The analysis of Value Added Tax, the effects of zero-rated VAT and exempt supplies and a look into who benefits more, the rich or the poor

by

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Dissertation
submitted in partial fulfilment of the requirements for the Degree of Master of Laws Taxation in the College of Law and Management Studies, School of Law, Howard College Campus, University of KwaZulu Natal

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February 2021

DECLARATION

I, WANDISA MJINDI declare that:

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DEDICATION

I would like to dedicate my thesis to my Son, Lulonke Mjindi to be an example to him that if you set your mind on something, you can do it no matter the limits and to always remember that everything happens in God’s time and not the time you’ve set for yourself or time that other individuals set for you.

ACKNOWLEDGEMENTS

The Bible verse in Jeremiah 29: 11 “For I know the plans I have for you declares the Lord, plans to prosper you and not to harm you, plans to give you Hope and a future” has given me strength throughout my Masters to complete my dissertation. I would like to thank the Lord almighty for giving me the determination and drive because I could never have done it alone.

I would also like to thank my parents for believing in me and each and every one who stood by me, was patient with me and lent an ear when I needed someone to discuss my dissertation with.

Finally, I am thankful to my supervisor, Mr Christopher Schembri who has provided support throughout my journey and availed himself time and again to ensure I complete this dissertation.

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CHAPTER 1:

Background of VAT

1.1 Introduction

With the introduction and implementation of Value Added Tax ("VAT") into the South African tax structure in the year 1991,[1] VAT currently is the second largest source of income for the South African fiscus after Personal Income Tax. [2] Although other taxes fare substantially well in respect of raising revenue,[3] VAT still produces one of the most substantial contributions towards the fiscus, even with the many challenges it faces.[4]

While the imposition of VAT is dealt with in terms of the Value Added Tax Act 89 of 1991 (VAT Act), VAT did not originate from the South African tax system[5] but from Germany and was later developed and modernised by France in 1954.[6] With Germany and France being the first countries to implement the initial version of VAT which was in the form of a general consumption tax, its modernisation meant that many countries now successfully use it to collect large amounts of tax revenue.[7] It is utilised in over 140 countries in the world and VAT rates vary depending on a country's specific tax structure.[8] Other countries still utilise the sales tax system, but it has been found that their sales tax system although not VAT, already functions like a VAT tax system, due to the VAT- like characteristics they possess. This is evident in the system applied in the United States of America.[9]

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[1] A Jansen, E Stoltz & D Yu '*Improving the targeting of zero-rated basic foodstuffs under value added tax (VAT) in South Africa – An exploratory analysis.*' (2012) 07/12, 3.

[2]Ibid.

[3] A joint publication between National Treasury and the South African Revenue Service '*2018 Tax Statistics, A joint publication between National Treasury and the South African Revenue Service*', December 2018 available at https://www.sars.gov.za/AllDocs/Documents/Tax%20Stats/Tax%20Stats%202018/Tax%20Statistics%202018.pdf accessed on 04 September 2019. The composition of the main sources of tax revenue is depicted as follows: in the fiscal year of 2013/14 Personal Income Tax ('PIT') was at 34.5 percent, Value Added Tax ('VAT') was at 26.4 percent, Other Taxes were at 19.2 percent and Corporate Income Tax ('CIT') was at 19.9 percent.
In the 2017/18 fiscal year, PIT was at a high of 38.1 percent, VAT decreased to 24.5 percent, Other Taxes slightly increased to 19.3 percent and CIT decreased by 1.8 percent and reached 18.1 percent.

[4] Ibid.

[5] A Charlet & and J Owens '*An International perspective on VAT* Tax's notes international (September 20, 2010), 943.

[6] '*Value Added Tax*' https://en.wikipedia.org/wiki/Value-added_tax#History accessed on 13 July 2019.

[7] Ibid.

[8] Ibid.

[9] Ibid.

South Africa made one of the most impactful tax progressions by introducing the VAT tax system.[10] Selecting a method of tax collection which is better suited to collect revenue was anticipated to assist in helping to decrease inequality and poverty faced in the country to some extent.[11] Not only was it important to consider the distributional effects VAT would have on income in the country, it was also imperative to ascertain whether it would be the desired tax system to adopt.[12] Its efficiency and practical administrative characteristics were of paramount significance.[13] Like many countries, the introduction of VAT was intended to yield greater revenue returns.

When South Africa migrated to the VAT method of collecting tax, it started to create legislation around how to regulate its collection by establishing a VAT committee, referred to as VATCOM to provide comments in respect of the draft VAT Bill at the time.[14] The Committee was also tasked to consider and produce a report making recommendations in respect of the introduction of VAT in South Africa.[15] Due to a lot of criticism and the reception, VAT was initially introduced at 10 percent rather than the 12 percent initially proposed.[16] It became apparent that an increase to the VAT rate would yield more revenue, the rate was thereafter increased to 14 percent in 1993.[17] The principal idea was that zero-rated and exempt items would be identified to counter the regressive effects of VAT[18] and such zero-rated and exempt items, if determined suitable, would be included to form part of the VAT structure and kept at a minimum.[19] The list of zero-rated and exempt foodstuffs were increased since the introduction of VAT and, contrary to a lot of debate on whether the zero-rated category of items should be increased, no further additions have been made since the increase in 1993.[20] However, in April 2019, more items were further zero-rated.

Another commission of inquiry, referred to as the Katz Commission, was later formed after the establishment of VATCOM to consider more characteristics in relation to the mechanisms of

[10] M Silver & C Beneke *Deloitte VAT Handbook*, LexisNexis February, 3.
[11] S Beer & M Kasper '*Who benefits from zero-ratings? A brief note on the South African VAT system*', 1.
[12] F Fourie & A Owen *'Value Added Tax and Regressivity in South Africa'* https://onlinelibrary.wiley.com/doi/pdf/10.1111/j.1813-6982.1993.tb01338.x accessed on 10 April 2018.
[13] Ibid.
[14] A De Koker '*Value added tax in South Africa – Commentary*' 2002.
[15] Ibid.
[16] M Silver & C Beneke (note 10 above), 5.
[17] Ibid, 6.
[18] D Go, M Kearney, S Robinson & K Thierfelder '*An Analysis of South Africa's Value Added Tax*' WPS3671, 2.
[19] A De Koker (note 14 above).
[20] M Silver & C Beneke (note 10 above), 6.

VAT after its introduction.[21] Named after the corporate lawyer, Michael Katz, this Commission sought to provide tax advice in respect of some aspects of the tax structure in the new government post-apartheid.[22] Further, ways to create an efficient tax administration system and also ways to minimise imbalances in the country were to be explored by the Commission.[23]

The Commission mainly had to consider the matter of the taxation of basic food items, whether it was possible to have differential rates applying at the same time, the imposition of a higher luxury VAT rate and the question of the taxation of financial services.[24] Other specific related aspects, which included *ad valorem* excise duties and the role of other governmental programmes aimed at enhancing poverty relief measures, were also dealt with by the Commission.[25] In respect of VAT and *ad valorem* excise duties, the Commission concluded, in an interim report, that more zero-ratings and exemptions should not be considered at that time as these measures provided a limited contribution to poverty alleviation.[26] Further, the Commission advised against the imposition of a higher luxury VAT rate or multiple rates of VAT applying as a measure to tackle the regressivity of VAT.[27] It was advised that the current *ad valorem* excise duties should remain unchanged, but it was possible that an *ad valorem* duty on luxury motor vehicles which is progressive could be introduced and needed to be investigated.[28] In respect of financial services, it was advised that the scope of the exemptions should be reduced.[29]

It is worth noting that since the tenure of the Katz Commission, the South African tax system has changed considerably and positively due to the recommendations made by the Commission in 1995.[30] One of the biggest changes which were effected was the formation of the South African Revenue Services ("SARS").[31] SARS was to act as an independent body with its own legislative regulation separately from the Government's operation and since then, there has been improvements in tax administration and tax collection in respect of all taxes collected in

[21] M Perrold, L Greyling & L Bonga – Bonga *'A CGE of a flat tax as a possibility for tax reform in South Africa'*, 10.
[22] Ibid. The Commission had to consider the taxation of basic foodstuffs, whether different tax rates could be applied, taxation of financial services, excise duties and measures to reduce poverty.
[23] Ibid.
[24] D Davis & I Woolard *'Final report on VAT for the minister of finance, The Davis Tax Committee'* March 2018, 13.
[25] Ibid.
[26] Ibid.
[27] Ibid.
[28] Ibid.
[29] Ibid.
[30] C De Wet '*Davis Tax Committee issues first interim report on VAT*' (2015), 1.
[31] D Davis & I Woolard (note 24 above).

the country which creates an effective system.[32] The Commission further also proposed the imposition of capital gains tax, tax on retirement funds and VAT on gambling and financial services.[33] The Katz Commission was thereafter followed by the Davis Tax Committee.

