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Domestic Resource Mobilization
for Poverty Reduction in East Africa:

South Africa Case Study

Regional Department East A (OREA)

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List of abbreviations

ACS	Anti-Corruption and Security
AEO	Authorised Economic Operator
AfDB	African Development Bank
AIDS	Acquired Immunodeficiency Syndrome
ANC	African National Congress
APRM	African Peer Review Mechanism
ATAF	African Tax Administration Forum
ATR	Advance Tax Ruling
AU	African Union
BLNS	Botswana, Lesotho, Namibia and Swaziland
CAGR	Compounded Annual Growth Rate
CCA	Customs Controlled Area
CET	Common External Tariff
CGT	Capital Gains Tax
CIT	Corporate Income Tax
CITPROD	Corporate Income Tax Revenue Productivity
COMESA	Common Market for East and South Africa
DRM	Domestic Resource Mobilization
EAC	East African Community
eFiling	Electronic Filing
EIU	Economist Intelligence Unit
EU	European Union
ExCO	Executive Committee
FAQ	Frequently Asked Question
FIAS	Financial Investment Advisory Service
FIFA	Fédération Internationale de Football Association
GDP	Gross Domestic Product
GEAR	Growth Employment and Redistribution
HIV	Human Immunodeficiency Virus
ICT	Information and Communication Technology
IDZ	Industrial Development Zone
IMF	International Monetary Fund
ITU	International Telecommunications Union
IVR	Interactive Voice Response
LBC	Large Business Centre
M&E	Monitoring and Evaluation
MTBPS	Medium Term Budget Policy Statement
MTEF	Medium Term Expenditure Framework
NGO	Non-Governmental Organisation
OECD	Organisation for Economic Cooperation and Development
PBO	Public Benefit Organisation
PIT	Personal Income Tax

PITPROD	Personal Income Tax Revenue Productivity
PwC	PricewaterhouseCoopers
RDP	Reconstruction and Development Programme
RFT	Tax on Retirement Funds
SACU	South African Customs Union
SADC	Southern Africa Development Cooperation
SARB	South African Reserve Bank
SARS	South African Revenue Service
SDL	Skills Development Levy
SITE	Standard Income Tax Employee
Siyakha	An indigenous word for “we are building”
SMS	Short Messaging Service
SSA	Sub-Saharan Africa
STC	Standard Tax on Companies
TAXSTAFF	Ratio of Tax Staff per Population
TOPP	Training Outside Public Practice
TPE	Taxpayer Education
UIF	Unemployment Insurance Fund
UK	United Kingdom of Great Britain and Northern Ireland
USA	United States of America
USAID	United States Agency for International Development
VAT	Value Added Tax
VATGCR	VAT Gross Compliance Ratio
WTO	World Trade Organisation

Preface

The African Development Bank (AfDB) has partnered with the African Tax Administration Forum (ATAF) and the East African Secretariat on a project aimed at sharing lessons of experience from Domestic Resource Mobilization (DRM) through case studies for the East African Community partner states (EAC), South Africa and South Korea. For the purposes of this work, DRM is defined to include only tax policy and administration and excludes other possible components of DRM such as domestic financial markets.

The overall objective of this project is to make recommendations, for the participating countries of the EAC, on the priority reforms and ways to sequence and implement them, in order to significantly enhance DRM. As such, the primary beneficiaries of the project are both the Ministries of Finance and the Revenue Administrations of the EAC.

This paper seeks to respond to the following question: *What key factors have contributed to or inhibited DRM in South Africa?* This case study has been prepared following an extensive review of available literature, interviews with key informants in South Africa, the collection of quantitative data, and the analysis of both primary and secondary data. Its development has also been informed by a methodological framework designed by the AfDB. The core principle of the methodological framework is to analyse tax performance as a result of tax systems, reforms and the political economy. The study adopts an explanatory case study approach to match patterns from our analysis of the literature and key informant interviews.

The achievements and lessons of experience contained in this and other country case studies will provide primary inputs for a policy note. The policy note will seek to address the following questions: *What are the priority reforms for EAC partner states and the EAC? How should these reforms be sequenced and implemented?*

Chapter 1 of this case study paper begins with an examination of South Africa's political economy and fiscal legacies. Thereafter, Chapters 2 and 3 explain and analyse the trends in the tax system and their impact on domestic revenue performance respectively. The final chapters highlight the challenges and issues currently faced by government (Chapter 4), and lessons of experience for consideration by the EAC partner states (Chapter 5).

Acknowledgements

The South Africa Case Study was prepared under the overall supervision of Mrs. Diarietou Gaye (Regional Director, Department East A, OREA) and Catherine Baumont-Keita (Lead Economist, OREA). Core team members were Edward Sennoga (Macro Economist, UGFO and Task Manager, Richard Walker (Country Economist, KEFO) and Christian Lim (Private Sector Specialist, OSGE). The external consultants were led by Elizabeth Kariuki and Kithingi Kiragu (PricewaterhouseCoopers).

Mr. Aloysius Ordu (Vice President, Country and Regional Programs), Mr. Steve Kayizzi-Mugerwa (Director, Operational Resources and Policies), and Ms. Radhika Bharat (Investment Officer) initiated the project and were involved in the early design of the study.

The production of this case study was made possible by the generous financial support from the Korea-Africa Fund for Economic Cooperation. We also thank the African Tax Administration Forum, East African Community Secretariat. Similar appreciation also goes to representatives of regional organizations, private sector organisations, think tanks and multilateral and bilateral development partners.

The case study also benefitted from valuable feedback provided by staff in different departments of the ADB both at headquarters and in the field offices (Kenya, Tanzania, Uganda and Rwanda).

There is not enough space here to name each and every one of those who have contributed immensely to the successful completion of this case study; however, Annex A lists some of the key contributors to this report. In addition, we seek the indulgence of all the contributors in accepting this blanket acknowledgement and appreciation of their efforts and contribution. We are indeed very thankful.

Executive summary

1. Context-Political economy and fiscal legacies

A review of political economy legacies underscores the fact that politics has pervasively impacted fiscal governance options in South Africa. The failure of fiscal governance in the wrought of apartheid politics precipitated its end. However, the legacies of that fiscal and macro-economic regime continue to influence the politics of fiscal governance in the post-apartheid era. In particular, post-apartheid politics espouses the rationale of using taxation to right the historical wrongs by using taxation as a distributional policy instrument. However, the ANC's sensitivity to international capital apprehension that the regime might collapse the economy, with socialistic and communistic interventions, has over the years, not only considerably moderated tax policies, but also, given cause to a strong emphasis on administrative measures – beginning with the establishment of the South African Revenue Service (SARS). This perspective, in part, explains the gradual decline in income tax rates. The other important factor underlying the policies to reduce personal income taxes and, in some cases eliminate trade tariffs, is the imperative to remain globally competitive as an attractive investment destination. Although the South African economy has a strong natural resource base, the larger part of its economy remains in the manufacturing and services sectors, which are open to external competition.

Given the constraints under which the post-apartheid governments have exercised fiscal governance, the administrative capacity and performance of SARS remains the key determinant of both fiscal space and effort. Therefore, political leaders have had to rely on SARS to grow domestic resources and enable the expansion of fiscal space despite a decline in tax rates. As Smith (2003) observes, in post-apartheid South Africa, the involvement of politicians has positively impacted on SARS's effectiveness. She also contends that "SARS's experience shows that, where the political and revenue-raising authorities have a common interest in enhanced collection, their collaboration is an important source of effectiveness".

In our view, three main factors will play out in the fiscal governance of South Africa in the short to medium term. First, sustained pressure from political leaders and trade union representatives (of low wage workers), for the government to more rapidly and demonstrably expand its public expenditure programmes for employment creation and poverty reduction. Second, there are the negative effects of the global financial crisis in terms of reduced trade volumes, commodity prices and business profits, and as a consequence, domestic revenue. Third, is – what the Economist (2010) has described as a large and growing problem – corruption. According to this publication, although in 2009 South Africa fared well in the

Transparency International Corruption Perception Index ranking (55th out of 180 countries), corruption in the country is on the rise. The ANC has publically expressed concern about the corruption scourge.

2. Tax reforms: Sequencing, implementation and results

The end of apartheid heralded reforms in the tax system. Between 1994 and 1999 the Katz Commission set the stage for reforming policy and institutional aspects of the tax system. Most of the commission's recommendations in these two areas have been implemented. The next series of reforms took place following the establishment of SARS. Specifically, between 1997 and 2000 SARS made changes to some of its operational processes, which contributed to the organisation surpassing revenue collection targets. However, SARS's management considered these changes as 'incremental' and were of the view that the organisation was performing significantly below its potential. Therefore, management initiated a diagnostic study of its operations in order to identify issues and problems and recommend measures for resolving them. This exercise culminated in the development of a programme 'Siyakha' ('we are building').

Siyakha 1's implementation commenced in 2001 and ran until 2005/06. It was sequenced by province. Key initiatives implemented under Siyakha 1 included: the development of a taxpayer and business strategy; process redesign in revenue and customs; overhauling taxpayer services; the implementation of policies to promote integrity and professionalism among staff (e.g. by re-advertising all new positions and through training, standardising work methods, the creation of work teams, creating a professional management cadre etc.); and refurbishment and re-tooling initiatives to improve the working environment. SARS reports the following results for Siyakha 1: (1) its organisation structure is flatter; (2) processes were redesigned and standardised; (3) a dedicated taxpayer function was established; (4) the enforcement function was strengthened; and (5) staff were better trained and more motivated.

In 2007/08, SARS launched Siyakha 2. The thrust under this second wave of reform centred on the modernisation of SARS over a five to seven year period, in particular, "transforming both the tax and customs administration through automation and other operational efficiency gains". Siyakha 2 comprises ten programmes of modernisation, which are clustered around implementing a new operating model, implementing national priorities (i.e. protecting borders and implementing social security and a wage subsidy) and strengthening SARS's operational foundation. At the end of Siyakha 2, SARS anticipates that it will be able to better: secure revenue; enhance compliance; secure and manage its borders; and maximise productivity as a result of operational effectiveness.

3. Domestic revenue performance

On the basic parameter of tax revenue to GDP ratio, the tax system in South Africa has consistently improved performance since the onset of the reforms that followed the end of the apartheid era. In 1980, the South African Reserve Bank (SARB) reports national revenue as a percentage of GDP was 20.2%. When the newly democratic government took office in 1994, national revenue as a percentage of GDP had risen slightly to 21.9%. By 2007/08, this figure had increased to 27.8%.

It's noteworthy that over 95% of general government funding from taxes is raised nationally, 3.5% by municipalities and less than 1% by provincial governments (Republic of South Africa, 2008). Tax revenue over the 13 years to 2007/08 grew at an average annual growth rate of 13.3%, in spite of the overall reduction in tax rates at the beginning of the decade. The latest published tax statistics available indicate that in 2007/08, the four largest sources of domestic revenue in South Africa, in order of their magnitude of contribution to total tax revenue, were: Personal Income Tax (29.5%); Value Added Tax (26.3%); Corporate Income Tax (24.5%); and the fuel levy (4.1%).

The wide breadth and depth of policy, and institutional and administrative changes, were informed by the analytical, policy and strategic development work of the Katz Commission, which existed in parallel to both the mainstream government policy organs and tax administration systems for a period of five years (1994-1999). One instructive facet of the Katz Commission was the phasing of its recommendations, which were delivered in nine separate packages (reports) over the five-year period.

4. Challenges and issues

As SARS charts its way to becoming a world class services provider, it grapples with a number challenges and issues, including the following:

- *DRM efforts must be stepped up to finance national development strategies:* South Africa needs to mobilise even more resources to fund programmes for job creation, expanding education and health, rural development, and combating crime. SARS is challenged to raise gross tax revenue as a percentage of GDP from about 24.5% in 2009/10 to 26.2% by 2012/13;
- *A different approach for dealing with taxpayer segments is needed:* SARS's management recognises that it cannot sustain the tax compliance culture it has cultivated over the years without rationalising the way in which it utilises its human resources. To this end and in particular, SARS has embarked on a review of segmentation arrangements, because it has realised that it does not have sufficient capacity to run them all;

- *SARS must continue to widen its tax base for the foreseeable future:* by further expanding its outreach through ‘walkabouts’ to establish unknown economic activities, which are outside the tax net; assessing how it can expand its footprint into areas where it has no branches; and increasing the number of lifestyle audits;
- *SARS’s staff capacity must keep abreast with its transformation:* A leadership management training initiative needs to be rolled out across the organisation. Furthermore, SARS is also looking at options for recruiting and retraining staff in critical areas with gaps such as enforcement, customs, strategy and analysis;
- *The additional burden of administering non-tax government programmes:* SARS has undertaken to support the implementation of government’s social security and wage subsidy interventions, and to administer a cash reimbursement system for employers. These developments place an additional administration burden on SARS;
- *The increased cases of crime and corruption need to be kept in check:* SARS reports an increase in syndicated crime, particularly in the areas of fraud and corruption. Also, such crimes have extended to the banking system, and there are increasing risks of using bank accounts and cheques to defraud SARS;
- *There are challenges around regional trade integration:* There are issues around rules of origin, which lead to a lot of paperwork. Also some member states of the South African Customs Union may be unwilling to reduce common external tariffs and/or admit new members. South Africa is challenged to lead in addressing these issues.

5. Lessons of experience

Although there are considerable lessons of experience from South Africa, only six are highlighted in this case study:

- *Strong collaboration between SARS and the National Treasury has been instrumental to successes in revenue mobilisation:* For example, since 2009, the National Treasury, in partnership with SARS, has initiated the production of very comprehensive tax statistics. A close working relationship is also evident in annual reports and strategic plans produced by SARS, which invariably contain insightful messages from the Minister of Finance;
- *Solid policy formulation and evaluation capacity is also key to strong revenue performance:* The Government of South Africa has strong tax policy capacity

within SARS and the National Treasury. The National Treasury also welcomes SARS's views on: new tax policy proposals, and the implications of trade policies and agreements for customs;

- *Compacts with professional and industry groups can reinforce compliance and facilitate administrative efficiency and effectiveness:* Compacts such as the banking accord can definitely be extended to other industries and professional groups;
- *Minimising the level of exemptions ensures tax policies remain neutral:* The government grants tax exemptions on an extremely exceptional basis. Only a few public benefit and public sector organisations are eligible for exemptions, and these are legislated and not discretionary;
- *Modernising through the use of ICT can result in significant operational efficiencies, but must be applied judiciously:* Particularly relevant lessons of experience from SARS's extensive use of ICT applications include: integrating core tax systems is critical to enabling a 'single view of the taxpayer'; use of eFiling throughout the year should be encouraged by offering incentives; and implementation should be gradual to cater for complexities in the tax environment;
- *Good client service is critical for promoting voluntary compliance:* SARS has focused its approach and efforts on three services: call centres, walk-in centres and eFiling. This also includes a lot of effort during the filing season to assist taxpayers in completing their tax returns;
- *A policy of zero tolerance for corruption is an important deterrent:* SARS established an Anti-Corruption and Security (ACAS) Unit in 2007. The ACAS Unit's work is informed by SARS's risk engine. It is also noteworthy that the unit: has developed standards to safeguard physical and information access; works closely with the police, banks, and the intelligence service; and pre-investigates each reported incident to establish its validity. In addition, the work of the unit is informed by extensive research and analysis.

