taxes		**-9 000**
Personal income tax		
Increasing brackets by inflation	–	
Revenue if no adjustment is made	*15 700*	
Increase in brackets and rebates by inflation	*-15 700*	
Rooftop solar tax incentive for individuals	-4 000	
Corporate income tax		-
Expansion of section 12B - renewable energy incentive	-5 000	
Indirect taxes		**-4 000**
Fuel levy		
Not adjusting the general fuel levy	-4 000	
Specific excise duties		
Increasing excise duties on alcohol by inflation	–	
Increasing excise duties on tobacco by inflation	–	
Gross tax revenue (after tax proposals)		**1 787 456**

Source: National Treasury

While the 2023 tax proposals have already been implemented, according to the Money Bills Amendment Procedure and Related Matters Act of 2009, Parliament, specifically the Standing Committee on Finance approves the fiscal framework and revenue proposals. Thus this brief provides an analysis to inform Members about the impact of the proposed tax changes.

The brief particularly covers proposed changes to Personal Income Tax (PIT), renewable tax incentives and indirect taxes and developments in the Base Erosion and Price Shifting (BEPS). It then highlights other tax issues highlighted in the PBO's 2022 Taxation and Revenue Brief which still require attention and provides updates on issues addressed since the 2022 brief.

2. Proposed changes to Personal Income Tax (PIT)

The 2023 Budget proposals include inflationary relief through a 4.9 per cent adjustment in personal income tax brackets and rebates. These measures reduce estimated tax revenue by R15.7 billion in 2023/24.

The 2023 Budget inflation estimation is lower than the South African Reserve Bank (SARB) estimate of 6.2 per cent in 2023[1]. Higher inflation rates, without adequate wage and tax relief adjustments, will lead to real declines in wages and disposable income for households, respectively.

The main argument for relief has been to support middle-income earners. However, the PBO analysis revealed that the relief disproportionately benefits upper-income earners as shown in Table 2. The analysis further revealed that 11.8 per cent of registered PIT payers (those within the taxable income threshold of R500 – R750 thousand) will receive R3.6 billion of the tax relief proposed which equates to 22.9 per cent of the relief. This tax relief is distributed to 1.4 million registered individuals out of 7.5 million individuals within the taxable income threshold.

Table 2: Estimates of individuals and taxable income, 2023/24

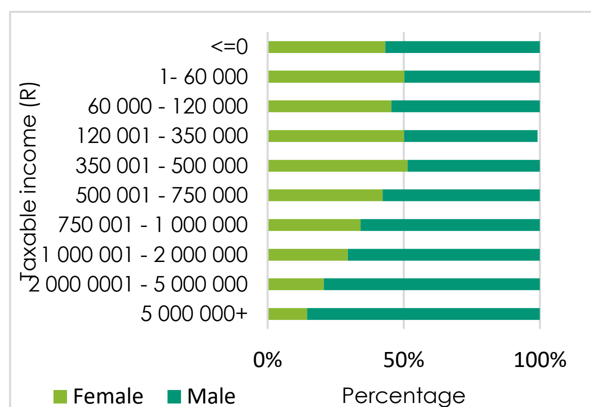
Taxable bracket	Registered individuals	Value of tax relief	% of the R13,5 billion relief	Average per capita (relief/registered individuals)
R Thousand	Number	R billion	%	Rands
R0 - R961	7 545 020	–		
R96 - R150	1 528 990	-1,1	7,0	719,4
R150 - R250	1 505 950	-1,4	8,9	929,6
R250 - R350	1 248 123	-2,2	14,0	1 762,6
R350 - R500	1 233 846	-3,3	21,0	2 674,6
R500 - R750	842 653	-3,6	22,9	4 272,2
R750 - R1 000	354 263	-2,2	14,0	6 210,1
R1 000 - R1 500	244 586	-2,5	15,9	13 901,0
R1 500 +	163 702	-3,3	20,9	14 049,9
Total	7122113			

Source: National Treasury data, PBO Calculations

From a gender perspective, the relief also disproportionately benefits men as they are represented in higher income brackets as shown in Figure 1.

