Tax & Exchange Control

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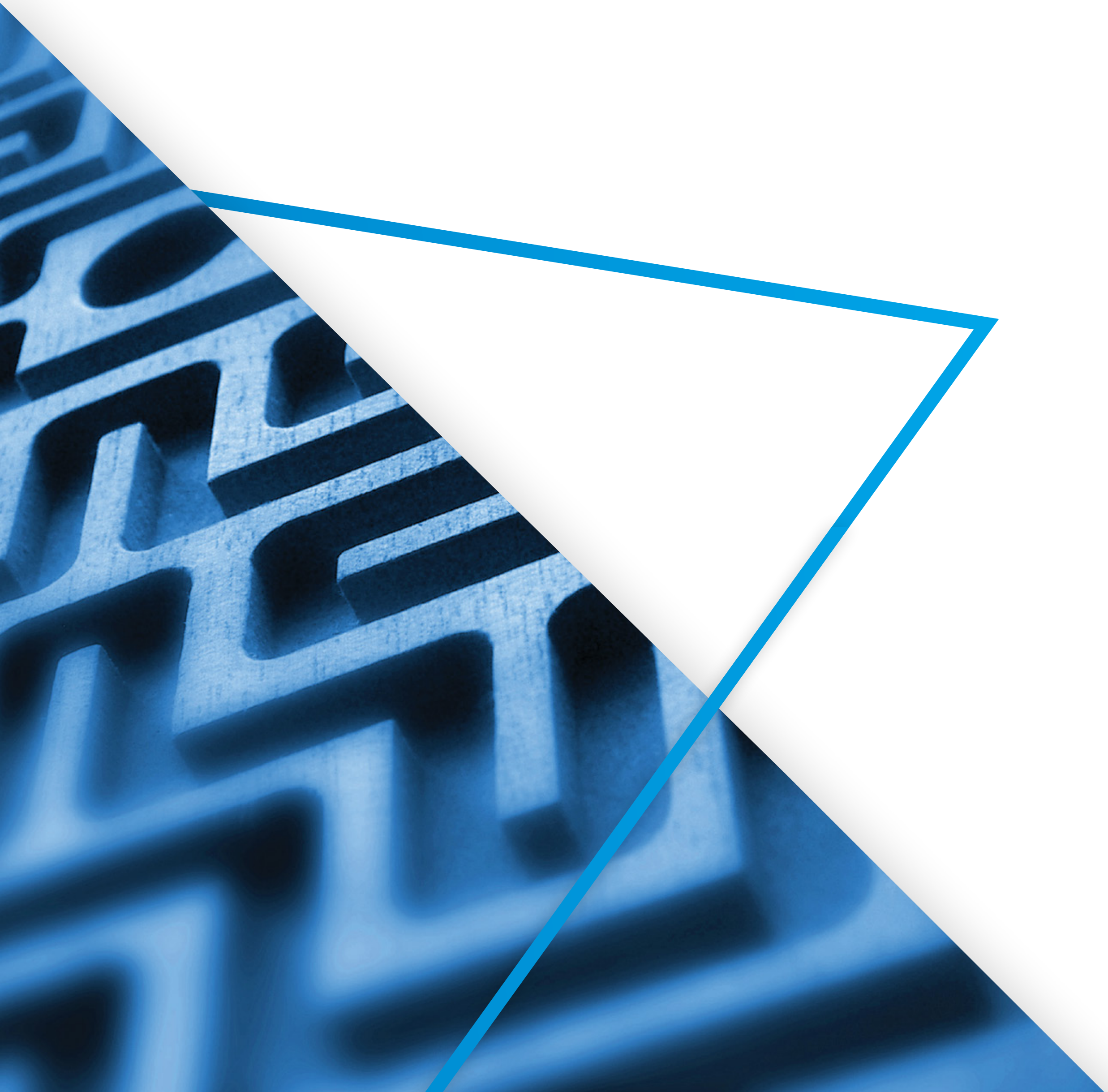