1 Context – Political economy and fiscal legacies

1.1 The legacy of the apartheid economy

In 1994, when South Africa's first post-apartheid democratic government assumed power, the nation's economy was in poor shape. For the period from 1985 to 1994, the economy grew by an average rate of 0.8% of Gross Domestic Product (GDP), representing a decline of "-1.3% in per capita terms" (Du Plessis and Smit, 2007). Thirty two years of an institutionalised apartheid regime which was vanquished by a long liberation struggle, and economic sanctions in later years, had contributed to high interest rates, low levels of investment in the economy, two digit inflation figures and, a weak international reserve position (Nowak, 2005). Furthermore, by 1993/94 the fiscal deficit had grown to 10.2% and 11.2% of GDP at national and provincial government levels respectively (IMF, 1998). According to the South African Reserve Bank, in 1994, total national debt as a percentage of GDP was 43.5%¹.

In the decade to liberation, the tertiary sector accounted for 94% of South Africa's GDP growth (see **Annex C: Table C1**). However, between 1984 and 1994, manufacturing was a significant contributor to the economy. Prior to the lifting of economic sanctions, South Africa's trade policy was essentially protectionist. Until the nineteen seventies, the apartheid government facilitated import substitution industrialisation to promote the growth of local manufacturing which tended to be capital-intensive. This policy contributed to the generation of "current account deficits and ...[drained] foreign exchange reserves" and which the revenue generated from mineral exports could not cover (Lowenberg and Kaempfer, 1998). Furthermore, by the nineteen seventies, import substitution industrialisation started to have less impact on economic growth. Government therefore started to encourage non-gold exports through the provision of incentives. In tandem, government attempted to reduce the level of protectionism by curtailing quantitative restrictions on imports.

Another major socio-economic legacy of the apartheid regime was that the new government inherited "a large pool of unskilled and unemployed labour, acute and widespread poverty" coupled with a vast population of South Africans with limited or no access to basic social services such as education and health (Nowak, 2005). The levels of poverty and inequality were also high by middle income country standards. Leibbrandt et al (2001) estimate that the percentage of the population living on R91 a month (or US\$2 a day) in 1996 was 26% (Leibbrandt et al, 2009).

¹ <http://www.reservebank.co.za/> [Accessed 28 February 2010].

There were also huge disparities in South Africa's per capita income across the different races.

1.2 Post-apartheid economic and development trends

Given the state of affairs presented above, the newly elected democratic government initiated several measures to ensure macro-economic stabilisation including reducing the fiscal deficit by exercising prudence over debt management, reforming the tax regime and revenue administration, and lowering public sector consumption expenditure (e.g. by limiting increases in the wage bill, reducing subsidies, rationalising structures and improving management particularly at provincial level) (Ajam and Aron, 2009; Horton, 2005).

Government's development objectives have remained consistent since the nineties. Its priority areas of action with respect to development continue to evolve around: promoting economic growth; investing in social and economic infrastructure; rural development; building human capacity through the provision of basic education and job creation; enhancing the health of South Africans; curbing crime and corruption; community development; effective resource management; and improved services delivery. Public expenditure as a percentage of GDP was 27.2% in 1997/98 and remained more or less at the same level until 2007/08 (29%). In 2008/09, public expenditure was budgeted to rise to 31.3% of GDP².

To address issues to do with poverty and inequality, in 1994 the government launched a Reconstruction and Development Programme (RDP) which implied the need to mobilise revenue resources for development to meet these challenges. The RDP "stressed tax simplification, reorientation...in spending, greater budget transparency, and the development of a five year fiscal framework" (Horton, 2005). The RDP mainly financed social sector investments. The RDP was effectively replaced by the Growth Employment and Redistribution (GEAR) Strategy. GEAR set a vision and framework for growth from 1996 to 2001. Key medium-term interventions under GEAR included: accelerating fiscal reforms; firming up trade and industrial policy reforms; investing in infrastructure; further relaxing exchange controls; moderating wages and prices to enhance public service delivery etc. Promoting the growth of small, medium and micro-enterprises was a key area of focus. Reforms in education, health and welfare, and housing were also high on the agenda.

² Ibid.

The measures taken by government bore fruit. By 2001 government's policies had contributed to reduced inflation and lower interest rates. As a result, the economy started to grow, and government was able to mobilise additional domestic resources through taxes (Faulkner and Loewald, 2008). From 2000/01 to 2005/06 the economy grew at an average rate of 3% of GDP. Thereafter, in 2006/07 and 2007/08, economic growth rose to about 5% of GDP. The fiscal deficit as a percentage of GDP steadily declined between 1997/98 (3.8%) and 2002/03 (1.1%), before it rose again in 2003/04 to 2.3% of GDP³. In the fiscal years 2005/06, 2006/07 and 2007/08, government recorded positive budget balances⁴.

1.3 Development financing mix and challenges

Figure 1.1 presents South Africa's overall development financing mix from 1996 to 2008. During the period, domestic revenue and exports of goods and services on average constituted the two top sources of development financing representing 24.6% and 28.9% of GDP respectively. Following the collapse of apartheid and the removal of sanctions, South Africa played a more active role in the international trade and finance markets. It is a signatory to various preferential trade agreements. In addition, the Government of South Africa has been proactive in promoting exports through schemes such as the Export Marketing and Investment Assistance Scheme and Industrial Development Zones (IDZs) (SARS, 2007b).

Private savings were the third largest source of development financing. However, between 1996 and 2008, gross private savings declined from 16.8% of GDP to 10.3% of GDP as a result of factors such as financial liberalisation which encouraged "borrowing by the personal sector to an excessive degree" and high levels of unemployment (Aron and Muellbauer, 2000).

Foreign direct investment (FDI) in South Africa averaged at 1.4% of GDP between 1996 and 2008, which is lower than the benchmark for emerging economies of 2.7% of GDP. A higher proportion (2.8% of GDP) of foreign investments were made through the financial markets by way of portfolio inflows⁵. Combined FDI and portfolio inflows constituted an average of 4.2% of GDP from 1996 to 2008.

South Africa has consistently resisted the influence of international development organisations in its macro-economic and fiscal affairs. Until 2009, South Africa's relationships with the International Monetary Fund (IMF) and World Bank were

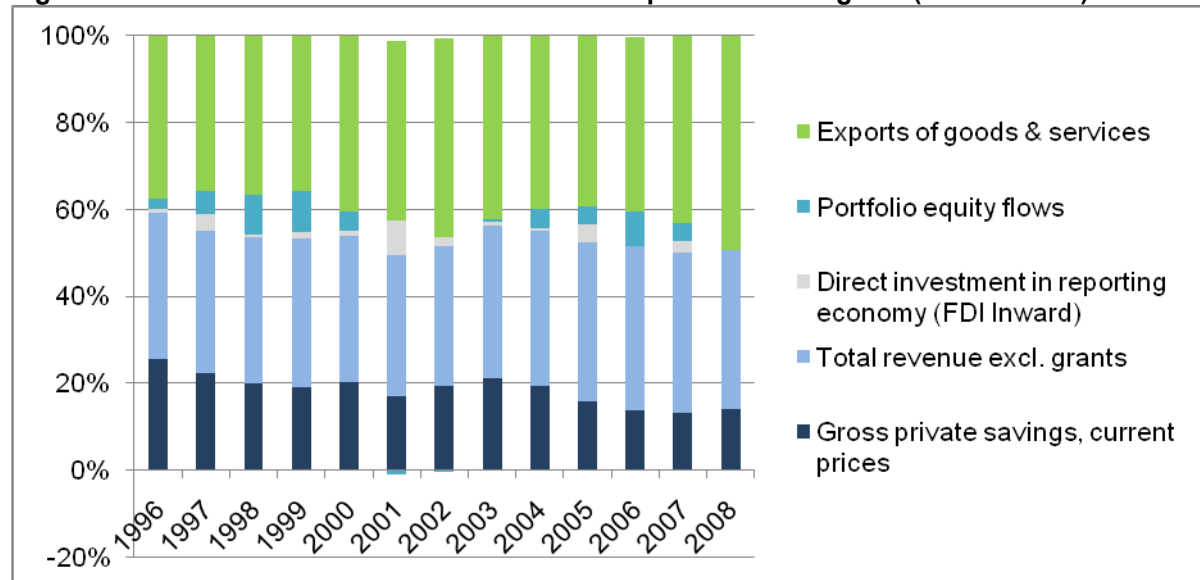
³ (<http://www.treasury.gov.za/documents/national%20budget/default.aspx>) [Accessed 2 February 2010].

⁴ Ibid.

⁵ <http://hbswk.hbs.edu/item/5528.html> [Accessed 15 June 2010].

limited to Article IV consultations and sharing of knowledge⁶. Also, the government is not a recipient of any significant assistance by any bilateral government.

Figure 1.1: Trends in South Africa's overall development financing mix (1996 to 2008)



Source: Africa Economic Outlook (AEO) 2010 data

The recent global financial crisis adversely affected government's ability to mobilise domestic resources from taxes. Nonetheless, government has undertaken to stimulate economic recovery by making capital investments. It has also made a commitment to continue to sustain the level of financing for social services. However, one of South Africa's development financing challenges is that at liberation, debt levels were significant. This high level of debt implied high servicing costs, squeezing out resources needed for development. Furthermore, there was concern that in the absence of a marked reduction, the high level of debt would be passed onto future generations. The Minister of Finance's budget speeches have over the years reiterated that government's objective is to reduce the overall level of debt. It is noteworthy that from 1999/2000, government was able to reduce its overall level of debt through restructuring and divestiture of state assets. Moreover, the government also benefited from the decrease in domestic interest rates as a result of prudent fiscal and monetary policies. In its most recent budget proposals (2009/10), government indicated that over the medium-term (to 2015/16) debt will peak at 44% of GDP. Government also appears fairly bullish that investors will

⁶ In 2010, the Government of South Africa guaranteed a loan from the World Bank to its electricity generating public enterprise.

remain confident in its macro-economic policies, and as a result South Africa's sovereign investment ratings will be maintained at current levels.

1.4 Political economy dynamics underpinning DRM

The synopsis of the political economy legacies that have impacted DRM, as presented in the subsections below, is based on Brautigam's (2008) analytical framework⁷, which consists of the following five facets: (1) level of economic development and economic structure; (2) societal factors: culture, values, trust and 'tax morale'; (3) war and taxes: bureaucratic modernisation as a response to threat; (4) political institutions and tax systems; and (5) taxation and the fiscal contract.

1.4.1 A modern economy but major structural imbalances persist

The economic structure at liberation was modern (see **Annex C: Table C1**). Therefore from one perspective, the apartheid regime did not wholly bequeath its successors with an economy in shambles. DRM at a national government level was comparatively modest (at 22% of GDP) compared to 38% for industrialised countries (Ndulu et al, 2007). However, the economy was already contracting. Yet, in comparison with virtually all other states on the African continent, South Africa is the most modern and strongest economy.

The downward trend in economic growth and fiscal performance in the sunset days of the apartheid regime, were symptomatic of the malaise in the political economy with regard to DRM. A comparatively small proportion of privileged White, Coloured and Asian populations had any wealth and property in the modern economy. Individual taxpayers were also preponderantly from the same communities. The vast majority of the population was conscribed to low pay, a peasant existence, unemployment and poverty.

Section 1.2 outlines government's efforts since 1994 to grow and restructure the economy. Until the global financial crisis whose impact was most felt in 2009, the government had succeeded in restoring macro-economic and fiscal stability, steadily growing the domestic product, and expanding the tertiary sector. In the latter context, the scope for DRM was significantly enhanced over the period. However, the imbalances from the apartheid regime persist.

⁷ Brautigam's framework is adopted because compared to others that were examined; it is judged to be more comprehensive and elegant. However, like most others, its historical perspective derives too much from emergence of the modern European state to be linearly applied to states that are legacies of colonial rule and apartheid.

The dual socio-economic system institutionalised under the apartheid regime, underlies the socio-cultural divide that characterises South African society. On one hand, the majority remains either in the primary and informal sectors or unemployed. Furthermore, the unemployment situation has much worsened since 1994. According to the South African Institute of Race Relations:

“The number of unemployed South Africans, using the strict definition of unemployment, increased from nearly 2 million to 4.3 million people between 1994 and 2007. The unemployment rate increased from 20% to 25.5% over the same period”⁸

On the other hand, there is a comparatively small proportion of the population that derives its income from modern economic activities, and therefore contributes most of the domestic resources. Thus out of a population of 49 million, only 5 million individuals (or 10% of the population) are registered as taxpayers, which is low for a country at South Africa’s stage of development. In this regard, for example, in 2007, two other upper-middle-income economies, Chile and Latvia had 45% and 44% of their population registered as taxpayers respectively (OECD, 2009a).

1.4.2 A culture that is more trusting of government and higher tax morality is evolving⁹

According to Smith (2003), the apartheid regime cultivated a culture of compliance among the majority of taxpayers. Still, the author notes that there is a widespread perception among tax specialists that “apartheid era tax collection was characterised by high levels of avoidance”. This latter view appears to be borne out of data in the growth of registered taxpayers which has more than doubled since liberation.

Some of our key informants also suggest that although the banking and mining industries were key drivers of the economy pre-1994, they did not necessarily pay taxes. However, compliance levels from these sectors has since considerably improved. Furthermore, South Africa has demonstrably vigorous anti-corruption and enforcement agencies. It can therefore be surmised that over the past decade or so, a culture that is more trusting of government and higher tax morality is evolving.