[1] SARB Monetary Policy Committee statement – May 2023

Figure 1: Estimates of individuals and taxable income, 2023/24



Source: SARS 2022 Tax Statistics

The 2023 Budget proposes to increase the medical tax credits from R347 to R364 per month for the first two members, and from R234 to R246 per month for additional members. These tax credits will disproportionately benefit the minority of the population (16.1% of all individuals in South Africa were members of medical aid schemes[2]) that have medical aid, which tends to be higher-income earners. Thus the inflationary adjustment of tax brackets (tax relief) plus the medical tax rebates disproportionately do not benefit low-income earners.

The PBO is concerned that given the current heightened cost of living crisis, low-income earners continue to not be at the core of tax relief objectives. Low-income groups fall outside the income tax net, so the relief provided through the tax system excludes the poorest groups. In this regard, the PBO's analysis shows that the distributional impacts of the income tax measures, taking into consideration principles of progressivity, may require reassessment.

The PBO notes that raising tax rates for high-income earners affects a small group of taxpayers and therefore does not generate a large amount of revenue. This does not mean that the taxes are not effective and should not be used to justify lowered tax rates for high-net-income individuals in the future.

3. Proposed renewable energy tax incentive

Approximately 69 per cent of the proposed tax relief is from renewable energy incentives. The incentive is not new. South Africa has been implementing the renewable energy tax incentive (Section 12b) since 2016.

Table 3: Summary of renewable tax incentives

Tax incentive	Details
Expansion of the renewable energy tax incentive	Businesses will be able to claim a 125 per cent deduction in the first year for all renewable energy projects with no thresholds on generation capacity. Duration: March 2023 – February 2025
Rooftop solar tax incentive	Individuals who install rooftop solar panels from 1 March 2023 to 29 February 2024 will be able to claim a rebate of 25 per cent of the panels, up to a maximum of R15 000 Effective: March 2023 - February 2024

Source: PBO table based on National Treasury

The 2023 Budget proposes an expansion of the incentive to businesses. The capital allowance for the cost of renewable energy assets is spread over three years:
50 per cent of the cost in the first year, 30 per cent in the second, and 20 per cent in the third. Businesses will be able to claim a 125 per cent deduction in the first year for all renewable energy projects with no thresholds on generation capacity. As an example, "a renewable energy investment of R1 million is made by a business, that business will qualify for a deduction of R1.25 million. According to National Treasury, this deduction could reduce the corporate income tax liability of a company by R337 500 in the first year of operation".[3] The PBO posits that it is likely that businesses with greater access to capital will be able to take greater advantage of the incentive than small and micro businesses as they can make the upfront payment required to get the incentive later in the tax cycle.

A discussion is also required on how the expansion of this incentive reduces the overall CIT Effective Tax Rate (ETR), meaning the actual tax paid made by corporate taxpayers. Businesses have already benefited from the 1 per cent reduction in the Statutory CIT rate announced last year. In 2017, when the CIT rate was 28 per cent, the all-sector average ETR was 18.2 per cent, which was lower than many countries including advanced countries. Some sector Effective Tax Rates are far lower, e.g., the mining sector reported rates of lower than 13.7 per cent

[2] Stats SA – General Household Survey 2018
[3] Brink, J. (2023). The lights are still not on, but someone has finally come home. https://www.cliffedekkerhofmeyr.com/en/news/publications/2023/Practice/Tax/special-budget-alert-22-february-The-lights-are-still-not-on-but-someone-has-finally-come-home.html

between 2005 and 2011[4]. Tax incentives have an impact on the ETR, which needs to be further taken into consideration.

Studies show that clean energy subsidies disproportionately go to higher-income and wealthier people. The bottom 50 per cent of the South African population has negative wealth, which the NT acknowledged in its response to the public hearings. The South African Reserve Banks *Financial Stability Review* shows that "[t]here is growing evidence to suggest that households and firms are investing in alternative energy sources to mitigate the effects of more severe load-shedding, although at the expense of other priorities". However, the report also acknowledges that "the transition of households to alternative energy sources is likely to widen the already skewed income and development distribution in South Africa, as it is mainly middle- to high-income households that can invest in alternative energy sources, while poorer households are largely without recourses".[5]

It must be asked whether the government should be incurring substantial expenditure to persuade consumers who would have chosen to spend on renewable energy anyway? How else could the government have utilised this expenditure to support the majority in their pursuit of energy security? In addition, National Treasury states that the incentive cap for households is due to limited fiscal space. However, there is no limit for businesses, which is contradictory. There are also broader revenue considerations about the incentivising of households and businesses to exit the grid. In particular, how these shifts may lead to reduced revenue for municipalities.