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SOUTH AFRICA

Now that the shock has settled, some thoughts on the 'rumoured' 2% VAT hike

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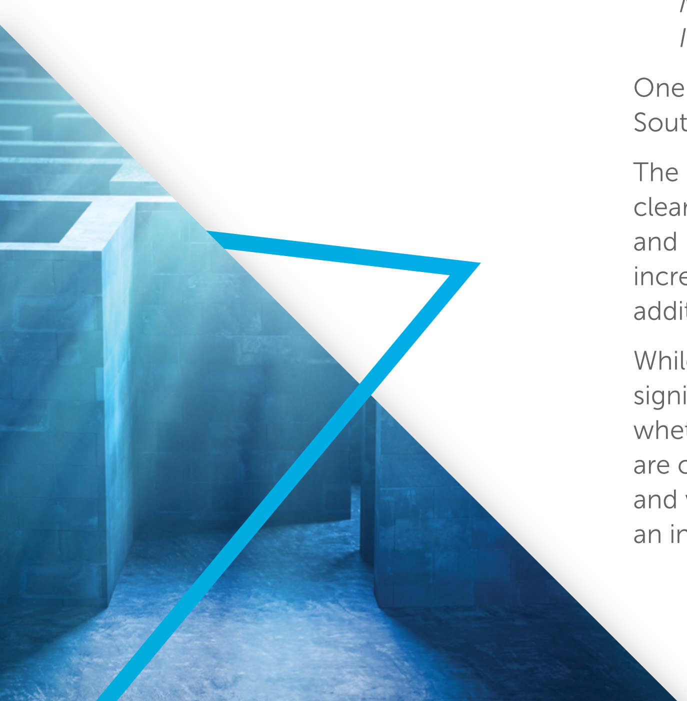

There has been a lot of commotion over the past week pursuant to the postponement of the Budget until 12 March 2025. The postponement will likely have significant legal and fiscal implications, some of which we may not yet fully appreciate, given the unprecedented nature of this event.

But commotions aside, what would an increase of value-added tax (VAT) from 15% to 17% mean for South Africa, its budget strategy and the ordinary person on the street?

We consider this question and also briefly consider whether there are any viable alternatives to raising the VAT rate.

The 'rumoured' vat increase and the need for money

> *"Money, money, money, must be funny*
> *In the rich man's world"* – ABBA

One thing that is clear from the rumoured VAT hike is that South Africa needs money, and it is not funny!

The driving force behind the proposed VAT increase is clearly the urgent need to increase government revenue and reduce the budget deficit. Through the proposed increase, it is said that the Government expects to raise an additional R60 billion in revenue.

While it has been no secret that the Government is facing significant fiscal pressures, many are concerned about whether a VAT increase is the best solution. These concerns are centred on who will be most affected by the increase and whether the current state of the economy can support an increase in VAT.

However, it is important to consider this question against the backdrop of the growing debt burden and the critical need to stimulate economic growth. South Africa **needs** money. It is no wonder that an increase in VAT is being considered to address some of the fiscal pressures. Where else could the money come from?

The nature of VAT

VAT is a consumption tax levied on the value added to goods and services at each stage of production and distribution. It's a broad-based tax that applies to most goods and services, making it a significant (and attractive) source of revenue for governments worldwide.

VAT is also considered a neutral tax as it doesn't distort the economy by favouring specific industries or sectors. This neutrality is said to encourage economic efficiency and growth. In addition, VAT is relatively easy to administer and also somewhat harder to evade than income taxes. As such, VAT tends to have a higher compliance rate. Most importantly, VAT can generate revenue quickly as it is collected on a continuous basis throughout the year.

Notwithstanding the apparent appeal of using VAT as a quick income-generating stream, the question as to whether it is the best solution in the circumstances remains.

Thinking about the ordinary person: Is this the best decision for all?

A VAT increase from 15% to 17% may seem like a small change, but it can have a significant impact on the daily lives of ordinary citizens. The effects will, no doubt, be felt across various aspects of life, from basic necessities to discretionary spending.

Now that the shock has settled, some thoughts on the ‘rumoured’ 2% VAT hike

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The most immediate (and obvious) effect of the VAT increase will be a rise in the cost of living.

As the cost of living increases, ordinary citizens will have less disposable income. If spending is not decreased, it can lead to decreased savings and, potentially, increased debt.

This can have a long-term impact. For example, people who are unable to save for retirement in their early years because of a reduction in disposable income could then become dependent on government subsidies and grants in their later years. This can place additional pressure on the Government in future.

As such, a VAT increase could not only disproportionately affect vulnerable populations for generations to come, but it can also be viewed as a temporary measure that does not address the underlying issue(s).

Specific groups that could be most affected include low-income households, pensioners and small businesses.

Relief measures to mitigate the effects

While there is a clear attractiveness in increasing VAT to generate more revenue, the socio-economic impact of this decision needs to be carefully weighed against the urgent need for money. It is unlikely that the Government is not aware of this. In this context, there are relief measures that are being proposed to accompany the VAT increase and mitigate the possible negative effects of a VAT increase.

The most obvious (and hotly debated) relief measure is the extension of the list of zero-rated goods, by, for example, including nappies and other basic food items, to help reduce the burden on low-income households.