⁸ South African Institute of Race Relations (<http://www.sairr.org.za/>) [Accessed 3 February 2010].

⁹ In a society where “tax morale” is high, there are low levels of tax evasion and avoidance. It is only in a social culture where citizens generally appreciate their responsibility for sustaining state services and where they have a trust in their state institutions and leaders that a “tax morale” evolves.

1.4.3 The insecure apartheid state modernised its bureaucracy by co-opting a White minority to pay high tax rates

The globalisation of resistance to the apartheid regime especially after the Soweto riots of 1976, which was followed by the progressive introduction of sanctions by the international community in the 1980s, posed a clear threat to the regime and its privileged beneficiaries. These developments explain the high tax rate regime and the legacy of an efficient inland revenue administration. As the minority White regime in successive decades promoted its apartheid policies and an anti-communist stance, it co-opted its followers who also dominated the modern economic sector to pay taxes (Lieberman, 2003). It is significant that by 1972, the top personal income tax rate in South Africa had risen to 62%. By then, resistance to the regime by the non-White population was gaining momentum.

1.4.4 Post-liberation - there was strong political and union support to increase DRM through the reform of the tax system

A top priority of the African National Congress (ANC), the dominant party in the post-apartheid coalition government of 1994, was to vastly and rapidly grow its domestic resources in order to fund its ambitious growth and poverty reduction programme. Therefore, in 1994, it pushed for the establishment of the Katz Commission to undertake an extensive review of tax policies and administration (Manuel, 2002). On the basis of the interim report of the Commission, in 1997, the autonomous South African Revenue Service (SARS) was established. It is noteworthy that the first Commissioner of SARS (Pravin Gordhan) as well as the long-serving former Minister of Finance (Trevor Manuel) are longstanding ANC stalwarts “who believe that tax collection is key in the shared political project of economic growth with redistribution” (Fjeldstad and Moore, 2008). Furthermore, as long as he remained in charge of SARS (until 2009), Commissioner Gordhan, did not hesitate to mobilise the ANC structures to campaign and educate for DRM among all sections of the population. The strong trade unions in South Africa have been close allies of the ANC for decades. According to Lieberman (2003), this alliance has not only served to support SARS, but also, to advance policies for resource redistribution through taxation. For these two predominant political institutions, the tax system is one of the several institutions targeted for righting past wrongs.

1.4.5 There is an implicit fiscal contract between the government and its taxpayers¹⁰

The relatively high compliance with taxation among the White population, and near total tax avoidance by Blacks under the apartheid is readily explainable. In the post-apartheid regime, levels of compliance have rapidly risen across the population, as reflected in the growth in the number of registered taxpayers. The majority of the Black population remain with high expectations that government will deliver on its pledges over the years to improve access to social services, and create employment and combat poverty. In this regard, the majority of the Black elite have a strong sense of the need to expand the public expenditure framework, and therefore the compelling case for them to pay taxes. The majority of the non-Blacks as well as the Black elite also support the expansion in government programmes to develop infrastructure, and reduce unemployment and thereby crime. Therefore, at an individual level, there is an implicit fiscal contract between the government and its taxpayers, which in any case is underscored in successive post-apartheid budget speeches. In this regard, for example, Lieberman (2003) asserts that while:

“Upper groups have expressed desires to shift the tax burden downwards, ...the normative order of post-apartheid...has provided compelling reasons for the rich to pony up to their tax obligations”

According to Lieberman (2003), the cohesiveness that existed among businesses in apartheid South Africa on matters of fiscal policy, have since then become stronger. By 2003, there was “remarkably little polarization within the ranks of business and professionals on key policy positions, particularly with respect to taxation” (Lieberman, 2003). Furthermore since the National Treasury and SARS have adopted a participatory approach to policymaking, and tax rates have been generally on the decline since the late nineties, the business community, on the whole, appreciates the benefits that they derive from the government’s services that are funded by their tax contributions.

1.5 Fiscal governance drivers, results and trajectory

The synopsis on political economy legacies underscores the fact that politics has pervasively impacted fiscal governance options in South Africa. The failure of fiscal governance in the wrought of apartheid politics, precipitated its end – in other words

¹⁰ Fiscal contract has its genesis in agreements between European monarchies and the propertied class and merchants that the latter would contribute to state coffers especially to fund war in return for specific benefits. In modern times a fiscal contract would be characterised by government pledges of specific socio-economic benefits to justify taxation. This is a more realistic proposition in a democratic dispensation.

the increasing inability of the apartheid regime to sustain a balanced fiscal position and thus a credible macro-economic environment was an important contributory factor to its demise. However, the legacy of that fiscal and macro-economic regime continues to influence the politics of fiscal governance in the post-apartheid era. The discrimination in the supply of public services under the apartheid regime is a key driver for the rapid expansion of the fiscal framework with a view to addressing historical disparities. Inherently there is a continuing and strong momentum to rapidly grow resources available for public expenditure.

Although the South African economy is relatively modern, it has remained fragile. Since the days of apartheid, the high political risks associated with capital flight have persuaded the government to maintain stringent foreign exchange controls. For this reason, South Africa has kept away from the option of mobilising resources from the Bretton Woods institutions, which in all probability would demand the end of such controls. Yet, at the same time, by remaining disengaged from these institutions, South Africa significantly constrains itself from international resource mobilisation. Therefore South Africa has remained predominantly reliant on DRM.

Post-apartheid politics espoused the rationale of the use of taxation to right the historical wrongs by using taxation as a distributional policy instrument. However, the ANC's sensitivity to international capital apprehension that the regime would collapse the economy with socialistic and communistic interventions has over the years, not only considerably moderated tax policies, but also, given cause to a strong emphasis on administrative measures – beginning with the establishment of SARS. This perspective, in part explains, the gradual decline in income tax rates. The other important factor underlying the policies to reduce personal income taxes, and in some cases, eliminate trade tariffs is the imperative to remain globally competitive as an attractive investment destination. Although the South African economy has a strong natural resource base, the larger part of its economy remains in the manufacturing and services sectors, which are open to external competition.

Given the constraints under which the post-apartheid governments have exercised fiscal governance, the administrative capacity and performance of SARS remains the key determinant of both fiscal space and effort. Therefore, political leaders have had to rely on SARS to grow domestic resources and enable the expansion of fiscal space despite a decline in tax rates. As Smith (2003) observes, in post-apartheid South Africa, the involvement of politicians has positively impacted on SARS's effectiveness. She also contends that "SARS's experience shows that, where the political and revenue-raising authorities have a common interest in enhanced collection, their collaboration is an important source of effectiveness". This is reflected in the growth of registered taxpayers (see **Annex C: Table C16**).

In our view, three main factors will play out in the fiscal governance of South Africa in the short to medium term. First, sustained pressure from political leaders and trade union representatives of low wage workers, for the government to more rapidly and demonstrably expand its public expenditure programmes for employment creation and poverty reduction. In other words, a strong socio-political demand for an expanded fiscal space and raised effort will prevail.

Second, there are the negative effects of the global financial crisis in terms of reduced trade volumes, commodity prices and business profits, and as a consequence, domestic revenue. Since the option of contracting the public expenditure framework may not be politically tenable, the quest for either alternative sources of additional revenue or raising the tax rates appear inescapable. With regard to the latter, for instance, as indeed already indicated by the Minister of Finance in his latest budget speech (for fiscal year 2010/11), there are distinct prospects that income tax and VAT rates will be raised in coming years.

Third, is – what the Economist (2010) has described as a large and growing problem – corruption. According to this publication, although in 2009, South Africa fared well in the Transparency International Corruption Perception Index ranking (55th out of 180 countries), corruption in the country is on the rise. The ANC has publically expressed concern about the corruption scourge. The Economist suggests that this trend is entangled with a culture of Black entitlement to compensate for past suffering under apartheid, and many South Africans seem relaxed about it. If this trend is not checked, there is a high risk that it will exacerbate corruption in the tax administration system. The end effects will be raised incidents of tax avoidance and collection leakages.

2 Trends in the tax system

2.1 Changes in tax policies over the years

This section covers three episodes in tax policy changes in South Africa: first, those in place during the apartheid era; thereafter, policies formulated following the dismantling of apartheid; and finally tax policies post 1994.

2.1.1 Tax policies in the apartheid era

Before and during the apartheid era the government's major source of revenue was income tax. According to Lieberman (2003), after many failed attempts, income tax was first introduced in South Africa at the advent of the First World War, in 1914. This is about the same time it was introduced in many European countries. In 1962, government enacted new income tax legislation which: consolidated the responsibility for collection of major taxes collected at a provincial government to central government; and introduced the pay as you earn (PAYE) system. Over the next two decades the Income Tax was amended to, for instance, reflect changes in rates. In addition, the Customs and Excise Act was promulgated in 1964. Since then, as outlined below there were two key periods in tax policy reforms.

2.1.2 Major tax policies formulated in the early 1990s

The VAT which replaced the goods and services tax came into force in 1991, amid huge protests by unionised workers (Lieberman, 2003). Still, VAT remained in force and was levied at a rate of 10% until 1993 when government hiked up the rate to 14%, where it remains today. The VAT rate in South Africa is lower than the rates in force in the rest of Africa and many other European countries. There have been calls by international financial institutions and businesses to raise it.

2.1.3 Tax policies introduced following liberation in 1994

Following liberation, the revision of government's tax policies was informed by recommendations made by the Katz Commission (1994 to 1999). Since 1994, the Government of South Africa's tax policy objectives have centred on: curbing evasion; widening its tax base; promoting greater compliance; facilitating private sector investment by ensuring that tax rates are competitive; reducing the compliance burden; and ensuring that the tax regime is equitable and neutral. Its focus has centred on policies which affect South Africa's three main sources of revenue: personal income tax (PIT); corporate income tax (CIT); and the VAT. Then again, government has formulated new policies outside these three main taxes, which are in line with international best practices and/or more suited to the modern-day nation of South Africa.

The Katz Commission recommended that one way by which government could widen the tax base with respect to VAT was to expand it to “include all fee-based financial services, except for premiums on life policies, contributions to pension, provident, retirement annuity and medical aid funds” (Manuel, 2002). Also, in recognition that VAT is often susceptible to evasion and fraud, in 1998 government: established a new scheme for VAT on exports; and introduced VAT on imports from the Botswana, Lesotho, Namibia and Swaziland (BLNS) countries to minimise “round tripping, which occurs when goods are exported to the BLNS countries, and then re-imported and sold in South Africa without the payment of VAT” (SARS, 1999).

With respect to income tax, government on the advice of the Katz Commission rationalised the PIT legislation by for instance: reducing the number of income tax brackets; offering greater relief to low income earners; and adjusting tax thresholds. It also progressively lowered CIT rates (see **Annex C: Table C2**). From 2000, in an effort to broaden the tax base, various taxation policies were amended to: disallow certain allowances given to employees as tax free; provide for individuals and companies to start paying taxes on a worldwide rather than resident basis; and remove loopholes in the income tax law (SARS, 2001). Government was able to sell these policy changes to taxpayers largely as a result of its promise to reduce taxes over time.

In line with the Katz Commission’s recommendation, in 2001 government introduced a capital gains tax (CGT). The rationale for a CGT was to¹¹:

- Make the income tax system more efficient by discouraging taxpayers from categorising ordinary income into tax-free capital gains;
- Promote equity by ensuring taxpayers with the same levels of income bear comparable tax burdens irrespective of their sources of income;
- Mobilise greater levels of domestic revenue;
- Align South Africa’s tax regime with international practices. In this regard, countries such as Australia, Brazil, Canada, India, Japan, Nigeria, the UK and USA levy CGT.

¹¹ See <http://www.treasury.gov.za/documents/national%20budget/2001/review/Default.aspx> [Accessed 9 March 2010].

More recently, in 2008, government introduced new measures to align South Africa's corporate tax policies with international good practices. Specifically, in an endeavour to remove the burden placed on companies to pay a Standard Tax on Companies (STC) which is levied on profits which are distributed through dividends, government announced its intention to introduce a dividend tax¹². Furthermore, the Mineral and Petroleum Resources Royalty Act, 2008 requires mining companies to pay royalties in recognition that minerals belong to the state and are not renewable sources of energy. The Minister of Finance postponed implementation of the Mineral and Petroleum Resources Royalty Act as a result of intensive debate on the formula to be applied to levy the tax, and the recession in 2008/09. However, legislation will become effective in 2010.

It is also insightful that over the years to encourage taxpayer registration and/or compliance, government has also offered various tax amnesties. First, the Exchange Control Amnesty and Amendment of Taxation Laws Act, 2003 gave amnesty to residents with unlawful holdings time to register them (SARS, 2004). An exchange control levy of 10 or 5% was payable if the illegal asset was kept offshore or repatriated to South Africa respectively. Second, the Small Business Tax Amnesty and Amendment of Taxation Laws Act, 2006 gave small businesses a chance to voluntarily state non-compliance with the law (SARS, 2007a). Third, in the Minister of Finance's most recent budget speech, he announced that government will offer non-compliant taxpayers the opportunity to disclose and make good their tax liabilities under the Voluntary Disclosure Programme which will run from November 2010 for a period of 12 months.

A study by the World Bank's Financial Investment Advisory Services (FIAS) group found "that overall the [tax] compliance costs are regressive – the smaller the business, the heavier the burden" (2007). As a result, the majority (over 60%) of businesses with an annual turnover of R300,000 or less preferred not to formalise their businesses. The study recommended the design and implementation of a simplified tax regime for small businesses. A survey of small business enterprises commissioned by the United States Agency for International Development (USAID, 2008) fed back a similar proposal. To this end, from 1 March 2009, government introduced a simplified tax system for micro-businesses (including sole proprietors, individuals, partnerships, close corporations, companies and co-operatives) with a turnover of R1 million or less. The new system requires that small taxpayers pay a single turnover tax rather than five separate taxes (i.e. VAT, provisional tax, income tax, CGT and STC).

¹² <http://www.sars.gov.za/home.asp?pid=2631> [Accessed 1 February 2010].