4. Levies

Fuel Levy

The non-adjustment to the fuel levy and the Road Accident Fund (RAF) will provide significant relief in the context of high inflation, rising fuel prices and an exacerbated cost of living crisis. According to the literature, fuel levy is considered to be a regressive tax instrument. The levy disproportionally impacts low-income households. Low-income households spend more of their income on transport than the rich. Since rich people spend so much more on consumption than poor people, they benefit more than everyone else. Similarly, informal businesses and Small Micro and Medium enterprises (SMMEs) are disproportionately impacted by the fuel levy.

Road Accident Fund levy

In addition to the non-adjustment of the fuel levy, the 2023 Budget proposed a non-adjustment to the RAF levy. These measures will provide much-needed relief to low-income households that will not benefit from the relief provided through the PIT relief. The extension of the RAF to food manufacturers and the extension of the general fuel levy relief will ease potential price pressures on households.

The RAF has been a subject of discussion for a long time. In particular, there have been concerns about the Fund's financial health. Continued oversight of the RAF which is funded through the RAF levy is necessary. In 2022, there was a dispute between RAF and the Auditor-General over the audit outcomes of RAF. The RAF lodged a case against the AGSA related to the application of new accounting standards. This dispute led to questions on oversight during this period. After the SCOPA hearing of 20 September 2022, the RAF received a request from the Minister of Transport to table the 2020/21 Annual Report of the RAF. The case was withdrawn in October after the Minister of Transport had requested for RAF and AGSA to find other dispute mechanisms. On 19 April 2023, according to the SCOPA report, the RAF had not submitted its 2021 annual report to Parliament, but the Deputy Minister assured Members that the RAF would do so by the end of April. In this meeting, the RAF informed Members that it had applied a new model to reduce its R10.6 billion litigation bill by 30 per cent, and had redirected the funds towards the core mandate of the RAF.

The PBO highlights this issue because the tax instrument must be linked to how it is spent. RAF has a direct bearing on the costs of living for all. It is also important that the levies collected from this fund serve their purpose given. The PBO has previously noted the importance of fiscal legitimacy, which is defined as the contract between taxpayers and the government. In the case of RAF, the PBO, therefore, supports SCOPA's continued efforts for transparency and oversight.

5. Developments in the Base Erosion and Profit Shifting (BEPS) project

BEPS emerged as countries recognised that there has been a rise of extremely powerful multinational corporations with highly integrated global operations and complex value chains. There was a recognition that global rules had not kept pace with the artificial shifting of profits, the rise of e-commerce, and the free movement of capital, labour and intellectual capital, amongst other developments. The failure of global tax rules to keep up had led to governments competing for limited capital employing aggressive tax incentives and the emergence of a massive industry supporting tax avoidance. The Inclusive Framework on BEPS was established in June 2016.

[4] Davis Tax Commission (DTC): Macro Analysis First Report: December 2014

[5] SARB. (2023). Financial Stability Review.

On 1 July 2021, the OECD issued a statement committing each of its countries to a two-pillar plan to reshape the global tax system: Multinational Enterprises (MNEs) to pay tax in the jurisdictions where revenue is earned and a global minimum effective tax rate (METR) of at least 15 per cent, categorised as Pillar One and Two, respectively. On 12 July 2023, at the conclusion of the 15th meeting of the OECD/G20 Inclusive Framework on BEPS, the Organisation for Economic Co-operation and Development (OECD) released a statement reflecting the agreement reached by 138 of the 143 members jurisdictions. The statement confirmed the agreements with regards to Pillar One and Two and also highlighted the current standstill agreement on imposing newly enacted digital services taxes (DSTs) and similar measures.