There have been many debates surrounding the topic of VAT and it has been argued that VAT has a regressive nature.[34] Zero-rated and exempt items were identified to alleviate pressure for many households suffering under the effects of VAT, with more focus being on lower income earning households.[35] Though it is not possible to completely and effectively target lower income earning households,[36] tax has to be distributed to all qualifying taxpayers in the country.

1.2 Statement of Purpose and Research Questions

The purpose of this dissertation is to examine the effects of VAT and whether zero-rated VAT and exempt supplies do indeed benefit lower income earners or whether the benefit largely accommodates high income earning households. The current zero-rated VAT items are considered as assisting in the redistributive consequences the effects VAT has on lower income earning households. However, it will be investigated whether these measures help to provide some ease towards the effects of VAT.

This dissertation will also make recommendations drawn from scholars and their academic arguments on the alternative sources which can be explored in countering the impact of VAT. It will be investigated whether any additions or adjustments can be targeted to assist with the impact of VAT on these low-income earning households, for example, the addition of more basic food items, or the increase of the VAT rate to compensate for the loss of revenue for the Government.

In addition, this dissertation will explore the viability of increasing other forms of tax and the possibility of an introduction of a higher luxury tax to assess whether that could compensate for lost revenue not obtained from VAT.

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[32] Ibid.
[33] Ibid.
[34] A Jansen, E Stoltz & D Yu (note 1 above), 4.
[35] M Kearney & J van Heerden '*Zero-rating food in South Africa: A computable general equilibrium analysis.*' (2004) No 3, 521.
[36] A Jansen, E Stoltz & D Yu (note 1 above).

1.3 Rationale for study

The researcher intends to argue that aside from the regressive nature of VAT, the current zero-rated items and exempt supplies are by far more beneficial for high income earners due to the items which fall into the zero-rated or exempt categories. While some may be practical for SARS and assist the taxpayer as well, most of the items listed are items a taxpayer from a high-income earning household largely benefits from because they also utilise such items and in turn end up having a VAT gain, whereas by contrast, a low-income earning household ends up not benefitting as highly and cannot counter the regressive effects of VAT effectively. A direct inspection of the 19 basic food items which fall into the zero-rated category rated will be conducted and the effects of its reach with regards to benefits when it comes to lower income earning households will be discussed.

1.4 Methodology

The study is a desktop research-based literature review. This study will rely on the confines of the Value Added Tax Act. Furthermore, regard will be had to related legislation, relevant case law, policy documents, commission reports, journal articles, books, dissertations and newspaper articles.

1.5 Literature Review

1.5.1 <u>Introduction:</u>

The advent of Value Added Tax (VAT) brought to South Africa a greater yield in respect of tax collection in that it has become a good and reliable source of revenue for the fiscus. VAT, however, has its disadvantages for low income earning groups due to its regressive impact.

This dissertation involves an analysis of the effects of VAT and whether zero-rated VAT and exemptions benefit lower income earners or in contrast, higher income earners. For the purposes of this analysis, focus will be on the items which are zero-rated and exemptions, and consideration will be given to whether such items sufficiently cater for lower income earners. A further analysis in respect of the 19 basic food items which are zero-rated will be made to ascertain whether such items accommodate lower income earning households, or whether alternative measures need to be considered in order to accommodate lower income earning households. This analysis will be achieved based on existing jurisprudence and academic opinion.

1.5.2 Overview of the legislative framework: Statutory requirements to pay taxes in South Africa

With South Africa being a constitutional State, the obligation to pay taxes is a constitutional one. Chapter 13 of the Constitution of the Republic of South Africa Act 108 of 1996 ("the Constitution") deals with Finance and establishes a National Revenue Fund (the "Fund") under section 213.[37]

The Fund is controlled by National Treasury in terms of the Public Finance Management Act No. 1 of 1999. Section 11 (1) reinforces National Treasury's mandate as prescribed by section 213 of the Constitution and section 11 (5) directs National Treasury to always ensure that there is adequate money in the Fund.

The South African Revenue Service ("SARS") is currently mandated under legislation to collect revenue through taxes, which revenue is then paid into the Fund.[38] Section 12 deals with the deposits and withdrawals which can be made by SARS from the Fund. This section states the following:

> *"(1) The South African Revenue Services must promptly deposit into a Revenue Fund all taxes, levies, duties, fees and other moneys collected by it for that Revenue Fund, in accordance with a framework determined by the National Treasury.*
>
> *(2) The South African Revenue Services may, despite section 15 (1), withdraw money from the National Revenue Fund—*
>
> *(a) to refund any tax, levy or duty credits or any other charges in connection with taxes, levies or duties;*
>
> *(b) to make other refunds approved by the National Treasury; or*
>
> *(c) to transfer to a member of the South African Customs Union any money collected on its behalf.*

[37] '*Summary of the Constitution of South Africa, no 108 of 1996*' https://ossafrica.com/esst/index.php?title=Summary_of_the_Constitution_of_South_Africa%2C_no._108_of_1996#Public_administration accessed on 07 September 2019. The section states that the Government must pay all monies raised from tax and other sources into the Fund.
[38] Ibid.

(3) The National Treasury must promptly transfer all taxes, levies, duties, fees and other moneys collected by the South African Revenue Services for a province and deposited into the National Revenue Fund, to that province's Provincial Revenue Fund."[39]

Section 7 of the Value Added Tax Act 89 of 1991 ("the Act") details the imposition of VAT and makes provision for persons to be obligated to pay VAT. The section states the following under subsection (1):

"Subject to the exemptions, exceptions, deductions and adjustments provided for in this Act, there shall be levied and paid for the benefit of the National Revenue Fund a tax, to be known as the value-added tax-

(a) on the supply by any vendor of goods or services supplied by him on or after the commencement date in the course or furtherance of any enterprise carried on by him;

(b) on the importation of any goods into the Republic by any person on or after the commencement date; and

(c) on the supply of any imported services by any person on or after the commencement date

calculated at the rate of 15 percent on the value of the supply concerned or the importation, as the case may be."[40]

Section 7 further regulates who is responsible for the payment of VAT and other VAT imposition consequences. Section 7 (2),[41] stipulates that:

"Except as otherwise provided in this Act, the tax payable in terms of paragraph (a) of subsection (1) shall be paid by the vendor referred to in that paragraph, the tax payable in terms of paragraph (b) of that subsection shall be paid by the person referred to in that paragraph and the tax payable in terms of paragraph (c) of that subsection shall be paid by the recipient of the imported services."[42]

Section 7 (3) stipulates that:

[39] Ibid.
[40] South African Revenue Services *'Primary Legislation'* http://sars.mylexisnexis.co.za/# accessed on 14 July 2019.
[41] Ibid.
[42] Ibid.

"(a) Where any goods manufactured in the Republic, being of a class or kind subject to excise duty or environmental levy under Part 2 or 3 of Schedule 1 to the Customs and Excise Act, have been supplied at a price which does not include such excise duty or environmental levy and tax has become payable in respect of the supply in terms of subsection (1) (a), value-added tax shall be levied and paid at the rate specified in section 7 (1) for the benefit of the National Revenue Fund on an amount equal to the amount of such excise duty or environmental levy which, subject to any rebate of such excise duty or environmental levy under the said Act, is paid."[43]

The VAT rate as stated above, has stood at 14 percent since 1993 until the 31st March 2018.[44] VAT has since seen a rise of a percentage point. It is now levied at the rate of 15 percent.[45]

1.5.3 Zero-rated VAT and exemptions:

The levying of VAT at the rate of 15 percent is referred to as the standard rated supply where there are zero-rated items and exemptions catered for by the Act.[46] Zero-rated VAT is charged at 0 percent.[47] This means that, VAT is levied at 0 percent on specific goods or supplies which qualify to be zero-rated although taxes on sales are credited on inputs.[48] For exemptions, VAT is not applicable[49] and thus no crediting is applied on inputs in this instance.

It becomes important to know which supplies fall under each category in order to know the relevant VAT treatment of each item.