However, the debate around this relief measure is, amongst others, that the benefits do not always trickle down to the people it is intended to benefit.

As such, it is debatable whether this relief measure (alone) will be sufficient to mitigate the negative effects of a proposed 2% increase.

Another relief measure that the Government can consider is providing targeted support. This can include increased social grants or subsidies for vulnerable populations to help mitigate the effects of the VAT increase. However, this particular relief measure may lead to a circular argument about where the money will come from to provide additional grants and subsidies on an already strained budget.

By considering a mix of the different types of relief measures, the Government can reduce the impact of the VAT increase on ordinary citizens and ensure that the burden is shared fairly – and perhaps even consider reducing the level of the increase from 2% to 1%. However, should increasing VAT even be an option?

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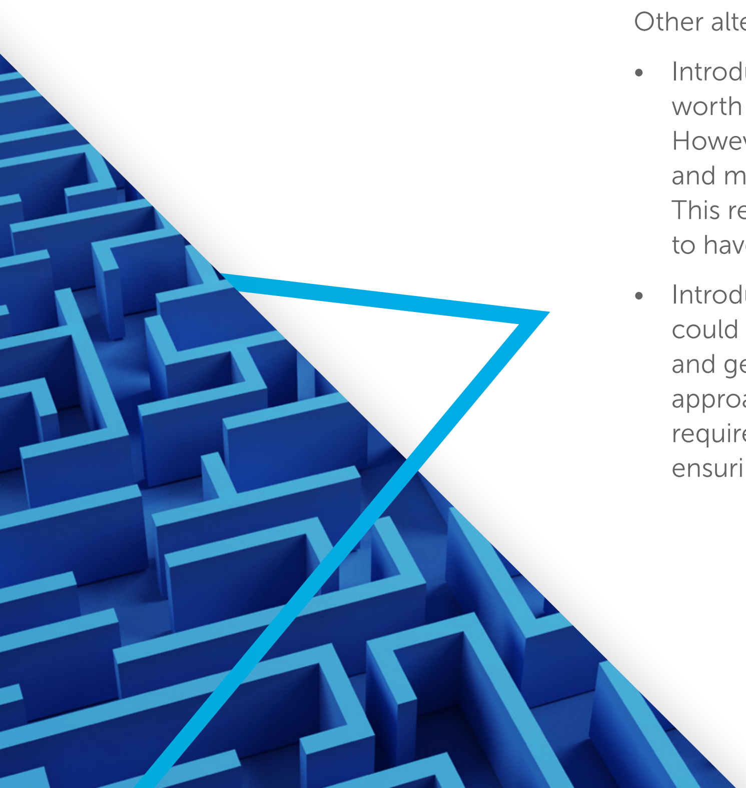

Other options

Instead of increasing the VAT rate, the Government is being urged to consider alternative measures to raise revenue.

The reduction of government spending by, *inter alia*, eliminating wasteful expenditure and cutting down on a bloated cabinet has been raised as the most obvious alternative.

Another approach that was suggested by the Commissioner of the South African Revenue Service (SARS) is to improve tax collection. The Commissioner advocates for investing in SARS to enhance its ability to recover uncollected revenue. According to SARS, there is about R200 to R450 billion in uncollected revenue which could be recovered through more effective tax enforcement.

Other alternatives include:

- Introducing a wealth tax, which could target high net worth individuals and help reduce income inequality. However, implementing a wealth tax can be complex and may require significant changes to existing tax laws. This requires time that the Government does not seem to have.
- Introducing a targeted VAT on luxury goods, which could help reduce consumption of non-essential items and generate additional revenue. Nevertheless, this approach may be challenging to implement, as it would require defining what constitutes a luxury good and ensuring that the tax is applied consistently.

When all is said and done

The proposed VAT increase is a complex issue that requires careful consideration of its potential impact on ordinary citizens, businesses and the economy. While the Government needs to raise revenue to address its fiscal challenges, it is essential that it is given the time and space to carefully explore the alternatives that are on the table to ensure that undue hardship is not placed on the most vulnerable.

Perhaps the solution is not a 'one size fits all' approach but rather introducing a combination of different measures i.e. reducing government spending, improving tax collection and introducing alternative tax measures. This may be a more effective and equitable approach, especially considering that the 2018 VAT increase did not sufficiently boost revenue as expected.

Ultimately, the Government must weigh the pros and cons of each option. However, it is hoped that the impact of any proposal on citizens, businesses and the economy of South Africa will be appropriately considered and addressed.

Puleng Mothabeng

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BBBEE STATUS: LEVEL ONE CONTRIBUTOR
Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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