Despite the conclusion of the BEPS framework, several issues have been raised about the 2021 approach. The first is that the Pillar One criteria for which companies would be considered was too narrow resulting in only a small part of the global profits of the largest and most profitable 100 or so multinationals. This meant that the vast bulk of MNEs' profits would continue to be allocated under the current inappropriate and ineffective rules. Second, the proposals seek to apportion taxable revenues only based on sales. The formula is unbalanced because it will fail to account for employment as a factor of production, and so would privilege large (rich) market economies over lower-income producer countries. African states also raised challenges concerning direct and indirect taxes that need to be leveraged on digital transactions. Third, the rules aren't sufficient to deter the race to the bottom phenomena, where countries continuously reduce tax rates to attract investment. The aim is to reduce the incentive for multinational companies to shift profits away from their countries of operation or residence to low-tax jurisdictions. However, the effectiveness of this proposal depends on the level of the METR.

The African Union has stated on several occasions, that the METR should be at least 20 per cent to be effective in protecting African tax bases and stem Illicit Financial Flows (IFFs) by reducing profit shifting by multinational enterprises. The Tax Justice Network estimates that with the current 15 per cent minimum tax, South Africa could get USD 1.5 billion more in revenue, whereas at a statutory rate of 21 per cent, South Africa could get a projected revenue gain of USD 3.5 billion.[6] In this regard, PBO advises that the government reconsider and assess the current provisions against the potential to raise additional revenue.

In March 2022, comprehensive commentary and illustration rules were published. The commentary offers direction on how to apply and interpret the Global Anti-Base Erosion (GloBE) rules. The GloBE rules particularly refer to the METR. Additionally, it clarifies the definition of specific terminology and describes the goals of the Rules.

On 20 December 2022, an implementation package was released, which included the following:

- Guidance on safe harbours and penalty relief
- Public consultation document on the GloBE Information Return
- Public consultation document on Tax Certainty for the GloBE Rules

A paper by the OECD on tax incentives and the global minimum corporate tax was also published on October 6, 2022, to help to develop and emerging nations assess the structure of their tax incentives as they get ready to implement the GloBE regulations.

The 2023 Budget states that "[a]minimum effective tax rate for large multinationals is expected to apply in several countries from December 2023. During the 2023 legislative cycle, the government will publish a draft position on the implementation of Pillar Two for public comment and draft legislation will be prepared for inclusion in the 2024 Taxation Laws Amendment Bill".

The government will need to prioritise meaningful public participation as highlighted by the implementation package as well as the Constitution of South Africa. There have been several institutions and individuals that have raised critiques about BEPS and the process overall. The African Tax Administration Forum (ATAF) has argued that the METR will help to fight IFFs. ATAF states that "a key focus of the work needs to be on developing rules that address base eroding payments such as excessive interest payments, management fees, royalties and service fees paid by African taxpayers to related entities located in no or low tax jurisdictions. Such payments are decimating the tax base of many African countries". [7]

Capital flight and the illicit export and concealment of wealth abroad lead to reductions in the tax bases. In 2017, the PBO highlighted issues of trade misinvoicing, which occurs through under-invoicing of exports and over-invoicing of imports, as being critical to solutions against IFFs. The PBO argued that trade misinvoicing was an important component of capital flight and is growing in many countries as a result of the complex and global value chains that have been developed

[6] Tax justice network. (2021). Is today a turning point against corporate tax abuse. Https://taxjustice.Net/2021/06/04/is-today-a-turning-point-against-corporate-tax-abuse/

[7] ATAF. (n.d). ATAF's opinion on the Inclusive Framework Pillar One (including the Unified Approach and Pillar Two proposals to address the tax challenges arising from the digitalisation of the economy. https://events.ataftax.org/includes/preview.php?file_id=44&language=en_US

by MNEs. MNEs have used their complex ownership structures and presence in many countries to manipulate quantities and prices and to obscure the destination and source of trade. This has enabled them to evade taxes and other levies on international trade. The PBO also highlighted how the elite and wealthy have used tax havens to avoid scrutiny of their wealth and therefore to evade taxes.

According to the OECD 2022, between USD 3.5 and USD 5 billion in IFFs are estimated to be departing South Africa annually, making IFFs a big burden for the nation, according to the report. This estimate, which corresponds to 1 per cent to 1.5 per cent of South Africa's yearly GDP, was created using estimates of the USD 40 to USD 54 billion in hidden South African assets held in international financial centers (IFCs) in 2018.[8] The assessing and disclosing of losses emerging from IFFs remains an inexact accounting exercise.