Zero-rated VAT, although charged at 0 percent, enables the VAT vendor to claim back VAT charged in respect of such supplies.[50] Whereas in respect of exempt supplies, the VAT vendor is unable to claim back from SARS, VAT in connection with the supply.[51]

At the outset, Jansen, Stoltz and Yu opine that the application of VAT, without any exemptions or zero-rating, is regressive and its impact on low income earning households must be borne in mind.[52] Go, Kearney, Robinson and Thierfelder note that, based on a study, VAT in South

[43] Ibid.
[44] 'VAT' available at https://www.sars.gov.za/TaxTypes/VAT/Pages/default.aspx accessed on 29 April 2019.
[45] Ibid.
[46] Note 40 above.
[47] A De Koker (note 14 above).
[48] M Kearney & J van Heerden (note 35 above), 523.
[49] Ibid.
[50] M Stighling et al *'Silke: South African Income Tax'* 2015, 1049.
[51] Ibid*,* 1050.
[52] A Jansen, E Stoltz & D Y (note 1 above).

Africa is mildly regressive.[53] The starting point in fact is that most of the authors note the regressiveness which is as a result of paying VAT and further, they also note that poor households are severely affected. Kearney and van Heerden draw attention to a report published in 2000 by Statistics South Africa, which highlights that lower income earning households use up a greater portion of their income on the purchase of food in contrast with high income earning households.[54] The study compiled by Go, Kearney, Robinson and Thierfelder also shares the same view that low income earning households use up most of their income towards the payment of VAT.[55] Many other scholars express the view that the progressiveness of the entire tax mechanism should be taken into consideration and not just the aspect of the regressiveness of VAT. The progressiveness of the taxes considers the direct taxes each household pays as well as VAT.[56] It will be of significance to examine the items which are zero-rated in order to determine the beneficial position on low income earning households in comparison to high income earning households.

Classification of zero-rated and exempt supplies[57]:

These goods and services are zero-rated:

- *"Exports;*
- *19 basic food items;*[58]
- *Illuminating paraffin;*
- *International transport and insurance services*
- *Goods which are subject to the fuel levy (petrol and diesel);*
- *International transport services;*
- *Farming inputs;*
- *Sales of going concerns, and*
- *Certain grants by Government."*[59]

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[53] D Go, M Kearney, S Robinson & K Thierfelder (note 18 above), 5.
[54] M Kearney & J van Heerden (note 35 above).
[55] D Go, M Kearney, S Robinson & K Thierfelder (note 18 above).
[56] Ibid.
[57] The further zero-rated items as of April 2019 will be listed and discussed in chapter 4 of this dissertation.
[58] The 19 basic foodstuffs which are zero-rated are as follows: *"brown bread, maize meal, samp, mealie rice, dried mealies, dried beans, lentils, pilchards or sardinella in tins or cans, milk powder, dairy powder blend, rice, fresh fruit and vegetables, vegetable oil, milk, cultured milk, brown wheaten meal, eggs and edible legumes."*
[59] 'National Treasury' https://view.officeapps.live.com/op/view.aspx?src=http%3A%2F%2Fwww.treasury.gov.za%2Fcomm_media%2Fpresentations%2FZero-rated%2520and%2520exempt%2520supplies.pps accessed on 07 July 2019.

These goods and services mentioned below are exempted from VAT:

- *"Non-fee related financial services;*
- *Educational services provided by an approved educational institution;*
- *Residential rental accommodation, and*
- *Public road and rail transport."* [60]

An observation worth noting is that, from the outset, the items which are zero-rated and exempt are more beneficial for a higher income earning household, as compared to a lower income earning household. This is due to the fact that most of the items listed as zero rated are largely also utilised by a taxpayer from a higher income earning household. Although zero-rating for SARS may be in place to combat a tax levying burden on the tax structure and to reduce the impact of VAT, lower income earning households are more accommodated in respect of the 19 basic foodstuffs which are zero-rated. What is unfortunate is that, even with being accommodated to benefit from VAT through the 19 basic foodstuffs, some items on the list largely benefit high income earning households as they are also staples in those households.

Turning to an analysis of the 19 basic food items which are zero-rated, Kearney and van Heerden comment that there could be a reduction in poverty and inequality by reducing the impact of VAT through applying zero-rated VAT on food.[61] This is due to the fact that low income earning households spend huge amounts of their income on VAT. Looking at the 19 basic foodstuffs which are zero-rated, some argue that a number of them are favourable to low income earning households as their burden towards paying VAT gets reduced.

A number of authors acknowledge the reasoning behind zero-rating basic foodstuffs as benefiting low income earning households. However, much debate surrounds the items which are not zero-rated.[62]

The Davis Tax Committee was tasked by the Minister of Finance to review the tax structure of South Africa[63] and consider methods which would be valuable in order to obtain fiscal growth.[64] The Committee argued that the focus must be more on redistributing excess income

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[60] Ibid.
[61] M Kearney and J van Heerden (note 35 above).
[62] Ibid.
[63] D Davis and I Woolard 'The *Davis Tax Committee First Interim Report on VAT to the Minister of Finance'* December 2014, 7.
[64] The Davis Tax Committee was announced by the then Minister of Finance, Pravin Gordhan in the year 2013 chaired by Judge Dennis Davis.

by targeting its allocation to low income earning households.[65] It makes the further argument that low income earning households must be targeted by the retention of items which are utilised by them, and there must be a dismissal of items which are beneficial for high income earning households.[66]

While many authors are of the view that more food items should be zero-rated, a look into zero-rating more vegetables is suggested by Jansen, Stoltz and Yu.[67] The Davis Tax Committee strongly recommends in its report that no further addition of zero-rated food items should be considered.[68] It is noted that zero-rating of foodstuffs addresses the impact of VAT on low income earning households.[69] While the impact of VAT may be addressed with zero-rating food items, it is however, evident that affluent households receive more of the benefit.[70] With the many different views made, in exploring alternatives with an effort to reduce the effects of VAT, the impact and strain on government expenditure will need to be explored and further, other alternatives which have a more beneficial impact for low income earning households compared to high income earning households must be considered.

A further examination of the zero-rated and exempt items will be carried out in the chapters to come to assess the actual extent and impact that is felt by low income earning households versus high income earning households.

1.6 Conclusion:

Despite the many views of how to address the impact of VAT, the VAT system is now rooted as a tax collecting method in South Africa and ways to improve its application practically to reduce its effects on low income earning households and the potential benefits it could have if other measures are introduced is an important aspect which will be discussed in this dissertation.

Whilst there isn't much material on GST, in the next chapter, the role of GST will be discussed. Its achievements and effects on the economy, the inadequacies of GST and what led to the VAT being preferred will be considered. Underlying factors such as unemployment, poverty

[65] D Davis and I Woolard (note 24 above), 8.
[66] Ibid.
[67] A Jansen, E Stoltz & D Yu (note 1 above).
[68] D Davis and I Woolard (note 24 above), 8.
[69] Ibid.
[70] M Kearney and J van Heerden (note 35 above).

and inequality which are directly impacted by the VAT system will also be considered in the discussion.

CHAPTER 2:

Tax collection and its effects, the impact of the GST, food insecurity and how these factors affect the introduction of Value Added Tax

2.1 Introduction

South Africa leaned towards reliance on indirect taxation due to many unfavourable attributes observed in the country's previous tax collecting method.[71] This was as a result of the shortcomings observed in the General Sales Tax ('GST') which was utilised previously in the country.[72] The reasons noted for the change to a consumption tax system was that the GST system permitted only a narrow range of goods and services to be taxed whereas the VAT system, later introduced incorporated a broader offering.[73] GST was introduced and implemented from the 3rd July 1978, at the rate of 4 percent.[74] GST progressed and was increased to 12 percent, which was the final rate prior to the VAT system being implemented in 1991.[75]

The GST method of tax collection levied tax at the final point of sale to a consumer disposing of those goods or taxable services.[76] This was in respect of a limited number of services on capital and transitional goods acquired by businesses.[77] The GST created a 'tax on tax' situation in that the tax which was due to be paid, was costed and charged to the final consumer.[78] This then led to an increase in business costs.[79] Revenue collection was at risk because if one tax collector failed or collected little to no tax at all, the Government stood to

[71] S Beer & M Kasper (note 11 above).
[72] M Silver & C Beneke (note 10 above), 4.
[73] Ibid.
[74] M Silver & C Beneke (note 10 above). In 1984, the first basic foodstuffs were zero-rated under General Sales Tax in order to ease pressure on poorer households.
[75] Ibid.
[76] A De Koker (note 14 above), 2.1.
[77] Ibid.
[78] M Silver & C Beneke (note 10 above), 4.
[79] Ibid.

suffer a loss.[80] Another risk was that of revenue being lost in instances where some taxpayers evaded paying tax.[81]

Discontinuing the GST method of tax collection was perceived to lead to improved and better audit trails to track tax payments made by consumers and to see if all the tax due was being received by the government.[82]

In looking at the GST tax structure previously utilised, attention must be directed to the contributing factors which determine the success or severity of any tax structure. Both GST and VAT cannot be considered in isolation without bearing in mind the state of poverty and inequality in the country at the time when GST was in effect and the impact VAT would have, in providing possible relief and driving some change. In this chapter, I will evaluate South Africa's current status to determine whether the effects of poverty and inequality are still a burden and whether any measures have been taken to control such effects.