South Africa has been very proactive in the international dialogue on trade facilitation. Therefore the government remains very cognisant of the global trends, and in particular, customs duty which is not part of the fiscus. As a consequence today, over 70% of South Africa's imports are tax free. "This is not the case in most Sub-Saharan African countries where Customs duties still account for a large, even majority share of total state revenues" (SARS, 2007b). The Minister of Trade and Industry sets the rates of customs and excise duties based on recommendations received from the International Trade Commission of South Africa.

2.2 Institutional changes

By the mid-nineties, morale in the former Directorates of Inland Revenue and Customs and Excise was low¹³. Poor pay contributed to a high staff turnover. Furthermore, the operations of the directorates were severely underfunded. In 1996, the directorates were merged into a general government department under the leadership of an ex-chief executive of a major bank (Marcus et al, 2005). Thereafter as a means for "taking on the issues of large-scale tax evasion and ineffective countering of avoidance, and to reduce the considerable tax gap" SARS was established under Act No. 34 of 1997 (Fan et al, 2007).

SARS is headed by a Commissioner, appointed by the President, who is accountable to the Minister of Finance. The Commissioner works closely with an Executive Committee (ExCo) that he chairs, and which comprises about fifteen members from senior management. ExCo is supported by various themes (e.g. on people and modernisation) and oversight committees (e.g. audit with some external members). It is noteworthy that until 2002, SARS had an Advisory Board. However, this board was dissolved following the passage of the SARS Amendment Act of 2002 (SARS, 2003).

SARS's organisational set-up has undergone restructuring over the years. It is currently organised into three types of business units: (1) delivery business units; (2) enabling; and (3) advisory (SARS, 2009b). Specifically, the following divisions fall under:

- Delivery: (1) taxpayer services; (2) business enabling and delivery services; (3) large business centre; (4) customs and border management; and (5) enforcement and compliance risk;

¹³ Under apartheid, there were also separate revenue administrations in the homelands.

- Advisory: (1) strategic services; (2) legal and policy; (3) segmentation and research; and (4) governance and enterprise risk;
- Enabling: (1) finance; (2) human resources; (3) institutional enablement and integrity; (4) modernisation and technology; and (5) internal audit.

There are 54 designated ports for customs purposes in South Africa – five marine, eight airports and the remainder land border points. In addition, SARS has 46 inland branch offices and mobile tax units. Branch offices are spread around the country's nine provinces.

As at 31st March 2009, SARS employed a total of 15,307 employees, out of which 556 were engaged on a temporary basis (SARS, 2009b). It is noteworthy that almost 90% of SARS's staff were employed to support its core business functions. Under its enabling Act, SARS has management autonomy, including freedom to operate outside the conditions of employment in the public service. In this latter regard, SARS aims to pay most of its staff against median market salary levels.

2.3 Changes in administrative systems

SARS's management has over the years exercised its influence in the areas of staff and other resource management to overhaul its administrative systems. In this regard, for example, it:

- Operates two bonus schemes. An annual bonus is paid out when SARS meets its revenue target and is tied to individuals meeting balanced scorecard metrics. There is also the 'Amakhwezi' Programme which runs throughout the year – Managers are allocated a certain number of points each year which they use to reward exceptional performance;
- Has also invested heavily in transforming the culture and work ethic of its work force through: intensive communication; enforcing ethical practices; and skills enhancement;
- Initiated a leadership management training initiative in 2008/09 targeted at mid-career managers and team leaders. The training aims to embed four main leadership qualities and competencies that SARS identifies as essential for supporting and reinforcing its values (SARS, 2009a). These qualities and competencies are: higher purpose and integrity; empowering delivery; transformation; and insight.

Also, since its establishment over thirteen years ago, SARS has invested heavily in modernising its systems. SARS's system modernisation has been driven by its objectives to increase revenue and reduce costs. Providing good service and making compliance easier underpin these objectives. Electronic filing (eFiling), the launch of a call centre and the automation of key support systems are probably the most fundamental and successful systems modernisation efforts that SARS has introduced (see **Annex D**).

2.4 Fiscal decentralisation and taxation by local governments

The 1996 Constitution recognises three autonomous levels or “spheres” of government, notably the national, the provincial, and the local (municipal) spheres. The South African intergovernmental fiscal transfer system is generally regarded as well-designed and well-implemented. The overarching system of intergovernmental fiscal relations is defined by the Intergovernmental Fiscal Relations Act (1997) and the Financial and Fiscal Commissions Act (1997). The latter act establishes the Financial and Fiscal Commission, which is constitutionally mandated to make recommendations to Parliament on the equitable division of revenues among the three spheres of government.

Over three-quarters of municipal revenues are collected from own source revenues (see **Annex C: Table C18**). Self-financing of municipal services is believed to ensure that they are directly accountable to local residents for the functions performed and the services provided. Local revenues empower residents to play an important role in deciding on the services they prefer and are willing to pay for, and ensure that municipalities remain responsive to the needs of their residents.

Municipalities in South Africa have traditionally had three main sources of own municipal revenues: service charges (including electricity fees, water tariff, sewerage fees and refuse collection charges), property taxes (known as property rates), and the RSC Levy. Municipal revenue potential varies considerably among jurisdictions, with metropolitan municipalities and urban local governments collecting the bulk of own source revenues.

2.5 Reform sequencing, implementation and results

2.5.1 Overview

The end of apartheid heralded reforms in the tax system. Thus according to Lieberman (2003), the “election of Nelson Mandela in 1994 provided a significant opening to reform the country's tax system”. Between 1994 and 1999, the Katz Commission set the stage for reforming policy and institutional aspects of the tax system in nine reports. Most of the commission's recommendations in these two

areas have been implemented and are reflected in **Sections 2.1.3 and 2.2**. The next series of reforms took place following the establishment of SARS. Specifically, between 1997 and 2000, SARS made changes to some of its operational processes which contributed to the organisation surpassing revenue collection targets. However, SARS's management considered these changes as 'incremental' and were of the view that the organisation was performing significantly below its potential (SARS, 2000). Therefore, management initiated a diagnostic study of its operations in order to identify issues and problems and recommend measures for resolving them. This exercise culminated in the development of a programme 'Siyakha' ('we are building') whose main objectives were to: "broaden the tax base, encourage a culture of voluntary compliance... (so making tax cheaper to collect), and create a much more efficient and effective business" (SARS, 2005). Siyakha was approved by Cabinet in September 2000.

2.5.2 Sequencing and implementation of reforms under 'Siyakha'

Siyakha 1's implementation commenced in 2001 and ran until 2005/06. It was sequenced by province as follows: Kwa Zulu Natal (2001); Western Cape (2003); Gauteng (2004); and other provinces (2005/06). Key initiatives implemented under Siyakha 1 included: the development of a taxpayer and business strategy; process redesign in revenue and customs; overhauling taxpayer services; the implementation of policies to promote integrity and professionalism among staff (e.g. by re-advertising all new positions and through training, standardising work methods, the creation of work teams, creating a professional management cadre etc.); and refurbishment and re-tooling initiatives to improve the working environment (SARS, 2000). SARS reports the following results for Siyakha 1: (1) its organisation structure is flatter; (2) processes were redesigned and standardised; (3) a dedicated taxpayer function was established; (4) the enforcement function was strengthened; and (5) staff were better trained and more motivated.

In 2007/08, SARS launched Siyakha 2. The thrust under this second wave of reform centred on the modernisation of SARS over a five to seven year period, in particular, "transforming both the tax and customs administration through automation and other operational efficiency gains" (SARS, 2008). Siyakha 2 comprises ten programmes of modernisation which are clustered around implementing a new operating model, implementing national priorities (i.e. protecting borders and implementing social security and a wage subsidy) and strengthening SARS's operational foundation. At the end of Siyakha 2, SARS anticipates that it will be able to better: secure revenue; enhance compliance; secure and manage its borders; and maximise productivity as a result of operational effectiveness. Siyakha 2 is sequenced into three implementation lots, each

spanning over two or so years (see **Table 2.1**). Some of the preliminary implementation results from Siyakha 2 are as follows:

- SARS's operating model was restructured. Specifically, in addition to the segmentation of large businesses, SARS clustered the remainder of its taxpayer base into nine segments¹⁴;
- The nine segments are served by state-of-the-art call and walk-in centres, and the eFiling service. With respect to the latter service, from 2007/08, taxpayers began to receive populated and restructured personal income tax forms, resulting in the reduction of errors (drop by 85% (from 600, 000 in 2007 to 90 000 in 2008)) and increased client satisfaction (see **Annex D**);
- Risk management processes were modernised. Using an intelligent risk engine, SARS profiles cases for audit/investigation to enable "enforcement to focus its activities on higher possible yield cases" (SARS, 2008). Furthermore, it is also able to compare tax returns against third party information to identify any variances;
- SARS was in the process of replacing 42 legacy systems in customs with TATIScms software. The increased use of ICT is expected to reduce the level of interaction with importers, and minimise corruption (see **Annex D**);
- SARS staff continued to receive training in client service and tools to enable them to be more responsive to taxpayer queries. It is noteworthy that SARS:
 - Developed a knowledge database as "a repository of [Frequently Asked Questions] FAQs, tax information and scripted responses" (SARS, 2009b);
 - Put in place standard operating procedures and scripted information for staff in customs and inland revenue branch offices respectively. These procedures aim to limit any level of discretion around day to day work, and ensure clarity and certainty in decision making;

¹⁴ The nine segments include: (1) tax practitioners; (2) trade intermediaries; (3) complex individuals; (4) standard individuals; (5) standard income tax employees and below threshold; (6) medium businesses; (7) micro to small businesses; (8) non governmental organisations, public benefit organisations and government departments; and (9) employers as agents (SARS, 2009b)

- A multi-lingual interactive voice response (IVR) system was launched in November 2008 to facilitate self-service. By March 2009, 1.3 million callers had used the IVR (SARS, 2009).

Table 2.1: Sequencing of Siyakha 2 interventions

Lot 1: Create capacity, design and prepare for modernisation	Lot 2: Implement new model	Lot 3: Deliver world-class service
<ul style="list-style-type: none"> • Align organisation on strategic choices and direction • Launch division specific quick-wins and no regrets moves • Develop intelligence and transparency on taxpayer and trader segments and develop differentiated business model • Develop core skills and capabilities to deliver • Take actions to improve performance transparency and business processes • Develop organisational capabilities and capacity 	<ul style="list-style-type: none"> • Implement new business model per segment • Capabilities in place • Shift in effort and allocation of resources • Core tax process re-design • Broader people process and values programme 	<ul style="list-style-type: none"> • Change the way SARS acts and performs in all areas and on all organisation levels • Deliver full results according to aspirational targets and desired end state (revenue, compliance, border management)

Source: SARS

Initially other than working towards meeting revenue targets, SARS focussed on a number of key result areas (e.g. improving technology, tighter customs control, business process changes etc.). However, from 2001/02 it embarked on the development of a performance management system informed by the ‘balanced scorecard’ approach (SARS, 2001). From 2007, SARS’s annual reports published actual achievements against targets (see **Annex C: Table C20**). In sum, the results suggest that the administrative reforms contributed to increased tax revenue due to one or more of the following factors: the simplification of systems and processes encouraging voluntary compliance; improved enforcement arrangements (e.g. with respect to risk based audits and debt collection); and quicker processing times (e.g. for tax returns).

With respect to these recent administrative reforms, it is also noteworthy that e-Filing contributed to a dramatic reduction in the time taken to process income tax returns - in 2006/07 and 2007/08 the percentage of tax returns processed within 48 hours was 1.6% and 34% respectively. **Table C19** also shows that efforts to improve SARS’s compliance and enforcement (i.e. audit, debt collection and investigation) functions paid off. In 2006/07 and 2007/08 the number of registered taxpayers (particularly CIT payers) grew by 17% and 12% respectively. So did SARS’s success in risk based audits – 68% (2006/07) and 73% (2007/08) of cases yielded additional revenue.

3 Domestic revenue performance

3.1 Domestic revenue performance trends

In 1980, the South African Reserve Bank (SARB) reports national revenue as a percentage of GDP was 20.2%. When the newly democratic government took office in 1994, national revenue as a percentage of GDP had risen slightly to 21.9%. By 2007/08, this figure had increased to 27.8% (see **Figure 3.1**). It noteworthy that over 95% of general government funding from taxes is raised nationally, 3.5% by municipalities and less than 1% by provincial governments (Republic of South Africa, 2008). Furthermore, non-tax revenues (departmental receipts) as a percentage of total budget revenue are low. In 2007/08, 2008/09 and 2009/10 non-tax revenues as a percentage of total budget revenue (gross of SACU payments) were 2%, 1.9% and 1.7% respectively¹⁵.

Figure 3.1: Tax and non-tax revenue as a percentage of GDP (1994/95 to 2007/08)



Source: Republic of South Africa (2008). Also see Table C6 in Annex C

Tax revenue over the 13 years to 2007/08 grew at an average annual growth rate of 13.3%, in spite of the overall reduction in tax rates at the beginning of the decade. The latest published tax statistics available indicate that in 2007/08, the four largest

¹⁵ (<http://www.treasury.gov.za/documents/national%20budget/2009/default.aspx>) [Accessed on 4 February 2009]

sources of domestic revenue in South Africa in order of their magnitude of contribution to total tax revenue were: PIT (29.5%); VAT (26.3%); CIT (24.5%); and fuel levy (4.1%). Revenue from CGT is included as part of PIT and CIT collections (see **Annex C: Table C9**). Other sources of tax revenue and their contribution to tax revenue in 2007/08 were: customs duties (4.7%); STC (3.6%); and specific excise duties (3.2%) (Republic of South Africa, 2008).

It is noteworthy that, PIT revenue peaked at 10.3% of GDP in 1999/00, but by 2007/08 had declined to 8.2% of GDP mainly on account of the substantial levels of tax relief provided largely to low income taxpayers - in line with government's policy objective to do with equity. "Tax relief in the 2002/03 - 2003/04 period amounted to R28.3 billion or 14.6% of PIT collected while the relief in the 2004/05 - 2007/08 period amounted to R32.2 billion or 5.9%" (SARS, 2008). Still, PIT revenues did grow at an average annual rate of 10.8% in the period from 1994/95 to 2007/08. SARS partly attributes this increase to higher levels of employment and compensation in the economy.

VAT collections grew by average annual rate of 13.5% between 1994/95 and 2007/08. SARS attributes this growth to an increase in consumer consumption, higher than expected prices, and increases in fixed capital formation in certain years (SARS, 2003). Also, from 2004/05, SARS started to set-off VAT refunds against other types of tax owed by taxpayers (SARS, 2005).