Tax avoidance by higher-earning individuals who aggressively plan their tax responsibilities to lower rates continues to negatively impact PIT revenue. In February 2023, SARS Commissioner, Edward Kieswetter stated that SARS was focusing its investigations on both individual taxpayers and syndicates. SARS was pursuing 829 cases against individuals, and of those, 178 were handed over for prosecution. Of the 94 cases that had been finalised, 92 of the cases had been found guilty, which meant a 97.8 per cent conviction rate.[9] Approximately, R3 billion was recovered from these processes. The PBO, therefore, maintains that continued effort is required to address tax avoidance and evasion by high net-worth taxpayers. The measures implemented by SARS are important in recouping tax losses, however, more preventative mechanisms are required.

The scale of the problem requires effective solutions. There have been positive developments since the High-Level Panel on Illicit Financial Flows from Africa headed by former President, Thabo Mbeki. In particular, the panel raised global awareness of the significant levels of IFFs leaving the African continent. A 2021 report of the High-Level Panel on Illicit Financial Flows from Africa, commissioned by the AU/ECA Conference of Ministers of Finance, Planning and Economic Development states that "[a]lthough the sources of IFFs are within our Continent, the mechanisms for moving IFFs often involve non-African private and public actors and are sometimes the result of policies and laws adopted by intergovernmental bodies and governments outside our Continent. It is, therefore, necessary for African governments to engage with these non-African actors to ensure that their practices do not facilitate the illicit outflow of funds from Africa". The government's active engagement with discussions on IFFs and oversight will remain critical as Treasury prepares and begins disseminating its proposed legislation. The government also needs to keep abreast of developments in BEPs developments as the discussions continue.

6. Issues raised on the 2022 Budget tax and revenue proposals

Below are highlights from the 2022 Taxation and Revenue Proposals Brief which the PBO finds to still be pertinent and provides updates where there have been further developments.

Corporate Income tax: In 2021, the government announced the intention to restructure the CIT rate. According to the government, the proposal is intended to broaden the CIT base while reducing the headline rate from 28 per cent to 27 per cent. The proposal was effected in the 2022 Budget proposals, and the amendments came into effect on 1 April 2022.

The PBO cautioned that, despite having a statutory rate of 28 per cent, research and the literature shows that South African corporate taxpayers enjoy a very low ETR. In particular, the PBO has shown in previous presentations that the all-sector average ETR was 18.2 per cent between 2011 and 2015. The PBO is concerned that the debate around the CIT rate in South Africa largely focuses on the statutory rate. This discourse disregards the low ETR enjoyed by corporates in South Africa, which should be the key compliance focus for tax policy.

One of the assumptions made to justify the reduction in the statutory CIT rate is that corporate taxpayers will respond by investing more in the economy. However, there is no consensus in the research evidence, on the causal relationship between lower CITs and investment. The PBO's' previous research has shown that out of ten factors considered by many corporate investors before investing, the CIT tax rate was among the least factors. The Davis Tax Committee (DTC) had also cautioned against using a reduction in the CIT rate as a measure to attract investment. Some of the important factors considered by investors include; reliability and price of electricity, availability of skills, cost of labour, safety etc.

The government is committed to fiscal neutrality, which means tax policy should neither create nor lose revenue for the government. The PBO is concerned that the goal of fiscal neutrality is punitive on the fiscus given the current macroeconomic (fiscal policy) context. The reduction in CIT disregards the fact that South Africa like other developing countries relies

[8] OECD. (2022). Assessing Tax Compliance and Illicit Financial Flows in South Africa. https://www.oecd-ilibrary.org/sites/e8c9ff5b-en/index.html?itemId=/content/publication/e8c9ff5b-en

[9] Dentlinger, L. (2023). Kieswetter: Sars making steady progress clamping down on tax fraudsters. https://ewn.co.za/2023/02/23/kieswetter-sars-making-steady-progress-clamping-down-on-tax-fraudsters

more on income tax revenue than other forms of taxes and measures should focus on increasing ETR. In addition, the PBO raises some concerns about the increases in offshoring thresholds which are counter the narrative on incentivising domestic investments.