I will go into further detail and look into the growing levels of unemployment which also directly correlates to the rise in poverty and an unequal state and determine whether any actions have been planned to reduce such levels. I will then consider the impact of GST against this background.

2.2 Food security and poverty in South Africa

Food security in South Africa is always an alarming aspect especially when raised in the context of the working-class South African citizen. The economy constantly faces challenges with rising food prices, causing a concern for affordability and availability of food.[83] Rising inflation costs influence the overall standard of living for the poor in the economy[84] and while it can be said that food prices have increased on a large scale, further increases can be expected with the many factors at play.[85] Amongst these many factors, affecting the economy, the slow growth rate of the economy stands out as causing the most pressure.[86] Unemployment levels are reaching higher levels with no solutions being provided.[87] Policy uncertainty coupled with

[80] Ibid.
[81] Ibid.
[82] Ibid.
[83] E Watkinson & N Makgetla *'South Africa's food security crisis'* July 2002, 1.
[84] Ibid.
[85] E Watkinson & N Makgetla (note 83 above).
[86] *'Poverty on the rise in South Africa, Statistics South Africa'* http://www.statssa.gov.za/?p=10334 accessed on 12 April 2018.
[87] Ibid.

the public sector is unable to provide more jobs and the private sector is not playing its role sufficiently and low commodity prices versus higher purchasing prices, are also issues to note.[88] The continuous rise in the unemployment rate in South Africa cannot be disregarded.[89] Statistics South Africa put this rate in 2019 at 27.6 percent in the first quarter of the year.[90] In the second quarter of 2019, it increased to 29 percent.[91] In the past year alone, it was measured at 27.2 percent.[92] From an overall average range of unemployment of 25.71 percent from 2000 to 2019, unemployment has seen its highest measurement since the year 2003 which sits at 31.20 percent.[93] Even though South Africa is riddled with constant impending internal investment downgrade ratings,[94] talks of near recessions and rising oil prices,[95] some people in the country are able to endure some changes in the economy due to their sources of income or other means.

An average South African may utilise 33 percent of their salary on the cost of food alone while the remaining portion goes to other living expenses.[96] An even poorer household parts with about 50 percent of its income just to be able to provide and put food on the table.[97] Many of these very poor households are situated in rural areas supporting elderly individuals who earn their pension and grant money and some are being supported mainly by women.[98] A rise in food prices produces an overwhelming consequence for poor households because, food is a very big and important commodity which no one can live without and it takes up the biggest

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[88] Ibid.

[89] *'South Africa unemployment rate'* https://tradingeconomics.com/south-africa/unemployment-rate accessed on 10 July 2019.

[90] Ibid.

[91] Ibid.

[92] Ibid.

[93] Ibid.

[94] L Donnelly *'Global credit ratings agency has downgraded South Africa to junk status'* 25 November 2017 https://mg.co.za/article/2017-11-25-global-credit-ratings-agency-has-downgraded-south-africa-to-junk-status/ accessed on 10 July 2019. In recent years and fairly recently in 2017, a global credit rating agency, Standard & Poor's (S&P) downgraded South Africa's credit rating to full junk status while Moody's at the time held South Africa a level above junk status by holding the downgrade for review. South Africa is still not stable as an economy in 2019 with the same factors causing instability in the country's credit rating results. *'Standard and Poor's maintains South Africa's credit ratings at junk status'* https://www.newsday.co.zw/2019/05/standard-and-poors-maintains-south-africas-credit-ratings-at-junk-status/ accessed on 10 July 2019.

[95] The oil price is constantly fluctuating in the economy because of the influence of demand and market sense.

[96] E Watkinson & N Makgetla (note 83 above).

[97] Ibid.

[98] Ibid.

share of a poor household's spending income.[99] This not only affects their overall standard of living, it also affects the effective operation of the economy as well.[100]

Poverty continues to affect poor households and those individuals who are barely able to make a living for themselves.[101] Its extent is a social and political challenge facing all and, it not only affects South Africa, but the world is also impacted by poverty and to differing degrees, inequality.[102]

The World Bank imagines a world that will no longer be disadvantaged, underprivileged and poor[103] and targets the year 2030 to achieve the decrease for it to be said that such a change has taken place.[104] Its objectives are that:

> *"we must promote growth that is sustained and inclusive; to create more and better jobs; to invest in people's health, education, nutrition, and sanitation; and to develop effective safety net programs to ensure that the most vulnerable can persevere in the face of shocks. While economic growth is vital, the quality of that growth also matters.*
>
> *With more than 60 percent of the world's extreme poor living in middle-income countries, we cannot focus solely on low-income countries if we want to end extreme poverty by 2030. We need to focus on the poorest people, regardless of where they live, and work with countries at all income levels to invest in their well-being and their future."*[105]

It believes that its objectives can be achieved through various funded projects for example in agriculture and education.[106]

In South Africa, the eradication of poverty has always been the aim of the new Government post-apartheid and this was captured in the Reconstruction and Development Programme (the "RDP") adopted by the Government.[107] Later on, the National Development Plan (the

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[99] Ibid.
[100] Ibid.
[101] *'Statistics South Africa'* http://www.statssa.gov.za/?page_id=739&id=1 accessed on 16 July 2019.
[102] Ibid.
[103] 'Poverty' The World Bank https://www.worldbank.org/en/topic/poverty/overview accessed on 17 July 2019.
[104] Ibid.
[105] Ibid.
[106] Ibid.
[107] Note 86 above.

"NDP") was adopted.[108] The RDP was not only conceptualised to reduce political inequality but to also reduce the severity of income inequality between the rich and the poor.[109] Despite these plans, over two and a half decades later after attaining constitutional democracy, South Africa still hasn't shown tangible improvement in eradicating poverty, let alone to successfully reduce it.[110] The RDP is *"an integrated, coherent socio-economic policy framework"*[111] which was conceived in the early 90's in order to eliminate poverty.[112]

It was created under the belief that no democratic society would be successful if the majority of the people in the country were impoverished and had no tangible property to sustain them.[113] Implemented as a governmental programme,[114] its intentions were to address wide civil society concerns through sustainable development and growth of the economy through redistribution.[115] It focused on programmes to develop basic needs to be met, for example,

> "*Land reform, housing and services, water and sanitation, energy and electrification, telecommunications, transport, environment, nutrition, health and social security and social welfare.*"[116]

It also focused on, the development of individuals through:

> *"Education and training, arts and culture, sports and recreation and youth development"* [117]

Raising the economy by focusing on:

> *"Rural and urban development, industry, trade and commerce."*[118]

Concentrating on industries, for example:

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[108] Ibid.
[109] H Bhorat & S Ravi Kanbur *'Poverty and Policy in post – apartheid South Africa'* (2006).
[110] Ibid.
[111] *'Reconstruction and Development Programme (RDP)'* https://omalley.nelsonmandela.org/omalley/index.php/site/q/03lv02039/04lv02103/05lv02120/06lv02126.htm accessed on 18 July 2019.
[112] Ibid. The Reconstruction and Development Programme framework was drafted in 1994 by means of consultations between various stakeholders i.e. ANC, its alliance partners, NGO's and other organisations.
[113] *'Our future make it work - National Development Plan 2013 Executive Summary'* https://www.gov.za/sites/default/files/Executive%20Summary-NDP%202030%20-%20Our%20future%20-%20make%20it%20work.pdf accessed on 24 July 2019.
[114] Ibid.
[115] Ibid.
[116] Ibid.
[117] Ibid.
[118] Ibid.