As earlier observed, despite of the reduction in top marginal rates, SARS was able to record a remarkable average annual growth in CIT revenue collections of 21.5% p.a. Specifically, CIT revenue grew from 2.4% of GDP in 1994/95 to 6.8% of GDP in 2007/08. The largest contributors to CIT growth were firms from the financial services, manufacturing, retail and wholesale, and telecommunications sectors which all recorded strong growth (SARS, 2009b). Also, the tax policy to widen the CIT base to include income from foreign sources yielded positive results.

In addition, SARS introduced a range of administrative reform measures to enforce and promote compliance. The key ones were:

- Ensuring that provisional CIT payments were more in line with companies' latest profit positions as provided for in legislation;
- Measures to enhance operational efficiencies (e.g. audits, debt collection) (see **Sub-section 2.5.2**). In particular, SARS assesses returns with the aid of a risk engine. Any discrepancies are subject to follow up by the Compliance Risk Unit. If a discrepancy cannot be resolved then the return is subject to

audit. Investigative audits look into: “allegations of intentional non-compliance; [and] ensure punitive actions are taken against offenders (SARS, 2008). SARS also investigates criminal cases which it hands over to the criminal justice system (i.e. the National Prosecution Service, Police and Courts);

- The introduction of an advance tax ruling (ATR) system in October 2006 to discourage tax avoidance or aggressive tax planning. The ATR “is intended to promote clarity, consistency, and certainty in respect of the interpretation and application of the tax laws to which it applies”¹⁶. Specifically, in an ATR SARS sets out its interpretation of tax legislation in the context of a transaction proposed by the taxpayer who applied for the ruling;
- Fostering “better and proactive” relationships with corporate taxpayers (SARS, 2008) (see **Sub-section 3.2.4**).

In addition to the above, other tax policies introduced since 1994 have also positively contributed to domestic revenue performance. First, the Exchange Control Amnesty and Amendment of Taxation Laws Act of 2003, achieved its intended purpose. SARS reports that it received 40,000 applications from South Africans with unlawful foreign exchange assets and income (SARS, 2004). In his 2005 budget speech, the Minister of Finance announced that the total value of assets disclosed was R65 billion. In its 2005/06 budget, government projected it would collect R2.1 billion in exchange control levies.

Second, the Small Business Tax Amnesty of 2006 was also a success. SARS launched an extensive campaign in the media, through ‘imbuzu’ (meetings) and by sponsoring industrial theatres to encourage small businesses to apply for amnesty. “Almost 350,000 applications were received, which included 12% new registrations” (SARS, 2008). In 2007/8, SARS collected an additional R12.8 billion as a result of the small business tax amnesty (SARS, 2009b). In 2007/08 this additional revenue constituted 2.2% of total tax collections.

3.2 Tax administration performance benchmarks

3.2.1 Performance efficiency

SARS’s operating costs as a percentage of tax revenue collections have remained at around the 1% mark (see **Annex C: Table C3**), which is comparable to the cost of collection in countries with a tax revenue to GDP ratio in the same range as South Africa. This ratio spans from less than 0.6% (USA) to over 1.4% (Japan)

¹⁶ <http://www.sars.gov.za/home.asp?pid=4109> [Accessed 10 March 2010].

(OECD, 2009a). However, between 1998/99 and 2007/08, operating costs grew at an average annual rate of around 14.8%. Employee costs (62%), administrative expenses (20%) and professional and special services (13%) constituted the bulk of SARS's expenditure in 2007/08. Yet it is worth drawing attention to the fact that the number of tax staff available for every 1,000 persons in South Africa is 0.30 (see **Annex C: Table C4**). This 'tax staff per population ratio' is low compared to World and Sub-Saharan African averages which are 0.82 and 0.37 respectively¹⁷. This low ratio may partly be attributable to the fact that over two million taxpayers submit their pre-populated tax returns electronically, thereby demanding fewer SARS resources to check submissions. It is unlikely therefore that SARS will vastly increase its staff numbers - rather the priority is to improve the way in which the organisation targets high revenue generating taxpayers through specialisation.

As alluded to in the previous chapter of this paper, SARS is organised along functional lines. As part of its delivery function, in 2004, SARS launched a Large Business Centre (LBC). It has LBC offices in Cape Town, Durban, Johannesburg and Port Elizabeth. The LBC is currently organised around industry sectors (e.g. manufacturing, mining, communications, construction, financial services etc.). The LBC serves around 22,000 taxpayers – both entities and high net worth individuals who in aggregate contribute 80% of CIT revenue. Each taxpayer has an assigned Tax Relationship Manager. All senior managers in the LBC have been recruited externally (e.g. from large accounting firms and banks), where they held senior positions.

The World Bank's 2010 Doing Business survey ranks South Africa 23rd out of 183 countries in terms of ease of paying taxes. The tax regime makes it easier for taxpayers to comply by keeping the number of payments a year at a low level. According to the World Bank's 2010 Paying Taxes Survey, a company is required to make only 9 payments a year which are far less than the Sub-Saharan Africa (SSA) and OECD averages of 37.7 and 12.8 a year respectively (see **Annex C: Table C15**). Furthermore, the use of the risk engine to assess tax returns together with eFiling services have been instrumental in speeding up the length of time taken by SARS to make income tax and VAT refunds. In 2006/7, SARS reported that it was able to process 81% and 83% of income tax and VAT refunds within 30 days and

¹⁷ http://www.fiscalreform.net/index.php?option=com_wrapper&Itemid=132 [Accessed 2 February 2010].

21 days respectively¹⁸ (SARS, 2007). These turnaround times were maintained in 2007/08.

As part of its administrative reforms (see **Sub-section 2.5.2**), SARS has also been fairly aggressive since 2004/05 in collecting tax debt (see **Annex C: Table C10**). Specifically tax arrears as a percentage of total tax revenue declined from 19.8% in 2002/03 to 10.7% in 2007/08. SARS ascribes this reduction to its debt equalisation practice – in which a taxpayer’s VAT, PAYE and income tax refund and debt balances are offset against each other. SARS also established a collections centre to chase up tax debts. In addition, where debt is uneconomical to collect, SARS uses the provisions of Section 91A of the Income Tax Act to write-off or suspend tax debts (SARS, 2007).

South Africa has a high VAT gross compliance ratio (VATGCR) of 86.90 in comparison to the world average ratio of 65.48¹⁹ (see **Annex C: Table C11**). This metric suggests that this revenue source is collected very efficiently with minimal exemptions (see **Sub-section 3.2.3**) albeit with some leakages (e.g. arising from under declarations, fraudulent VAT refunds etc.). Nevertheless, a high VATGCR has benefited from increased enforcement efforts. For example, in 2007/08: SARS in collaboration with other government institutions reported 228 convictions and 32 successful prosecutions; and a further 27 cases were referred to criminal investigations.

Measures from the same source of both CIT revenue productivity (CITPROD) and PIT revenue productivity (PITPROD) of 0.27 and 0.22 respectively indicate that South Africa uses the two taxes more efficiently in generating revenue than World averages of 0.13 and 0.14 for CITPROD and PITPROD respectively – again due to strong enforcement and other improvements in the tax system. The preparation of a preliminary compliance evaluation report in 2007/08 was instrumental to the development of SARS’s enforcement programme. As part of this programme, SARS launched “specialised campaigns to bring into the tax register’s ambit entities such as small businesses”. It is also better able to identify cases for audit (see **Sub-section 2.5.2**). Furthermore, “improvements in service and outreach to large corporations have generated a strong culture of tax compliance” (Fan et al, 2007).

¹⁸ The residual refund applications took longer to process as they were identified as ‘outliers’ requiring an audit.

¹⁹ http://www.fiscalreform.net/index.php?option=com_wrapper&Itemid=132 [Accessed 2 February 2010].

3.2.2 Allocative efficiency

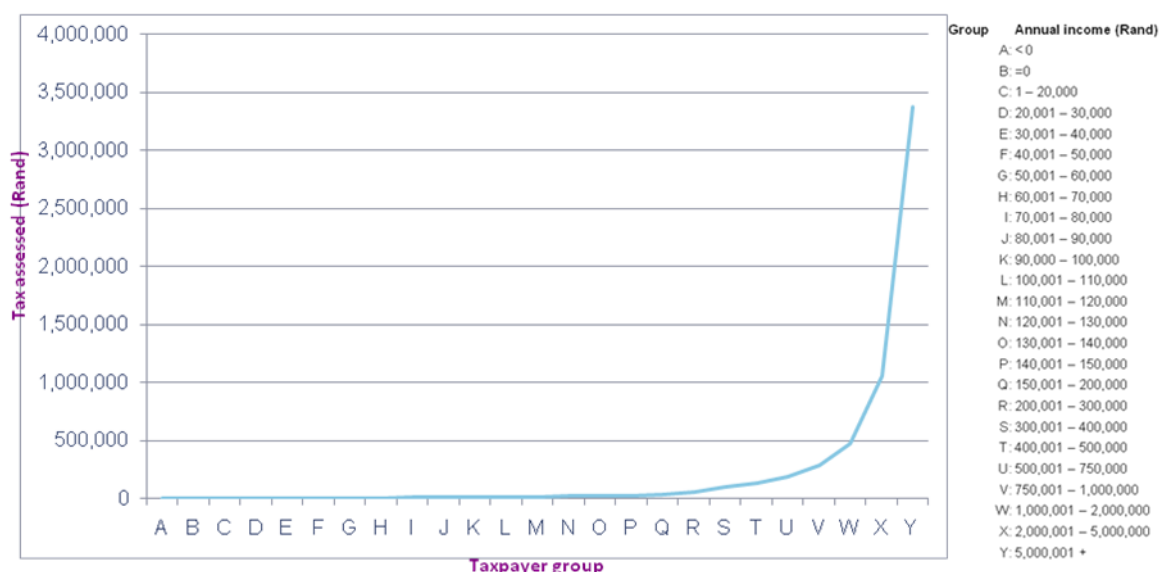
South Africa's equivalent to the export and special processing zones in East Africa is the industrial development zone (IDZ). The government offers various customs and VAT incentives to firms operating in IDZs such as: duty and VAT suspension on imported goods for manufacturing or storage; zero rating of VAT on local inputs; and various trade facilitation services²⁰. However, any duty and tax waivers are only offered within a customs controlled area (CCA). When manufactured goods are exported they are not subject to tax. But should goods enter the domestic market they are subject to tax as they are deemed to be imports. Therefore, IDZs have no real tax expenditure implications and are therefore more allocatively efficient than their equivalents in EAC countries.

3.2.3 Performance equity

Figure 3.2 which presents the average PIT liability in 2006, by each taxpayer group, suggests that the regime is progressive, with low income earners (groups A to I) who constitute about 38% of total taxpayers, each paying taxes ranging from an average of Rand 0 to Rand 6,952 (around US\$ 0 to US\$ 964). In contrast, high income earners (groups S to Y) constitute 7% of total taxpayers, and each pay taxes ranging from an average of Rand 95,014 to Rand 3.4 million (approximately US\$13,200 to US\$ 470,000) or between 27% and 68% of total income tax respectively.

Figure 3.2: Average PIT assessed by taxpayer income group (2006)

²⁰ <http://www.sars.gov.za/home.asp?pid=44747> [Accessed 22 June 2010].



Source: Republic of South Africa (2008)

Under South Africa's PIT regime low income taxpayers retain around 47% more income after taxes making it "one of the most progressive tax systems in the world" (Lieberman, 2003). Furthermore, the government regularly revises tax brackets (see **Annex C: Table C13**). For example, between 2002/03 and 2008/09, government increased the tax brackets for the lowest and highest income earners by 205% and 104% respectively. In the process, some lower income earners dropped out of the tax net, and the rise in tax liabilities for lower groups as their incomes increased was delayed.

Yet, if one analyses the tax burden for CIT, large taxpayers contribute almost 80% of this revenue source (SARS, 2009b). Furthermore, key informants indicate that the top 50 and 200 large taxpayers pay 30% and 80% of CIT revenues respectively. However, the 'total tax rate' as a percentage of profit of 30.2% is more than half and significantly lower than the SSA and OECD averages of 67.5% and 44.5% respectively²¹ (see **Annex C: Table C16**).

A few studies on the equity of VAT in South Africa suggest that to a minor degree it is regressive. In particular, a study by Fourie and Owen (1993) suggests that the VAT in South Africa is 'mildly regressive' even though legislation provides for exemptions or zero rated items (e.g. on basic foods and paraffin) utilised by poor

²¹ <http://www.doingbusiness.org/ExploreEconomies/?economyid=172#PayingTaxes> [Accessed 10 March 2010].

households (Go et al, 2004). Also, a subsequent study by Go et al (2004) concludes that the “presence of a VAT in the South African tax system, impacts negatively on the welfare of low-income households” with high and low income groups spending less than 4% and more the 5% of their incomes respectively. “Removing the VAT on food and increasing the base rate on other goods to 16.4% so as to keep VAT revenue constant transforms” it into a progressive tax (Gillingham, 2008).

Another indicator of the tax burden has to do with the amount of time taken by taxpayers to comply with the major types of taxes. In this regard, the 2010 World Bank paying taxes survey indicates that South African companies spend 200 hours a year on this task, as opposed to 350 hours in 2008²². This latest result compares favourably with the OCED average of 194.1 hours.

3.2.4 Performance effectiveness

According to IMF computations there was no tax gap in South Africa in 2005 – it was -0.4% (see **Annex C: Table C18**). Furthermore, the tax effort was 101.4%. However, the results of SARS’s enforcement initiatives suggest that a tax gap exists. On the one hand, key informants to this case study indicated the tax gap may range between R25 and 35 billion (or 4.4% of 2007/08 revenue). On the other hand, the Commissioner of SARS is recently quoted as having said that a definitive amount is not available – “We have to be certain that we can depend on a figure and explain it before we release any percentage” (Temkin, 2010a). Still, relative to the EAC countries South Africa has a substantially lower tax gap and higher tax effort.

At an operational level SARS seeks to improve its effectiveness by soliciting feedback on its performance from various sources as a basis for informing the authority on its strengths and areas for improvement. Each year, SARS engages big businesses from up to five industries on tax trends, policies, administration in South Africa vis-à-vis the rest of the world. It has in recent times also started to dialogue with public sector institutions (primarily parastatals and local governments) focussing on compliance trends. These interventions also both directly and indirectly aim to promote tax morality, and discourage aggressive tax planning.