There have not been further developments in these tax reforms. The impacts of these measures require continuous monitoring and evaluation. There was no review period stipulated for these measures when they were announced.

Employment tax incentive: Out of R5.2 billion in tax relief announced in the 2020 Budget, R2.2 billion is for the expansion of the ETI. The ETI Act was introduced in 2014 to allow expense deductions for every young unemployed person being absorbed. This was to encourage employers to hire young and less experienced workers given the chronically high unemployment rates for the youth. The ETI has subsequently been renewed multiple times since its introduction. And as of 1 March 2022, the ETI allowable expense rate has been increased by 50 per cent from R1 000 to R1 500.

The PBO is concerned that despite the continued implementation of the ETI incentive over the years, the real impact and benefits remain debatable. Various research evidence shows that generally, the ETI has had little to no effect on creating employment for youth. However, the evidence shows that the ETI positively impacts business profitability, particularly SMMEs. But it remains unclear whether the incentive saves jobs. The PBO proposes that there should be measures used by Parliament, including requesting the government to provide evidence of the effectiveness of the incentives given their impact on tax revenue**.**

Carbon Taxation (Green Taxonomy): In 2019, Parliament passed a bill that introduced a carbon tax. The 2022 Budget proposed an increase to the carbon tax rate in line with COP 26 commitments. The budget announcement further provided clarity that the first phase of the carbon tax will be extended by three years for the period 01 January 2023 to 31 December 2025. Effective 1 January 2023, the carbon tax rate increased from R144 to R159 per tonne of carbon dioxide equivalent. To ensure transparency and provide certainty, future adjustments to the tax rate are provided in the Carbon Tax Act (2019), as outlined in the 2022 Taxation Laws Amendments Act. In line with the carbon tax rate increase, the carbon fuel levy for 2023/24 will increase by 1c to 10c/l for petrol and 11c/l for diesel from 5 April 2023.

The PBO has noted and cautioned that given the status of South African socioeconomic challenges, climate-fighting measures introduced by the government should never disproportionally affect low-income households. For example, the increase in electricity to accommodate carbon tax.

Multilateral institution tax amendments: The Cabinet in March 2022 approved the submission of the OECD Multilateral Instrument (MLI) Convention to Implement Tax Treaty-related measures to prevent Base Erosion and Profit Shifting (BEPS- MLI) to Parliament for ratification. Many developing countries have raised issues around the dispute resolution requirements in the MLI. In considering instruments, the PBO highlighted the importance of South Africa remaining abreast of the issues that are being raised and considering how they impact and protect the state' taxing rights (ability) to raise tax revenue.

The BEPS MLI was published in Government Gazette 47559 on 25 November 2022. The BEPS MLI was approved and ratified by Parliament.

Wealth Tax: SARS has established a dedicated new unit focusing on high-wealth individuals. This process is in line with DTC recommendations and may be seen as an important step in informing the debate about wealth tax given the context of South Africa where wealth inequality remains significantly high.

Gender dimensions of taxation policy: The National Treasury is working with other stakeholders to implement gender-responsive budgeting across government. This is expected to roll out in the 2023 Medium Term Expenditure Framework (MTEF) process. The recently published MTEF guidelines make explicit reference to gender-responsive budgeting. While this is welcomed, the PBO is concerned that gender responsiveness budgeting is only limited to the expenditure side of the budget.

Tax administration: According to the government, SARS has made significant strides to improve its tax revenue collection since 219/20. However, the governance and operational issues raised by the Tax Ombudsman are important to be considered and measures implemented to improve SARS administration. The PBO supported the Finance Committees' decision to refocus on ensuring the legal status of the Tax Ombudsman. However, the PBO did not find further developments with regard to the issues raised in 2022.

Value Added Tax: The VAT was increased from 14 to 15 per cent in 2018 with the expectation that the amendment would be reviewed in 2021 (after three years). Parliament should require the government to provide a status update on the Vat increase and consider further measures to reduce the regressive impacts of the tax. It remains unclear whether a review of the VAT increase will be undertaken.