"Mining and minerals," labour rights including living wages, affirmative action and many other programmes.[119]

One of its proposed solutions was the institution of a National Nutrition Surveillance which would ensure that children below the age of five years, from all areas would have their weight checked each month and data would be collected in order ensure the growth and the welfare of those children.[120] It further conceived that obtaining and monitoring such data would assist with targeting relief efforts and health planning.[121] After the RDP, the NDP[122] was created with the aim of continuing with the objectives of the RDP,[123] but eliminating some shortcomings which had been noted with the RDP. Some of those shortcomings were a failure to implement economic progression in the development and execution of the RDP objectives.[124] The NDP was seen as a policy which could correct these shortcomings.[125] The view was that the NDP presented a long term perception of eradicating poverty and decreasing inequality in the country.[126]

A Diagnostic Report issued by the National Planning Committee[127] in 2011 depicts the accomplishments and inadequacies since 1994,[128] which was when the RDP was in place. While it can be said that some progress has been observed well into South Africans democracy, many poor South African's can still attest to not having witnessed much changing for them.[129] The biggest difference between the RDP and the NDP is that the RDP focused more on implementation and less on express objectives. However, the NDP clearly specifies what objectives need to be followed, but its flaw is that it lacks direction on how

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[119] Ibid.
[120] E Watkinson & N Makgetla (note 83 above), 3.
[121] Ibid.
[122] *'National Development Plan 2030'* https://www.gov.za/issues/national-development-plan-2030 accessed on 24 July 2019. The National Development Plan was announced at a media briefing and how the plan would be carried out, by the then Minister in The Presidency, Trevor Manuel on the 19th February 2013.
[123] R Tryphosa *'Time for SA to use lessons learnt from RDP to make NDP a success'* https://www.iol.co.za/business-report/opinion/time-for-sa-to-use-lessons-learnt-from-rdp-to-make-ndp-a-success-1755578 accessed on 14 July 2020.
[124] Ibid.
[125] *'National Development Plan Vision 2030'* file:///C:/Users/wmjindi/Desktop/Research/2020%20research/National%20Development%20Plan%202030.pdf accessed on 14 July 2020.
[126] *'National Development Plan 2030'* (note 122 above).
[127] The National Planning Committee was formed by a group of 26 individual South Africans which was Chaired by Trevor A. Manuel who was an MP at the time and our now Honourable President Cyril Ramaphosa who acted in his capacity as Deputy Chairperson at the time. The Committee is responsible for the birth of the NDP.
[128] *'National Development Plan Vision 2030'* (note 125 above).
[129] Ibid.

these objectives can be implemented.[130] For South Africa to reach its objectives of eliminating poverty and reducing inequality, the levels of unemployment, most importantly amongst the youth, must be addressed.[131] This is one of the objectives of the NDP. Not only was it made to create an inclusive rather than passive stance of people waiting to receive assistance from the Government, the NDP promotes the approach of an active society which works with the Government to achieve the envisaged development required.[132]

The projected timeline to fulfill the NDP's plan is the year 2030.[133] The plan dictates that,

> *"South Africa can realise these goals by drawing on the energies of its people, growing an inclusive economy, building capabilities, enhancing the capacity of the state, and promoting leadership and partnerships throughout society."*[134]

The NDP has similar plans to the World Bank with regards to eradicating poverty and inequality by the year 2030.

Very few objectives of the RDP as well as the NDP can be said to have been met in that, even though it can be shown that a lot more people now have access to water, sanitation, education, housing, electricity etc, many more people still live below the poverty line with very few employed to make a difference.[135] The gap in education is still vast with black learners receiving education of low quality and school infrastructure being dismal.[136] Lack of land reform, spatial segregation and racial divides continue to be the reality for most people in the country.[137]

Statistics South Africa published a Living Conditions of Households in South Africa ('LCS') survey[138] as recently as 2017, and the survey, together with the Income and Expenditure Survey ("IES"), provided sampled household expenditure patterns in order to be able to measure the levels of poverty and inequality.[139] The release provided a comprehensive description of household consumption expenditure between twelve expenditure areas which

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[130] Ibid.
[131] Ibid.
[132] Ibid.
[133] *'National Development Plan Vision 2030'* (note 125 above).
[134] Note 113 above.
[135] Ibid.
[136] Ibid.
[137] Ibid.
[138] Stats SA *'Living Conditions of Households in South Africa: An analysis of household expenditure and income data using the LCS 2014/2015'* http://www.statssa.gov.za/publications/P0310/P03102014.pdf embargoed until 27 January 2017, accessed on 16 July 2019.
[139] Ibid.

information was further separated by geography looking into the province, the type of settlement and the demographics of the household head measured by the sex and which population group they belong to.[140]

These two surveys remain important for South Africa to monitor the extent of poverty and inequality.[141] They are vital for informing our Consumer Price Index in order for the country to remain present with the changing spending and consumption patterns.[142]

The country has already introduced some food security interventions and a vast number of such interventions have been implemented in the form of food programmes, grants and many other forms of social assistance.[143] VAT zero rating and exemptions, tariffs and policies on trade, government grants supporting the production of food for personal or commercial use, government pension grants from the Department of Social Security Services and nutrition programmes are but a few of the positive actions implemented by our Government to fight poverty.[144] Non-governmental organisations and non-profit organisations assist a great deal in providing food security in that they do not depend on the government but raise their own funds in order to assist the impoverished.[145] For the extremely poor, feeding scheme initiatives are still carried out in schools so that no child is absent from school as a result of poverty.[146]

The following important points in respect of these initiatives are noted by Watkinson:

> *"a) VAT zero rating affords some benefit to low income households, but these benefits have been eroded by a lack of compliance by business and shifts in consumption expenditure (i.e. the VAT zero-rated basket has stayed the same since 1994, while consumption patterns have shifted significantly).*
>
> *b) Trade and tariff policy have an important impact on domestic food prices by delivering real increases in protection to producers at the same time as encouraging a large-scale shift to food exports. Trade and tariff policy institutions should reconsider the dispensation for basic foods.*

[140] Ibid.
[141] Note 123 above.
[142] Ibid.
[143] E Watkinson *'Overview of the current food security crisis in South Africa – National Labour and Economic Development Institute (NALEDI)'*, 8.
[144] Ibid.
[145] Ibid.
[146] Ibid.

c) Although support for sustainable production by resource poor farmers has increased, overall government support for food production continues to be heavily biased in favour of large-scale commercial farming. A private sector driven approach to land and agricultural development will further entrench this pattern.

d) Deregulation has led to a decrease in the state's capacity to control food quality and ensure that food standards are met by the private sector.

e) The impasse on food fortification is creating scope for problematic nutritional claims and pricing by different food companies.

f) The School Food Programme is suffering from an inadequate budget and a lack of coherence when it comes to procurement policy.

g) State pensions and grants are not keeping pace with food price inflation. While the proposals for expanding and re-orienting the current social security system are valid, additional state intervention is required to prevent consumer subsidies from being eroded by increased food prices."[147]

It is undeniable that more government intervention is needed to prevent the further erosion of the social assistance programmes to assist the poor.[148] The impact of GST will now be examined against this background.

2.3 Conclusion

Transitioning from the GST method of tax collection into the VAT system has had some impact but very few positive effects in South Africa. The country has witnessed some growth towards revenue collection, with tax administration structures like SARS put in place for efficient tax collection. While the VAT system was met with excitement at its introduction, there was a lot of fear as to how it would impact South Africans in the greater scheme of things.

Being a consumption tax, VAT affects all consumers in the country right down to the extremely poor. This chapter has highlighted the impact of VAT in the levels of inequality plaguing the country. It is evident that not as much as was initially planned, has progressed since the time when the GST system was introduced during the apartheid era versus our

[147] Ibid.
[148] Ibid.

current system right now.[149] A number of people remain displaced with many households living close to the poverty line.[150]

The government has tried to implement social actions to curb the high levels of poverty and inequality as evidenced by Watkinson.[151] However, when sitting and calculating how much income has gone towards the fiscus from a high-income earning household as compared to a low-income earning household, it becomes clear which way the odds are tipped and are more in favour of high-income earning households as those individuals already spend smaller amounts of their income consuming. Strain is placed on low income earning households on the income they use to support their households. This creates a burden on the poor when the opposite can be said for the salaries supporting high income earning households.

Even with the worldwide aim of the World Bank and further our domestic intervention actions as evidenced by the RDP and the NDP to reduce poverty by 2030, the country needs to continue working hard to strengthen the economy following the plans put in place and efficiently collect revenue in order to fund other interventions and programmes which can be implemented to protect the poor from the effects of VAT. For VAT to succeed and reduce its regressive impact on individuals in the country, combating the effects VAT brings about the need to ensure that the underlying factors mentioned in the chapter are at an adequate level or at least reduced to a controllable point.

Chapter 3:

VAT imposition and collection in South Africa

3.1 Introduction

After having discussed the backdrop and confines against which both VAT and GST operate in the previous chapter, this chapter looks into the imposition and collection of VAT in South Africa and how the need to follow the VAT tax structure was influenced. The chapter deals with an overview of the VAT structure. For VAT liability to reduce, particularly on poorer taxpayers, allowances in respect of exemptions, exceptions, deductions and adjustments have

[149] I Woolard, R Metz, G Inchauste, N Lustig, M Maboshe, C Purfield *'How much is inequality reduced by progressive taxation and government spending?'* October 2015, 1.
[150] Note 122 above.
[151] E Watkinson (note 143 above).

to be made.[152] In addition, with the increase in the VAT rate in 2018 to 15%, a comparison is made of the different VAT rates applicable in other countries versus South Africa's VAT rate, to establish whether our VAT rate is in line with international norms. The tax burden is examined and a look into who is affected by the imposition of VAT between the consumer and supplier is discussed. The role of the VAT gap in South Africa is also detailed in the chapter. Measures taken by the biggest contributing factor causing the deficit, the Government, to reduce the VAT gap burden are explored. Zero-rated and exempt supplies are further examined, and this chapter explores the legislative treatment of certain goods and supplies and the progress which has been made since the introduction of zero-rating and exemptions being introduced and their impact on VAT.