In 2009, SARS and the Banking Association signed the South African Banking Accord, which sets out a framework for cooperation which for instance aims to ensure: that SARS provides the industry with quality services; there are high levels of compliance by banks; and that impermissible tax avoidance is prevented etc. As part of the accord, both parties undertook to establish ‘A Banking - SARS

²² Ibid.

Operational Forum' comprising senior executives from the authority and association which will meet every six months to discuss tax compliance, administrative and legislative issues. The Commissioner of SARS is also expected to meet the Banking Association's Board at least once a year (OECD, 2009b). The signing of the accord is a major scoop for SARS in that very few countries in the world have such an arrangement. And yet, the financial services sector tends to have many complex transactions. The sector can also be the source of extremely useful third party information.

In addition, SARS commissions independent surveys on the effectiveness of its services on an annual basis. In 2005/06, SARS reported: that it achieved a year-on-year reduction in the number of complaints of 14%; and a customer satisfaction index rating of 93% (SARS, 2006). Also, in its 2006/07 annual report, SARS highlights "widespread public approval of SARS as revealed by market research; [and] a high rating in 'best government department' newspaper surveys" (SARS, 2007). In 2007/08, SARS focussed on obtaining feedback from taxpayers on the services provided by the LBC.

3.3 Summary of overall trends

On the basic parameter of tax revenue to GDP ratio, the tax system in South Africa has consistently improved performance since the onset of the reforms that followed the end of the apartheid era (see **Figure 3.1**). The wide breadth and depth of policy, institutional and administrative changes were informed by the analytical, policy and strategic development work of the Katz Commission, which existed parallel to both the mainstream government policy organs and tax administration systems for a period of five years, 1994-1999.

One instructive facet of the Katz Commission was the phasing of its recommendations, which were delivered in nine separate packages (reports) over the five-year period. In this sense, the commission set the strategy and pace for the sequencing of reforms in the early years of their implementation. Thus, for example, the establishment of SARS in the 1996-1997 period was in line with the early recommendations of the Commission. Thereafter, the sequencing of the reforms was anchored in successive strategic plans of SARS.

Yet another unique feature of the reforms that reflect the comprehensiveness and rigour of the work of the Katz Commission was the depth of policy development. An example of the latter was the successful introduction of the policy to levy tax on income earned on a world-wide basis. This policy introduced by government in

2000, has yet to find a place, in for instance, many SSA countries – possibly because it is administratively challenging.

Impressive and sustained improvements in the efficiency and effectiveness of SARS since its establishment, has of course been crucial to achieving the overall high rate of growth in tax revenue (an annual average rate of about 13.3% in the 1995-2008 period). SARS has been particularly successful in building and applying systems and capacity for enforcements as well as encouraging compliance. In more recent years, aggressive and smart utilisation of ICT applications has been the bedrock of the reforms.

4 Challenges and issues

SARS is respected by many revenue administrations in Africa and beyond. It is particularly strong because of its ability as an organisation to be introspective, reflective, plan next steps and take action. As SARS charts its way to becoming a world class services provider, in our considered view, it grapples with a few key medium to long-term challenges and issues. In addition, there are some challenges with policy implications or which require the involvement of other public sector institutions. These challenges and issues are elaborated on in the remainder of this chapter.

4.1 DRM efforts must be stepped up to finance national development strategies

When he presented South Africa's Medium Term Budget Policy Statement (MTBPS) for 2010/11 to 2012/13, Minister Gordhan acknowledged that government has "made much progress since the advent of democracy, yet much more remains to be done" particularly with respect to job creation, the provision of services in education and health, rural development, and combating corruption and crime (National Treasury, 2009). To these ends, it is imperative for government to mobilise greater levels of resources to address its development priorities.

Government has indicated that it will borrow resources as a short-term measure while the economy recovers, and as tax revenue collections rise. By 2012/13, government expects to have reduced the fiscal deficit from its current level of 7.6% to 4.2%. This reduction implies that SARS must raise gross tax revenue as a percentage of GDP from its projected level in 2009/10 of 24.5% to 26.2% by 2012/13.

4.2 A different approach for dealing with taxpayer segments is needed

The MTBPS anticipates that SARS will sustain the tax compliance culture that it has cultivated over the years. SARS's management recognises it cannot achieve this objective without rationalising the way in which the authority utilises its human resources. Most SARS staff serve middle-level taxpayers who form the bulk of its clientele but contribute much less revenue than large businesses and high net worth individuals. In order to perform better with the same resources, modernising SARS's systems to minimise processing effort, coupled with ensuring that staff dealing with large taxpayers become increasingly specialised will be key success factors.

There is also an on-going review of segmentation arrangements. Specifically, SARS has assessed that it does not have sufficient capacity to run them all. The LBC is already undergoing restructuring (see **Box 4.1**). The restructuring of other segments will build on existing infrastructure. However, it will be important to bear in mind the different risks associated with each segment (e.g. keeping practitioners honest and ensuring that any exceptions arising with respect to small businesses are dealt with at contact).

Box 4.1: Rationale for restructuring the LBC

There are several issues that call for the reorganisation of the LBC. First, the case for being organised around industry sectors (which was influenced by arrangements in the UK), is with hindsight and experience, not entirely suitable for South Africa. There is therefore a proposal that in future the LBC operates along functional lines (in the same way that firms such as PwC operate). However, the LBC is likely to maintain some industry specialism in mining and financial services as these two industry sectors have specific tax rules.

Second, there is a view that too many criteria are currently used to select taxpayers for the LBC. For instance, a taxpayer is eligible to receive LBC services if it: is a listed entity or a parastatal or financial services or mining or multinational institution; or has a turnover of over R250 million, or an annual income of more than R7 million or assets worth more than R75 million for individuals. Therefore, SARS on the basis of country comparisons is considering revising the eligibility criteria to: groups with a combined turnover of more than R1 billion; and entities which are considered risky (e.g. multi-nationals, financial services and mining institutions). If SARS adopts this new measure, around 10,000 taxpayers will be transferred from the LBC, possibly to a medium-sized taxpayer grouping.

There are also discussions as to whether high net worth individuals should continue to be served by the LBC or be moved into the 'complex individuals' segment. Many high net worth individuals in South Africa have international investments, which are currently only dealt with by the LBC as their tax implications require specialist skills. If these individuals are shifted, then the LBC would need to sign service level agreements with other units in SARS. However, SARS is aware that a similar change in the USA was subsequently reversed.

Source: Key informant interviews

4.3 SARS must continue to widen its tax base for the foreseeable future

In addition to the above, SARS is challenged to bring into the tax net both new taxpayers evolving as a result of economic growth, and actors operating in the informal economy. With respect to the latter group, Friedman (2003), contends that SARS has not been successful in assessing "the ideologies, and institutions which underpin informal activity", and thereafter devise interventions which could be used to enhance compliance. However, in recent years, SARS has attempted to engage both groups through education and outreach initiatives such as the small business amnesty, which was an enormous success. Still, in the medium-term, SARS is challenged to reduce the tax gap by:

- Further expanding its outreach through ‘walkabouts’ to establish unknown economic activities which are outside the tax net;
- Assessing how SARS can expand its footprint into areas where there are no branches. For example, according to key informants, Soweto has one branch but should probably have five. Such an expansion would offer SARS the opportunity to educate small businesses but may not be economically viable in the short-term;
- Increasing the number of lifestyle audits. A SARS spokesperson recently indicated to the press that “a lifestyle questionnaire is used to obtain information about the lifestyle of an identified taxpayer” (Temkin, 2010b). In the same article, a tax practitioner described what lifestyle audits entail as follows:

“SARS may obtain information about nondisclosure of taxable income from various sources, for instance a disgruntled employee, a recently divorced spouse or media reports that raise suspicion about a taxpayer...”

4.4 SARS’s staff capacity must keep abreast with its transformation

SARS is aware that whilst it has made great strides in enhancing staff capacity, more needs to be done to strengthen skills. The leadership management training initiative (see **Section 2.3**) needs to be rolled out across the organisation. SARS must also deepen its staff’s business and technical skills, ensuring that they are aligned with the new operating model. In this regard, for example, one of the priority areas of action in 2009/10 was the development and launch of a customs core skills training programme (SARS, 2009a). SARS was also looking at options for recruiting and retaining staff in critical areas with gaps such as enforcement, customs, strategy and analysis.

4.5 There may be trade-offs between administering tax and non-tax revenues

In addition to administering taxes, SARS currently collects UIF contributions and SDLs on an agency basis. It has also undertaken to support the implementation of government’s social security and wage subsidy interventions from 2010. According to the Minister of Finance’s 2010/11 budget speech, the government is considering offering “a cash reimbursement to employers for a two-year period, operating through the SARS payroll tax platform”. Whilst there is clearly advantage in using SARS’s infrastructure and intelligence on compliant taxpayers, this initiative is likely to place an additional burden on the authority.

4.6 The increased cases of crime and corruption need to be kept in check

The composition of the tax gap includes revenue forgone as a result of criminal and corrupt activities. On this matter, SARS reports an increase in syndicated crime, particularly in the areas of fraud and corruption. It is also alleged that corrupt officers employed by the Companies and Intellectual Property Registration Office may have been part of a syndicate which registered non-existent companies with the intention of defrauding SARS of VAT revenue²³. In addition, key informants indicated to us that syndicated crime has extended to the banking system – specifically by using bank accounts and cheques to defraud SARS.

4.7 There are challenges around regional trade integration

The SACU arrangement has been in place since 1910 when the Republic of South Africa was formed. South Africa and the BLNS countries which form SACU have agreed fixed common external tariffs (CETs). The formula for sharing customs receipts is as follows: the customs duty pool is shared on the basis of intra SACU imports; and the excise duty pool is split two ways – 85% on the basis of GDP, and the remaining 15% on developmental indicators (e.g. life expectancy and literacy). Edwards et al (2009) argue that current revenue sharing arrangements could encourage countries to overstate SACU intra-trade statistics. Furthermore, the same authors consider that “the formula has perpetuated a dependency on customs revenue as a source of government revenue in many BLNS economies”.

There is on-going dialogue around expanding this customs union arrangement to the 14 SADC countries which are all signatories to a free trade agreement. However, there are issues around rules of origin, leading to a lot of paperwork. Also, Edwards et al (2009) suggest that some BLNS countries may be unwilling to further reduce CETs and/or admit new members to a customs union as these measures would imply a reduction in customs revenue. South Africa is challenged to lead in addressing these issues.

²³ <http://corruptionwatchdog.blogspot.com/> [Accessed 12 March 2010].

5 Lessons of experience

There are considerable lessons of experience to be garnered from South Africa around the trends in the tax system, Siyakha, revenue performance and even the challenges it faces going forward. However, in this chapter we have selected what we consider to be the six most profound lessons to be considered for inclusion in the EAC policy note.

5.1 The strong collaboration between SARS and the National Treasury has been instrumental to revenue mobilisation

SARS and the National Treasury collaborate effectively at several levels. Since 2009, the National Treasury, in partnership with SARS, has initiated the production of very comprehensive tax statistics. SARS also participates in a committee chaired by the National Treasury which sets revenue targets. There is even closer collaboration on a daily basis. SARS advises the National Treasury on a daily basis of any likely changes to cash collections. If there is a collection shortfall, this notification allows the National Treasury to borrow funds on a short-term basis to finance public expenditure.

By all accounts the National Treasury seems in touch with SARS's plans, operations and performance. A close working relationship is evident in annual reports and strategic plans produced by SARS, which all contain insightful messages from the Minister of Finance, that for example, reinforce the linkage between government's development agenda and revenue performance. In the Minister of Finance's budget speeches there is always mention of the results and impact of SARS's administrative reforms. It is also laudable that on the first day following the fiscal year end (31 March), as a result of excellent planning and coordination as well as unyielding commitment, SARS staff are able to provide the Minister of Finance with preliminary revenue results for the year that has just ended. The Minister of Finance announces the results to the press on the same day.

5.2 Solid policy formulation and evaluation capacity is also key to strong revenue performance

The Government of South Africa has strong tax policy capacity within SARS and the National Treasury. Until three or so years ago, SARS was extensively involved in tax policy development and drafting of legislation. Since then, the National Treasury has developed its own capacity in this area. Nevertheless, in recognition of its expertise, the National Treasury welcomes SARS's views on the: extent of fit of new tax policy proposals with the prevailing tax structure; and implications of trade

policies and agreements for customs. Key informants indicate that when the two institutions deliberate on tax policy proposals, there is a 'healthy tension'.

It appears that the arrangements above have borne fruit. Government's post-liberation tax policies have achieved their intended aims. Furthermore, despite resistance from strong lobby groups, government has not been forced at any time to reverse any tax policies. Rather, it has been accommodating of national and global economic developments. Thus, for example, the small business amnesty has been extended to April 2010, and the Mining Royalties Act of 2008 will not be enforced until 2010/11.

5.3 Compacts with professional and industry groups can reinforce compliance and facilitate administrative efficiency and effectiveness

SARS has entered into a unique accord with the banks in South Africa. Under the accord, SARS has committed to provide quality services to the banks, and in turn the banks have committed to promoting tax compliance, and in particular discourage tax avoidance among their customers. This kind of compact can definitely be extended to other industries and professional groups. The results of SARS's initiative should be closely watched for possible replication by other ARAs.

5.4 Minimising the level of exemptions ensures tax policies remain neutral

The government grants tax exemptions on an extremely exceptional basis. Only a few public benefit and public sector organisations are eligible for exemptions, and these are legislated and not discretionary. Also tax incentives offered in IDZs are designed to have limited implications for tax expenditure (see **Section 3.2.2**).