3.2 Overview of VAT

One of the biggest controversies which surrounded the introduction of VAT was its impact on retail prices.[153] Where there is a VAT increase, prices usually also increase.[154] The level of increase to prices depends on suppliers ability to shift the burden of tax to the consumer, which is also then dependent upon supply and demand elasticities.[155] The VAT system used in South Africa is a transaction-based system of collecting tax[156] This system can also be referred to as "an indirect tax levied on the value added in production during the separate stages undergone."[157] This means that, "each time a taxable supply of goods and services occurs, VAT is imposed on the net value add of each person in the production, manufacturing and distribution chain."[158] With the exception of exempt and zero-rated items, VAT is applicable to a variety of goods and services namely, from business related services, personal related necessities i.e. food consumed, clothes, sale of any item, movable or immovable property, any goods and services an individual wants to utilise and a lot more other transactions which can be imagined, hence it is referred to as a transaction-based system. This therefore means that each person involved in the distribution or production of goods or services is required to account for VAT at each of the stages and in the case of businesses

[152] M Kearney '*Restructuring Value Added Tax in South Africa: A computable general equilibrium analysis'* (unpublished LLM Thesis, University of Pretoria, 2003).
[153] D Go, M Kearney, S Robinson & K Thierfelder (note 18 above), 5.
[154] Ibid.
[155] Ibid.
[156] A De Koker (note 14 above), 2.1.
[157] M Kearney (note 152 above).
[158] A De Koker (note 14 above), 2.1.

which are VAT vendors, VAT can be claimed back as input tax and only in instances where the goods or service was not obtained for private use.[159]

Section 1 of the VAT Act defines input tax as, a tax which is charged and due for payment by a supplier for goods or services that they have made and sold to a vendor for importing goods by a vendor.[160]

Output tax is defined in the Act as:

"a tax which is levied when a vendor supplies goods or services in the course of conducting any enterprise, an enterprise basically being an on-going business activity."[161]

Only imported goods and services warrant the payment of VAT.[162] Exported goods and services on the other hand are zero-rated and do not attract any VAT.[163]

It is an inevitable fact that in a day a VAT transaction will be undertaken by a person in some form of consumption and this will be the usual order as time goes. The collection of VAT requires businesses (referred to as VAT vendors) acting as agents of the South African Revenue Service (SARS) to collect VAT on its behalf, because VAT is not paid directly to SARS.[164] These VAT Vendors must register, charge and collect VAT on the supply of goods and services and pay same over to SARS.[165] A business can voluntarily register itself as a VAT vendor when its taxable supplies exceed R50 000 but are less than R1 Million in a 12 months period.[166] When a business's turnover exceeds R1 Million in a 12 month period, it is mandatory for such business to automatically register as a VAT vendor and collect VAT on behalf of SARS.[167] To avoid late payments, which attracts fines, penalties and interest charges,[168] a VAT vendor must pay the VAT due to SARS and further submit the VAT return on or prior to the 25th day after the end of the tax period allocated to that vendor.[169]

159 M Silver & C Beneke (note 10 above).
160 Note 40 above.
161 M Silver & C Beneke (note 10 above), 14.
162 Ibid.
163 Ibid.
164 Note 44 above.
165 SARS *'Register for VAT'* https://www.sars.gov.za/ClientSegments/Businesses/My-Bus-and-Tax/Pages/Register-and-Deregister-for-VAT.aspx accessed on 14 July 2019.
166 Ibid.
167 Ibid.
168 Note 40 above.
169 Ibid.

3.3 Implementation of VAT and its impact

Prior to the 2018 rate increase, VAT was applied in collaboration with a specified basket of zero-rated and exempt items which include the 19 basic food items.[170] This is due to the perception that they seem to be in a better position to assist with the redistributive consequences of the effects of VAT on lower income earning households.[171] It existed in the South African structure at a rate of 14 percent since 1993.[172] In 2018, the VAT rate was increased by 1 percent to the rate of 15 percent.[173] Such increase was conveyed to all South Africans by the then Minister of Finance, Minister Malusi Gigaba, in his 2018 budget speech.[174] The increase took effect as of the 1st April 2018 and was thought to be a healthier alternative to maintain public finances, as it was anticipated to generate approximately R22.9 billion more for the government.[175]

Additional tax and benefit policy changes were further introduced in 2018, which include various increases to the amount of social grants, where it was intended that these increases would further reduce the effects of VAT for low-income households.[176] These increases have helped to reduce the impact of the increase in VAT for low-income earning households to an extent and it was also helpful that the government introduced further measures targeted at affluent households to ensure that not only low-income households were affected by the increase in taxes. *Ad-valorem* excise duty increased to 9 per cent.[177] A larger estate duty tax rate for any estates greater than R30 million was introduced.[178] The fuel levy together with the Road Accident Fund Levy also increased and there was an increase in excise duty for alcohol and tobacco.[179]

Many scholars have debated the effects of an increase in the VAT rate and how this would affect the weakening South African economy. Some scholars maintained that an increase of the VAT rate would be exactly what the economy needed to raise revenue. Although much scepticism has surrounded this topic, VAT was increased as a desperate measure to increase

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170 A Jansen, E Stoltz & D Yu (note 1 above).
171 Ibid.
172 *'Budget Speech 2018'* Malusi Gigaba, Minister of Finance, 21 February 2018, 11.
173 Ibid.
174 Ibid.
175 *'VAT to increase to 15% from 1 April'* https://businesstech.co.za/news/finance/226899/vat-to-increase-to-15-from-1-april/ accessed on 23 July 2019.
176 Ibid.
177 Ibid.
178 Ibid.
179 Ibid.

the country's revenues at a time when aid had to be given because the government spending was at its poorest levels.[180] Moreover, a VAT increase was considered the only alternative in the interim mainly because VAT had not been increased for about almost 25 years in South Africa.[181]

South Africa still operates on an average VAT rate as compared to other European Union countries. While it may not be referred to as VAT in some countries, the systems adopted have some VAT type characteristics.[182] The table below illustrates the different VAT rates applicable worldwide:

"Table 1

Country	***Standard VAT rate***
Australia	*Goods and Service tax: 10*
Belgium	*21*
China	*13, 9, or 6 depending on the types of goods and services*
Denmark	*25*
Equatorial Guinea	*15*
France	*Turnover tax: 20*
Germany	*19*
Hong Kong	*N/A*
Ireland	*23*
India	*The rate of GST varies from 5% to 28% depending on the category of goods and services, the general rate of tax being 18%.*
Italy	*22*
Japan	*Consumption tax: 8*
Portugal	*23*
South Africa	*15*
United States	*N/A*
United Arab Emirates	*5*
United Kingdom	*20"*[183]

[180] Note 152 above.
[181] Ibid.
[182] M Silver & C Beneke (note 10 above), 7.
[183] PWC Worldwide Tax Summaries *'Value Added Tax (VAT) rates'* http://taxsummaries.pwc.com/ID/Value-added-tax-(VAT)-rates accessed on 08 September 2019. For Germany, (the standard rate has been reduced to 16% from the 1st July 2020 until the 31st December 2020 in order to respond to the COVID-19 pandemic).

With such a bold move taken by the government to increase the public purse, one cannot disregard the increase of pressure from the impact, which will be felt by lower income earning households due to such an increase. It has been acknowledged that some individuals are not part of households which receive some form of social relief grant, therefore it is reasonable to consider that an increase in grant values does not necessarily mitigate against the effects of a VAT increase.[184]

VAT has been seen to be a highly successful mechanism to generate revenue for the fiscus and it presents lower marginal costs to raise income for public purposes when compared to other taxes.[185] VAT is largely more secure from serious crimes in a domestic market, like fraud and VAT is an efficient tax due to its revenue being collected throughout the production chain which is a characteristic different from a retail sales tax where tax to be collected is lost if there is circumvention at the final stage.[186]

3.4 Tax incidence:

When reference is made to tax incidence or the tax burden, this refers to the pressure on economic welfare placed daily on individual South Africans in relation to any tax and in this particular case, the strain which is as a result of VAT.[187] In usual circumstances, this tax burden is experienced between the individuals that are the suppliers/producers and in a lot more cases, the end consumer who buys the products.[188] It is not in all cases that the individual on whom the tax is imposed, bears its full.[189] This means that the consumer pays a higher amount for a product when tax is included than when it is excluded whereas the producer does not make more for a product than the amount he would've made if tax was not included.[190] Individuals supplying any products may try to reduce the effects of the tax burden by passing the VAT obligation due on to the buyer. This may be done by bearing in

[184] R Gcabo et al *'Modelling value-added tax (VAT) in South Africa: Assessing the distributional impact of the recent increase in the VAT rate and options for redress through the benefits system'* WIDER Working Paper, No. 2019/13, The United Nations University World Institute for Development Economics Research (UNU-WIDER), Helsinki, 3.
[185] Ibid, 4.
[186] Ibid.
[187] *'Tax incidence'* https://en.wikipedia.org/wiki/Tax_incidence accessed on 14 July 2019.
[188] J Beggs *'Elasticity and Tax burden'* Updated 05 March 2019 https://www.thoughtco.com/elasticity-and-tax-incidence-1147952 accessed on 07 September 2019.
[189] Note 175 above.
[190] Ibid.

mind the VAT which was charged when the product was being made, how the product was processed and the cost incurred for the product to be transported.[191]

To measure who suffers the tax burden at a time, between the supplier and consumer, depends on whether the *"supply is more elastic than demand"*[192] or whether *"demand is more elastic than supply"*[193]

Elasticity of demand can be explained to mean the imposition of VAT on any consumer[194] while elasticity of supply means the imposition of VAT on the supplier.[195] Elasticity of supply occurs where the supplier is unable to pass on VAT to the consumer.[196]

3.4.1 <u>Inelastic supply, elastic demand</u>

The producer is said to be inelastic as they will continue producing their products in the same manner irrespective of the shifts in the value they have to pay for the production of that product.[197] In this case the consumer is regarded as elastic and is highly sensitive to price.[198] Any increase in price whatever the degree affects the demand of a product therefore affecting the quantity demanded which results in a decline.[199] It is said that:

> *"The imposition of the tax causes the market price to increase from P without tax to P with tax and the quantity demanded to fall from Q without tax to Q with tax. Because the consumer is elastic, the quantity change is significant. Because the producer is inelastic, the price doesn't change much. The producer is unable to pass the tax onto the consumer and the tax incidence falls on the producer. In this example, the tax is collected from the producer and the producer bears the tax burden. This is known as back shifting."*[200]

An example where the producer would not be able to pass on the tax to the consumer could be specific foods where the consumer will opt for less costly food options to substitute for the

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[191] Ibid.
[192] *'Elasticity and tax revenue'* Khan Academy https://www.khanacademy.org/economics-finance-domain/microeconomics/elasticity-tutorial/price-elasticity-tutorial/a/elasticity-and-tax-incidence accessed on 14 July 2019.
[193] Ibid.
[194] Note 175 above.
[195] Ibid.
[196] Ibid.
[197] Ibid.
[198] Ibid.
[199] Ibid.
[200] Ibid.

expensive food, or the consumer no longer consumes that particular item due to the increased VAT burden.

3.4.2 <u>Elastic supply, inelastic demand</u>

This can best be explained as a situation where:

> *"The consumer is perfectly inelastic, and they will demand the same quantity no matter the price. Because the producer is elastic, the producer is very sensitive to price. A small drop in price leads to a large drop in the quantity produced. The imposition of the tax causes the market price to increase from P without tax to P with tax and the quantity demanded to fall from Q without tax to Q with tax. Because the consumer is inelastic, the quantity doesn't change much."*[201]

An example for when demand is inelastic is the purchasing of alcohol products. Even with the price changes experienced, the consumer still purchases alcohol products so in that way, the producer is able to increase the price for the alcohol and the consumer will still purchase it. The tax burden gets passed on to the consumer in this case.[202]

3.4.3 <u>Variances</u>

Variances occur in some situations where the tax burden falls on both the producer and the consumer and it is shared in different quantities.[203] Other circumstances occur depending on whether *"the supply curve is elastic (horizontal) or the demand curve is perfectly inelastic (vertical), the whole tax burden will be levied on consumers."*[204]

3.5 The VAT gap

The VAT gap experienced in the country is due to a number of contributing factors[205] and it is certainly not a unique concept to South Africa alone.[206] While some of these factors could be minimised or better yet, even avoided, the country more often than not, needs to keep up

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[201] Ibid.
[202] Ibid.
[203] Ibid.
[204] Ibid.
[205] C De Wet (note 30 above). Contributing factors to a gap in VAT are tax evasion, tax avoidance, fraud and in some cases incorrect calculations.
[206] D Davis & I Woolard (note 24 above), 5.

good fiscal returns and consistently endeavour to grow its revenue to maintain a healthy and well performing gross domestic product.[207]

A VAT gap, simply stated, occurs where an economy collects less VAT than what is actually legally due to the State.[208] This then creates a deficit between the amounts of revenue that an economy was supposed to have collected versus the amounts it has actually received.[209] This results in pressure being created in respect of the actual budget. It further affects government allocations due for distribution for resources and results in the government having to find other alternatives, to an already strained economy, in order to sustain the public purse.[210] It has been argued that other alternatives to be explored cannot include public borrowing as the rate of public borrowing in South Africa currently far exceeds 50% of the gross domestic product.[211]

A VAT gap also helps to identify whether VAT collection is properly enforced, whether it is effective and whether it is being properly complied with.[212] The methods utilised in order to assess a VAT gap are looking at compliance and policy[213] where in turn, any gaps identified between the two will allow for redress by the relevant authorities in respect of performance of VAT or a gap related to policy.[214]

South Africa has been facing budget deficits over the years, with the deficit sitting at -1.5 percent in the year 2000 and measuring at -4.38 percent in the year 2017.[215] The government was not collecting nearly as much as it was spending. This was unacceptable for South Africa from a fiscal health standpoint and meant that action needed to be taken at that time in order to improve the situation.[216]

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[207] C De Wet (note 30 above).
[208] Ibid.
[209] Ibid.
[210] M Silver & C Beneke (note 10 above).
[211] Ibid.
[212] Ibid.
[213] The 'compliance gap' looks at non-compliance and its impact by looking at the differences in a tax year between VAT that would have been collected as against policies in place and the 'policy gap' looks at the effects of policy choices which indicates the efficiency of the VAT policy framework.
[214] E Hutton *'International Monetary Fund: The Revenue Administration Gap Analysis Program: Model and Methodology for Value Added Tax Gap Estimation'* 7 April 2017 https://www.imf.org/en/Publications/TNM/Issues/2017/04/07/The-Revenue-AdministrationGap-Analysis-Program-Model-and-Methodology-for-Value-Added-Tax-Gap-44715 accessed on 14 August 2019, 4.
[215] *'South Africa Government Budget deficit 2017'* https://countryeconomy.com/deficit/south-africa accessed on 31 July 2019.
[216] Ibid.

While it has been a long time coming, taxpayers continued to require the goverment to spend the fiscal budget in a conservative manner. The Finance Minister, Mr Pravin Gordhan, was met with a warm reception in 2014 when he responded to the call for government to minimise its spending.[217] The President, Mr Cyril Ramaphosa, might have made the biggest budget cut when he reduced his cabinet size from 36 Ministers, to just 28 in 2019.[218] Various provinces have also responded to the call to implement measures to stabilise the government's budget, with some Premiers promising to end luxurious and unnecessary spending by reducing costs and not buying new cars for their MECs and also doing away with the blue lights brigade.[219]

The size of the VAT gap in South Africa is inconceivable and in order to correct this predicament, our Government has to directly address what causes such disparities resulting in a VAT gap and formulate action plans in order to mitigate the current and continuing situation.

3.6 Zero-rating versus exemptions:

Every successful, revenue yielding VAT system needs to cater for a range of zero ratings and exemptions for various products.[220] This range needs to be in different sectors in order to effectively counter or even mildly counter VAT's regressive effects.[221] The VAT charge at 0 percent is, as in many jurisdictions around the world, known as zero-rating of such goods or supplies.[222]

South Africa's range of zero-rated items was introduced in the belief that it would assist with the distributional implications of VAT. Such items have not changed since the last increase in the year 1993.[223] The increase in 1993 was the first increase to the zero-rated and exempt items since their introduction when the VAT system came into effect.[224] However, in 2019

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[217] I Lamprecht *'Taxpayers want State to tighten its belt'* https://citizen.co.za/uncategorized/115821/taxpayers-want-state-to-tighten-its-belt/ accessed on 30 July 2019.