5.5 Modernising through the use of ICT can result in significant operational efficiencies but must be applied judiciously

This paper has highlighted SARS's accomplishments in the application of ICT systems. In particular, SARS has used ICT to simplify its operating environment and enhance business intelligence (e.g. through the use of third party information and risk engines), enabling it to reduce transaction and compliance costs, and focus more on high risk taxpayer segments. Yet, there are some discernable lessons of experience for other revenue authorities embarking on the modernisation journey as follows:

- It is invaluable to have a 'single view of the taxpayer', and therefore, integrating core tax systems is critical – this practice was not observed by SARS from the word go, but measures are underway towards this goal. Integrated systems also assist in enhancing data quality;
- Systems usage by eFilers is not even throughout the year. It peaks towards the end of the filing season. This uneven usage can have significant cost implications. In this regard, SARS is considering offering taxpayers discounts for filing within prescribed periods – as is the practice in the UK;
- The tax environment is complex and therefore change must be gradual. **Table C17** in **Annex C** shows the number of registered CIT, PIT and VAT taxpayers. In addition, customs deals with an even higher volume of transactions. For example, SARS indicates that in a year there are: 1.7 million import transactions; 1.8 million SACU movements; almost 1 million export transactions; and 14 million passengers passing through customs;
- Systems need to be kept secure on an on-going basis. In this respect, SARS is continuously strengthening its security. It is subject to two fishing attempts a week. This statistic should not come as a surprise considering the magnitude of SARS's revenue collections, and the fact that the bulk of taxpayer payments are effected electronically;
- Once systems are fully functional, maximising the use of information generated is critical. In this respect, SARS works on using the information available from its modern ICT systems more effectively by continuously questioning what it should be measuring. This quest is expected to drive up revenues collected;
- There is need to accommodate taxpayers who for whatever reasons cannot access electronic services. Probably the most important consideration in an African context is that such a small percentage of the population has access to the internet, let alone a personal computer.

5.6 Good client service is critical for promoting voluntary compliance

One key informant aptly described SARS's overall strategy around services delivery as to ensure that 'people pay taxes with a smile'. SARS's approach has therefore been to resist intimidating taxpayers. Instead considerable effort has gone into enhancing its three product offerings – call centres, walk-in centres and eFiling. In addition, as part of its taxpayer education (TPE) service, SARS puts in a lot of effort during the filing season in assisting taxpayers to complete their tax returns – according to key informants that we interviewed, in 2009, SARS served up to

56,000 taxpayers a day. This latter part of SARS's TPE service offering is unique on the African continent. And so is TPE's:

- Points of service intervention for which SARS employs a two pronged approach. First SARS partners with shopping malls who provide space and internet access to enable it to provide services to individual taxpayers. Second, SARS provides the same service in collaboration with other government departments via 'Thusong' (one-stop) centres;
- Outreach service. TPE vets applications for VAT registration by physically inspecting applicants' places of business. It passes suspect cases to the enforcement and compliance risk unit for further investigation.

5.7 A policy of zero tolerance to corruption is an important deterrent

On 1 April 2007, SARS established an Anti-Corruption and Security (ACAS) Unit. Its mandate is to detect and investigate: taxpayers who are registered but do not make full or submit fraudulent declarations; and employees who steal from taxpayers. The ACAS Unit's work is informed by SARS's risk engine which provides information on taxpayers: who are generally compliant (and therefore low risk); and those who are non compliant (and therefore high risk).

The ACAS has developed a model to support its efforts to curb corruption and ensure security covering: prevention; detection; and investigation. It is noteworthy, that as part of its:

- Prevention intervention, the unit has developed standards to safeguard physical and information access. Furthermore, all SARS personnel must be vetted prior to their confirmation of employment, and are also required to declare their interests on an annual basis;
- Detection activities, the unit works closely with the police, banks, and the intelligence service. The unit maintains a register of incidences which list the type of crime and whether it is limited, medium or serious;
- Investigation activities, the unit pre-investigates each reported incidence to establish its validity. If an allegation is valid, the unit fully investigates the case, which could result in a staff dismissal and/or the criminal prosecution of a taxpayer/staff. SARS employs prosecutors who compile case evidence for submission to the National Prosecution Service and South African Police. SARS also makes every effort to recover lost revenue.

The work of the unit is also informed by research and analysis activities which pinpoint: the most prevalent crimes; and thematic/systemic problem areas to address. As syndicated operations continue to become more complex with time, SARS also uses the results of research and analysis to fine-tune its policies, procedures and systems.

Annex A: Key informants

Aidan Keanly (Mr), South African Revenue Service

Alfred Cuevas (Mr) – Senior Resident Representative, International Monetary Fund

Andrew Fisher (Mr), Group Executive – Segmentation, South African Revenue Service

Brandley Ngcobo (Mr), Senior Manager Capacity Development, South African Revenue Service

Clifford Collings (Mr), Head of Anti-Corruption and Security, South African Revenue Service

Deprose Muchena (Mr), Economic Justice Programme Manager, Open Society Initiative for Southern Africa

Erich Kieck (Mr), Group Executive - Customs Policy and Strategy, South African Revenue Service

Frank Strake (Mr), Manager - Taxpayer Services (Services), South African Revenue Service

Franz Tomasek (Mr), Group Executive, Legal Research and Development, South African Revenue Service

Godfrey Modise (Mr), Manager - Taxpayer Services (Services), South African Revenue Service

Hannelie Schoeman (Ms), Remuneration (Human Resources), South African Revenue Service

Hope Selana (Ms), Self-employed

John Roberts (Captain), Marine Superintendent/Barge Move Master

Joseph Rock (Mr), Group Executive: Large Business Centre, Technical Enablement, South African Revenue Service

Keith Brebnor (Mr), Chief Executive Officer, Chamber of Commerce and Industry – Johannesburg

Lionel Schoeman (Mr), Project Management Office (IDZs), South African Revenue Service

Logan Wort (Mr), Group Executive – Reputation Management, South African Revenue Service

Mike Jarvis (Mr), Head of Architecture Division – Modernisation and Technology, South African Revenue Service

Nancy Dubosse (Dr), Head of Research – Economic Governance Programme, Idasa

Randall Carolissen (Dr), Group Executive: Revenue Analysis, Planning and Reporting, South African Revenue Service

Saki Macozoma (Mr), Chairman, Business Leadership South Africa

Sandeep Mahajan (Mr), Lead Economist and Cluster Leader – Poverty Reduction and Economic Management, World Bank

Sekgobela Mi Conty (Mr), Employee in the service sector

Sobantu Ndlantalavu (Mr), Manager – Taxpayer Services (Education), South African Revenue Service

Varsha Singh (Ms), Senior Manager International Relations, South African Revenue Service

Victor Masola (Mr), Executive - Enforcement Legal (Enforcement), South African Revenue Service

Yotam Longwe (Mr), Divisional Executive: International Finance Cluster, Development Bank of South Africa

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Annex C: Select indicators

Table C1: An analysis of sector contributions to production

Sector	Ratio to nominal GDP (%)		Average annual real change (%)
	1984	1994	1985-1994
Primary sector			
Agriculture, forestry and fishing	4.8	4.6	3.9
Mining and quarrying	12.7	7.3	-0.6
Secondary sector			
Manufacturing	23.0	20.9	-0.1
Electricity, gas and water	3.7	3.6	4.0
Construction (contractors)	3.7	3.1	-2.6
Tertiary sector			
Wholesale and retail trade, catering and accommodation	11.6	14.2	-0.1
Transport, storage and communication	9.0	8.7	1.6
Financial intermediation insurance, real estate and business services	13.1	16.0	1.8
Community, social and personal services	18.3	21.5	2.0
GDP at basic prices	100	100	3.1

Source: South African Reserve Bank and Du Plessis and Smit (2007)

Table C2: Tax policy – Maximum marginal tax rates (1994/95 to 2007/08)

Fiscal year	PIT	CIT	STC	VAT
1994/95	-	35%	-	14%
1995/96	-	35%	-	14%
1996/97	-	35%	-	14%
1997/98	-	35%	-	14%
1998/99	-	35%	-	14%
1999/00	45%	30%	-	14%
2000/01	45%	30%	-	14%
2001/02	42%	30%	-	14%
2002/03	40%	30%	12.5%	14%
2003/04	40%	30%	12.5%	14%
2004/05	40%	30%	12.5%	14%
2005/06	40%	30%	12.5%	14%
2006/07	40%	30%	12.5%	14%
2007/08	40%	30%	10%	14%

Source: Republic of South Africa (2008)

Table C3: Tax administration costs (1998/99 to 2007/08)

Fiscal year	Operating cost (R million)	Operating cost as a % of tax revenue
1998/99	1,663.2	0.90%
1999/00	1,906.3	0.95%
2000/01	1,922.5	0.87%
2001/02	2,332.6	0.92%
2002/03	2,878.5	1.02%
2003/04	3,562.8	1.18%
2004/05	4,311.7	1.21%
2005/06	5,135.5	1.23%
2006/07	5,156.1	1.04%
2007/08	5,607.9	0.98%

Source: Republic of South Africa (2008)

Table C4: Ratio of tax staff per population (TAXSTAFF)

Indicator	South Africa's measure	World's measure	SSA's measure	Upper income economies' measure
TAXSTAFF	0.30	0.82	0.37	0.88

Source: http://www.fiscalreform.net/index.php?option=com_wrapper&Itemid=132 [Accessed 2 February 2010].

Table C5: National government revenue, debt and deficit as a percentage of GDP

Year	Revenue	Debt	Deficit
1980	20.2%	35.9%	-3.1%
1981	21.2%	30.4%	-0.1%
1982	20.2%	29.6%	-2.1%
1983	21.2%	30.9%	-2.2%
1984	20.5%	30.8%	-3.2%
1985	21.5%	32.4%	-3.3%
1986	23.8%	31.6%	-2.3%
1987	22.5%	32.3%	-4.4%
1988	22.2%	33.0%	-5.0%
1989	23.5%	36.4%	-3.5%
1990	25.1%	36.8%	-1.4%
1991	24.0%	35.3%	-1.9%
1992	22.6%	36.8%	-3.7%
1993	21.7%	40.4%	-7.3%
1994	21.9%	43.5%	-5.6%
1995	22.5%	49.1%	-4.6%
1996	22.5%	49.5%	-5.1%
1997	23.0%	48.9%	-5.0%
1998	23.4%	48.0%	-3.7%

Year	Revenue	Debt	Deficit
1999	24.2%	49.9%	-2.8%
2000	23.7%	46.6%	-2.1%
2001	22.7%	43.9%	-1.9%
2002	23.7%	43.9%	-1.4%
2003	23.2%	38.5%	-1.1%
2004	22.9%	36.3%	-2.3%
2005	24.0%	35.0%	-1.5%
2006	25.5%	32.6%	-0.3%
2007	26.3%	28.6%	0.7%
2008	26.9%	24.0%	0.9%
2009	20.2%	22.4%	-1.2%

Source: South African Reserve Bank

Table C6: Total budgeted tax and non-tax revenue as a percentage of GDP gross of SACU payments (1994/95 to 2007/08)

Fiscal year	Tax revenue	Non-tax revenue
1994/95	22.9%	0.4%
1995/96	22.6%	0.5%
1996/97	23.2%	0.6%
1997/98	23.6%	0.5%
1998/99	24.4%	0.6%
1999/00	24.1%	0.5%
2000/01	23.2%	0.4%
2001/02	24.1%	0.4%
2002/03	23.5%	0.4%
2003/04	23.5%	0.5%
2004/05	24.9%	0.4%
2005/06	26.3%	0.5%
2006/07	27.4%	0.6%
2007/08	27.8%	0.6%

Source: Republic of South Africa (2008)

Table C7: Tax revenue collected at national, provincial and local government level as a percentage of GDP (2002/03 to 2007/08)

Fiscal year	National	Provinces	Local government
2002/03	23.5%	0.2%	1.4%
2003/04	23.5%	0.3%	1.5%
2004/05	24.9%	0.2%	1.6%
2005/06	26.3%	0.3%	1.6%
2006/07	27.4%	0.3%	1.0%
2007/08	27.8%	0.2%	1.0%

Source: Republic of South Africa (2008)

Table C8: Breakdown of provincial and local government tax revenues (2002/03 to 2007/08)

Fiscal year	Provinces				Local government	
	Casino taxes	Horse racing taxes	Liquor licences	Motor vehicle licences	Property taxes	Regional service levies
2002/03	19.2%	3.7%	0.5%	76.5%	73.9%	26.1%
2003/04	19.7%	3.1%	0.4%	76.8%	73.7%	26.3%
2004/05	20.5%	2.5%	0.5%	76.4%	70.1%	29.9%
2005/06	20.8%	2.2%	0.4%	76.5%	69.6%	30.4%
2006/07	22.1%	2.6%	0.4%	74.9%	98.0%	2.0%
2007/08 ²⁴	22.5%	2.4%	0.8%	74.3%	99.6%	0.4%

Source: Republic of South Africa (2008)

Table C9: Composition of national government tax revenues (1994/95 to 2007/08)

Fiscal year	PIT	CIT	STC	VAT	Fuel levy	Customs	Excise duties	Other	Total tax revenue
1994/95	39.50%	10.5%	1.1%	25.7%	7.3%	4.9%	4.8%	6.0%	100%
1995/96	40.20%	11.0%	1.0%	25.7%	7.0%	4.8%	4.8%	5.4%	100%
1996/97	40.40%	11.5%	0.9%	24.4%	7.1%	4.9%	4.0%	6.8%	100%
1997/98	41.30%	11.9%	0.9%	24.3%	7.3%	3.4%	4.5%	6.4%	100%
1998/99	42.10%	11.0%	1.0%	23.8%	7.4%	3.3%	4.4%	7.1%	100%
1999/00	42.60%	10.4%	1.6%	24.0%	7.1%	3.4%	4.4%	6.5%	100%
2000/01	39.20%	13.4%	1.8%	24.7%	6.6%	3.7%	4.1%	6.4%	100%
2001/02	35.80%	16.8%	2.8%	24.2%	5.9%	3.4%	3.9%	7.1%	100%
2002/03	33.40%	19.8%	2.2%	24.9%	5.4%	3.4%	3.7%	7.2%	100%
2003/04	32.60%	20.1%	2.0%	26.7%	5.5%	2.8%	3.8%	6.6%	100%
2004/05	31.30%	19.9%	2.1%	27.7%	5.4%	3.7%	3.7%	6.2%	100%
2005/06	30.10%	20.6%	2.9%	27.4%	4.9%	4.4%	3.5%	6.1%	100%
2006/07	28.40%	24.0%	3.1%	27.1%	4.4%	4.8%	3.3%	4.8%	100%
2007/08	29.50%	24.5%	3.6%	26.3%	4.1%	4.7%	3.2%	4.2%	100%

Source: Republic of South Africa (2008)

²⁴ Budget figures

Table C10: Analysis of tax arrears (2002/03 to 2007/08)

Item	Fiscal year					
	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Due debt (R billion)	56.0	56.2	62.0	60.0	64.0	63.0
Total tax revenue (R billion)	282.2	302.5	387	424	509	590
Debt revenue (%)	19.8%	18.6%	16.9%	14.2%	12.6%	10.7%

Source: SARS (2008) and SARS (2004)

Table C11: CIT and PIT revenue productivity and VAT gross compliance ratio (2008/09)

Indicator	South Africa's measure	World's measure	SSA's measure	Upper income economies' measure
CITPROD	0.27	0.13	0.09	0.15
PITPROD	0.22	0.14	0.08	0.14
VATGCR	86.90	65.48	42.3	70.82

Source: http://www.fiscalreform.net/index.php?option=com_wrapper&Itemid=132 [Accessed 2 February 2010].

Table C12: Analysis of PIT and CIT burden – Tax assessed as a percentage of taxable income (2002/03 to 2005/06)

Fiscal year	PIT assessed as a % of taxable income	CIT assessed as a % of taxable income
2002/03	23.8%	30.2%
2003/04	21.7%	30.1%
2004/05	21.7%	29.9%
2005/06	20.7%	28.8%

Source: Republic of South Africa (2008)

Table C13: Personal Income Tax (PIT) brackets, 2002/03 and 2008/09

Brackets in Rand				Marginal	Cumulative
2002/03		2008/09		PIT rates	% increase
-	40,000	-	122,000	18%	205%
40,001	80,000	122,001	195,000	25%	144%
80,001	110,000	195,001	270,000	30%	145%
110,001	170,000	270,001	380,000	35%	124%
170,001	240,000	380,001	490,000	38%	104%
240,001	& over	490,001	& over	40%	

Source: Republic of South Africa (2008)

Table C14: Analysis of tax burden – Taxes paid by the various taxpayer segments in 2008/09

Segment	Number registered	CIT	VAT	PAYE	Total
Large businesses	21,561	79%	4%	43%	31%
Medium businesses	42,286	12%	57%	26%	22%

Segment	Number registered	CIT	VAT	PAYE	Total
Micro to small businesses	2,347,341	9%	36%	16%	15%
Complex individuals	2,750,000	0%	0%	0%	18%
Standard individuals	2,900,000	0%	0%	0%	9%
SITE	5,600,000	0%	0%	0%	1%
NGOs, PBOs, Embassies and Government departments	27,568	0%	3%	15%	4%
Total	13,688,756	100%	100%	100%	100%

Source: SARS (2009b)

Table C15: World Bank Doing Business indicators on the tax burden (South Africa only)

Indicator	Year		
	2008	2009	2010
South Africa's global ranking	-	23	23
Number of tax payments a year	11	9	9
Time taken to comply with the major tax types	350	200	200

Source: <http://www.doingbusiness.org/ExploreEconomies/?economyid=172> [Accessed 10 March 2010]

Table C16: World Bank Doing Business indicators (2010) on the tax burden (South Africa vis-à-vis the OECD and SSA)

Indicator	Region		
	South Africa	OECD	SSA
Number of tax payments a year	9	12.8	37.7
Time taken to comply with the major tax types	200	194.1	306.0
Total tax rate as % of profit	30.2%	44.5%	67.5%

Source: <http://www.doingbusiness.org/ExploreEconomies/?economyid=172> [Accessed 10 March 2010]

Table C17: Growth of registered taxpayers

Registered as	Total number registered for tax				Percentage increase (1998/99 to 2007/08)
	1998/99	2002/03	2005/06	2007/08	
Individuals	2,485,703	3,415,432	4,476,261	5,204,805	109%
Companies	777,864	814,894	1,054,969	1,584,002	104%
Trusts	-	254,593	344,882	348,747	-

PAYE	202,806	252,589	330,194	633,703	212%
VAT vendors	-	506,098	633,703	745,487	-

Source: Smith (2003) and Republic of South Africa (2008)

Table C18: Tax gap and tax effort for select EAC countries and South Africa (select years)

Country	Year	Tax revenue (A)	Estimated potential tax revenue (B)	Tax gap (B) – (A)	Tax effort (A)/(B) as a %
		As a % of GDP			
Kenya	2001	17.8	20.8	3.0	85.5
	2005	18.6	20.6	2.0	90.5
South Africa	2001	24.8	26.7	1.9	92.9
	2005	27.4	27.0	-0.4	101.4
Rwanda	2001	10.7	20.9	10.2	51.2
	2005	12.2	21.4	9.9	57.0
	2008	13.5	22.0	8.5	61.4
Tanzania	2001	9.7	20.0	10.3	48.5
	2005	11.2	20.5	9.3	54.4
	2008	15.0	20.9	5.9	71.6
Uganda	2001	10.4	19.2	8.8	54.3
	2005	11.8	19.5	7.8	60.3

Source: IMF (2009b)

Table C19: Aggregate municipal operating revenue in South Africa, 2005/06 to 2009/10

	2005/06	2006/07	2007/08	2008/09	2009/10
Operating Revenue (R Million)					
Property rates	17,401	18,521	21,486	22,770	24,136
Service charges	40,201	44,498	49,223	51,549	54,777
Regional Service Levies	7,604	386	95	2	0
Investment revenue	2,357	2,970	3,845	3,818	4,133
Government grants	17,398	27,223	26,571	28,311	28,491
Public contributions	664	695	0	0	0
Other own revenue	10,375	11,763	17,184	16,260	16,167
Total revenue	96,000	106,056	118,404	122,710	127,704
Percentage of total revenue					
Property rates	18.1%	17.5%	18.1%	18.6%	18.9%
Service charges	41.9%	42.0%	41.6%	42.0%	42.9%
Regional Service Council (RSC) Levies	7.9%	0.4%	0.1%	0.0%	0.0%
Investment revenue	2.5%	2.8%	3.2%	3.1%	3.2%
Government grants	18.1%	25.7%	22.4%	23.1%	22.3%
Public contributions	0.7%	0.7%	0.0%	0.0%	0.0%
Other own revenue	10.8%	11.1%	14.5%	13.3%	12.7%
Total revenue	100.0%	100.0%	100.0%	100.0%	100.0%

Note: RSC levies abolished from 1 July 2006. Interim replacement grant included in Equitable share. Figures for 2006/07 reflect Budget Estimates; figures for subsequent years reflect medium-term estimates.

Source: National Treasury local government database / Local Government Budgets and Expenditure Review 2008 (Table 3.2).

Table C20: Balanced scorecard performance measures

Strategic objective	Performance indicator	Target	Actual results	
			2006/07	2007/08
Optimising compliance & managing risk	Revenue collections	Budget	Exceeded	Exceeded
	Administrative cost as a % of total revenue	1.06%	1.04%	0.98%
	Due debt as a % of total revenue	14%	12.6%	10.7%
Ensuring a better taxpayer & trader experience	% achievement against service charter	85%	94%	99.8%
	Call centre—80% of calls answered in 20 seconds	80%	71%	49%
	Branch office walk ins- attend 95% in 15 mins, 90% (peak)	Off peak - 95% Peak - 90%	Off peak – 96.5% (March – June) Peak – 93.9% (July – February)	98.6%
	Correspondence—respond to 80% within 21 working days	80%	80%	-
Improving enforcement	% overall increase in compliance behaviour—increase in active register, decrease in outstanding returns, & decrease in debtors	9%	Increase of 17% in active register Decrease of 6% in Outstanding Return book Decrease of 3,75% in debt book	12%
	Increase ineffective tax rates per selected industry	5%	Not measured	-
	Due debt collected	R17bn	R17.7bn	R15,6bn
	% success in risk based audits	70%	68%	73%
	Audit coverage across all tax types	66,000	69,270	69,118
Continuing staff development & promoting a culture of integrity & professionalism	% compliance with equity plan	100%	90%	-
	% closure of skills gap	25%	55.4%	-
	Implement new performance management development system	90%	90%	100%
Enhancing trade facilitation & border control	% documentation compliance with customs regulation coverage and examination success rate- imports & exports (I&E)	15%	34%	-
	% achievement of turnaround times for trade processes- I&E -	95%	96%	100%

Strategic objective	Performance indicator	Target	Actual results	
			2006/07	2007/08
	Imports 4 hrs – electronic data interchange			
	% success of anti-smuggling activities : SACU	15%	30.3%	-
	% achievement of passenger examination and success rate: SACU success rate	2%	1%	1%
Ensuring greater efficiency	% of returns processed within target time: income tax	Non-peak period: 80% within 34 working days (March – June) Peak period: 80% within 90 working days (July – February)	Non-Peak period: 61% within 34 working days (March – June) Peak period: 88% within 90 working days (July – February) 1.6% within 48 hours	34% of returns processed within 48 hours
	% accuracy of assessments	92%	91.2%	-
	% of returns reworked as a result of own error	4%	2.7%	-
	Maintaining success rate in litigation of appeals	65%	82% (average)	82%
Ensuring good governance	% of governance framework implemented across organisation	100%	100%	100%

Source: SARS annual reports and OECD (2009a)

Annex D: Changes to the administrative systems at SARS

SARS first introduced eFiling in July 2001 for VAT and provisional income tax returns and payments which were submitted via a third party provider at a cost. The initial uptake in 2001/02 of 10,500 returns was not as high expected due to the associated third party provider costs (SARS, 2002). The use of a third party provider was abandoned, and instead taxpayers could file returns directly to SARS. Since then eFiling has been extended to cover PAYE, SDL, UIF, STC, transfer duty, ATR and Provisional Tax. With respect to PAYE, SARS launched 'e@syfile for employers'. This platform enables SARS to receive over 90% of PAYE submissions electronically.

Furthermore, SARS has since directed significant resources to pre-populating PIT records with information available from third parties (e.g. employers and individuals), thereby enhancing the accuracy of records. In addition, SARS restructured the tax return form from 11 to 2 pages; and "the need to provide paper schedules with the tax returns was done away with" (SARS, 2008). Also, SARS invested resources in educating taxpayers on new arrangements – especially eFiling. Taxpayers have every incentive to file their returns electronically, especially since they have a longer submission deadline than those who submit manual returns. Furthermore, SARS is able to provide eFilers with a 24 hour service, seven days a week as well as a short messaging service (SMS) to remind taxpayers when returns are due. SARS estimates that there are currently 2 million eFilers. Moreover, this technology has: enabled SARS staff to improve its workflow management – it takes 48 hours to complete a tax assessment as opposed to 58 days under the manual filing system; and empowered and enabled frontline staff by providing them with business Intelligence and data mining facilities.

In 2004/05, SARS launched a National Call Centre to offer a single contact for all taxpayer enquiries (SARS, 2005). Within one year, SARS reports that it received over 3 million calls of which 80% were answered within 20 seconds. This level of responsiveness can be attributed to staff training to maximise timeliness of service – in particular: that a taxpayer only calls once; call times are reduced; issues are resolved as quickly as possible; and backlogs are minimised. In 2008/09, SARS

further modernised the call centre by incorporating an interactive voice response system.

SARS has also modernised its internal systems. In 2004/05, SARS settled on a SAP solution for its financial management system (SARS, 2005). The SAP system enables SARS to: undertake bank reconciliations nationally on a daily basis; obtain a daily view of revenue accounts; and a view every 15 minutes on deposits which serves many uses – for example, SARS sends daily SMS on collections to relevant staff. In 2008/9, SARS extended the functionality of SAP to manage its human resource processes and transactions.

Over and above the SAP financials platform, considerable effort has gone into finessing revenue planning and monitoring systems. In particular, SARS maintains various models (e.g. time series, regression analysis, bottom-up) to inform revenue forecasting. The models are built on the basis of indicators in the macro-economic framework, collection patterns, compliance trends and so forth. SARS tests the validity of the models on an ongoing basis. It also compares its models with those used in world class revenue services.

In terms of the framework in place for monitoring and evaluation (M&E) of its operations, SARS prepares medium-term strategic plans with clear objectives and specific measures of performance. These plans feed into SARS's MTEF for financial resource allocation purposes. In addition to revenue targets by type of tax, the M&E framework defines targets for: number of taxpayers and traders; volumes of tax returns and bills of entry to be processed per annum; service volumes; processing and response times; compliance actions (e.g. number of audits per annum); and effectiveness (e.g. success rates) (SARS, 2009a). SARS reports on its performance in annual reports. Reports detail actual performance against the targets set in the strategic plan. These metrics are supplemented by narratives which explain any positive and negative variances (SARS, 2009b).

SARS was in the process of replacing 42 legacy systems in customs with TATIScms software. The new system builds on the lessons of experience from the modernisation of the income tax system. TATIScms offers features such as: the generation of statistics; reconciliation/acquittal; risk engine rules; and facilities to support the Authorised Economic Operator (AEO) accreditation programme across SACU and SADC. SARS on the back of TATIScms has embarked on simplifying processes (in a similar way to inland revenue), so that there is no requirement in

future for importers/agents to provide supporting documentation. Furthermore, increased use of ICT is expected to reduce the level of interaction with importers, and minimise corruption.

SARS receives a grant from the National Treasury to fund its operations. It budgets for its resource requirements in the Medium Term Expenditure Framework (MTEF). “Other operating revenue consists mainly of commissions earned from acting as the agent for the Department of Labour” (SARS, 2009b). In particular, SARS collects Unemployment Insurance Fund (UIF) contributions and Skills Development Levies (SDLs) in line with the Unemployment Insurance Contributions Act, 2002 and the Skills Development Levies Act, 1999. SARS invests surplus cash and retains any interest.

Annex E: Glossary of definitions of select terms

CITPROD	CITPROD indicates how well CIT does in terms of producing revenue, given the prevailing tax rate. It is calculated by dividing total corporate income tax revenues by GDP and then dividing this by the general corporate income tax rate.
PITPROD	PITPROD attempts to provide an indication of how well the personal income tax in a country does in terms of producing revenue. It is calculated by taking the actual revenue collected as a percentage of GDP, divided by the weighted average PIT rate.
Tax effort	Actual tax revenue as a percentage of estimated potential tax revenue
Tax gap	The difference between estimated potential tax revenue and actual tax revenue
VATCGR	This is a measure of how well the VAT produces revenue for the government. It is computed by dividing VAT revenues by total private consumption in the economy and then dividing this by the VAT rate.