[218] G Nicolson *'Ramaphosa cuts Cabinet from 36 to 28 ministers, half of whom are women'* 29 March 2019 https://www.dailymaverick.co.za/article/2019-05-29-ramaphosa-cuts-cabinet-from-36-to-28-ministers-half-of-whom-are-women/ accessed on 1 August 2019.

[219] K Madisa *'Premier Zamani Saul vows to end executive splurge'* 08 July 2019 https://www.sowetanlive.co.za/news/south-africa/2019-07-08-premier-zamani-saul-vows-to-end-executive-splurge/ accessed on 1 August 2019.

[220] M Kearney (note 152 above).

[221] Ibid.

[222] D Davis & I Woolard (note 24 above). The Davis Tax Commission in their report ('The Davis Tax Committee First Interim Report on VAT to the Minister of Finance') opine that zero-rating of foodstuffs cannot be taken in isolation.

[223] A Jansen, E Stoltz & D Yu (note 1 above).

[224] Ibid.

the progress was made. Section 11 of the VAT Act provides direction on the supply of certain goods and the tax treatment of these when charging VAT at 0 percent[225] and section 12 stipulates the tax treatment of certain supplies which are considered to be exempt from tax.[226]

A lot of considerations had to be determined in order to ascertain what food should be zero-rated from tax.[227] SAICA stipulates that zero rating of food will not apply when the following basic guiding principles are not met:

a) where any additional additives that the standard VAT rate applies to were added to such food;
b) where a specific technique (aside from the preservation of food in its natural form) was utilised; and
c) where the food is made ready to consume.[228]

Part of the listed zero-rated items detailed in Chapter 1, mainly the 19 basic food stuffs, illuminating paraffin, farming inputs and the specified government grants can be said to directly assist the poor with the majority of the items that are zero-rated not applying to the extremely poor.

In respect of the 19 basic food stuffs, there are some views that the extremely poor individuals in the country survive on much more than is catered for under the zero-rated items and possible addition of food items will be beneficial for the poor.[229]

3.7 Conclusion:

With the increase in VAT coming into effect, a lot of concerns surrounded the topic of how VAT would further impact the poor. With the same breath, government could not implement an increase to the VAT rate to increase revenue collection, while government's own spending patterns exhibited signs of recklessness and was still of poor quality. There are many more things that can be done by the government to close the VAT gap. The little efforts that they have done should in the long run show a difference if it continues to tighten its spending.

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[225] Note 40 above.
[226] Ibid.
[227] *'Value-added Tax 1671. Zero-rating of foodstuff'* October 2008, Issue 110. See https://www.saica.co.za/Integritax/2008/1671_Zero_rating_of_foodstuff.htm accessed on 10 September 2019.
[228] Ibid.
[229] *'Are 19 VAT-free items enough to save the poor when VAT hike hits'* Fin24, 25 March 2018 *https://www.fin24.com/Economy/are-19-vat-free-items-enough-to-save-the-poor-when-vat-hike-hits-20180325* accessed on 13 September 2019.

The table above evidences that the VAT rate charged in South Africa is relatively average as compared to the rates used in other countries. Some could argue that the country could withstand a further increase to the VAT rate because of the range it is in. Further, the question of whether zero-ratings require an increase and whether such an increase would be viable for government is something that also needs to be inspected. Whether or not such an increase could be achievable will be answerable in the chapter to come.

Besides increasing the VAT rate, even with the other measures being introduced and implemented as mentioned in this Chapter, low-income earning households still experience the brunt of the VAT increase more than high-income earning households however, they are able to feel some reprieve with the government trying to even the scales. Chapter 4 takes a look into the alternative measures which can be explored in addressing the effects of VAT and possibly increasing the zero-rated supplies will be one of the avenues explored and how it would work.

Chapter 4

Alternative measures to explore in addressing the effects of VAT

4.1 Introduction

Tax is a burden on every taxpayer, but it is felt differently in the different income brackets of individuals. As some tax rates gradually increase over the years some difficulty will be felt by taxpayers.[230] Different groups ranging from scholars, experts to politicians are divided on the subject of increasing the VAT rate. Some argue that an increase of the VAT rate will put more burden on already strained taxpayers, while others argue that an increase in direct taxes[231] will be more burdensome. This chapter will explore whether there can be a reduction in the impact of VAT if there is an increase in the VAT rate or alternatively in the rate of direct taxes. It will also take a look at whether alternative outcomes will be experienced if only the VAT rate is increased, or will multiple efforts bring a better solution?

[230] 'SARS income Tax Rates' https://www.sars.gov.za/Tax-Rates/Pages/default.aspx SARS, accessed on 06 March 2020.
[231] Note 3 above.

Out of the four categories of zero-rated supplies,[232] the concessional social welfare supplies category,[233] which mostly caters for low income earning households will be the focus. This chapter will also look into the introduction of more zero-rated food items as another alternative to be explored in order to determine whether zero-rating has been effective in alleviating pressure on low income earning households. Finally, the effect of increased zero-rating on revenue collection will be discussed. To this end, this chapter scrutinises a report[234] detailing the possibility of further zero-ratings and will determine whether more zero-ratings will be achievable.

Targeting particular foodstuffs, will be assessed as another alternative that Government can implement in the future to reduce the burden of VAT.

The application of VAT on luxury goods is another option that will be explored.[235] This chapter will further analyse this option by determining whether it makes any sense to impose such a VAT, and how such a VAT would compare to modifying excise duty rates instead.[236] The types of items which could plausibly be identified as luxury goods through targeting will be discussed, as well as the revenue implications thereof.[237]

4.2 Increasing direct taxes:

The challenges being faced with the more modernised tax structure adopted, are the effects of redistribution which have been experienced on a large scale when it comes to the reduction of poverty and inequality.[238] In the past five years, the South African economy has significantly underperformed, as evidenced by economic growth which has shown a slow growth compared to global market levels.[239] While the country was reluctant to accept increases in

[232] C Evans, R Franzsen & E Stack *'Tax simplification: An African Perspective'* Pretoria University Law Press (PULP) 2019, 166. The other types of zero-rated supplies are exports, municipal taxes on property, and supplies of going concerns.
[233] Ibid, 168. This category includes zero-rated basic food items, farming inputs and all social welfare services.
[234] *'Minister Nhlanhla Nene reviews terms of reference for zero rated food items'* 29 May 2018 https://www.gov.za/speeches/vat-zero-rated-food-items-29-may-2018-0000 accessed on 28 July 2020.
[235] A Jansen & E Calitz *'Reconsidering the effectiveness of zero-rating of value-added tax in South Africa'* working paper 9 June 2015, 18.
[236] Ibid.
[237] Ibid.
[238] C Lewis & T Alton *'How can South Africa's tax system meet revenue raising challenges?'* OECD Economics Department Working Papers No. 1276, 6.
[239] *'Tax Statistics 2019'* https://www.sars.gov.za/AllDocs/Documents/Tax%20Stats/Tax%20Stats%202019/Tax%20Stats%202019%20Full%20doc.pdf Department of National treasury accessed on 28 July 2020, II.

the VAT rate, the recent increase seen in 2018 has had a high impact on the revenue collected by the fiscus.

Direct Taxes have always been the preferred method the Government utilised to balance the scales between the poor and the rich coupled with increases to luxury or wealth taxes.[240] Further the Government relied on direct taxes to rectify deficits in the fiscus for any shortfalls in revenue collection.[241]

> *"There has been an increase in the number of individuals registered for PIT by 5.1% from 21.1 million in 2017/18 to 22.2 million in 2018/19. On the other hand, the number of companies registered for Income Tax has decreased from 3.2 million in 2017/18 to 2.0 million in 2018/19. Registered trusts increased in number by 1.8% from 351 564 in 2017/18 to 357 859 in 2018/19 and the number of employees registered for PAYE grew by 6.1% to 552 611 in 2018/19. VAT registrations grew by 3.8% to 802 957 and Year-on-year (y/y) growth of registered importers and exporters was 2.5% to 319 949 and 2.3% to 288 604 respectively".*[242]

Tax revenue collection for the 2018/19 tax year amounted to R1 287.7 billion, which equated to a shortfall of R14.5 billion against the targeted revenue collection of R1 302.2 billion.[243] The deficit was as a result of the contribution of taxes on income and profits which was nearly 90% of the tax revenue shortfall of R14.5 billion.[244]

The tax register appended hereunder details the different revenues collected for tax from 31 March 2015 to 31 March 2019:

[240] Ibid.
[241] Ibid, 3.
[242] Ibid.
[243] Note 219 above, I.
[244] Note 214 above.

"Table 2

Number as at	*Individuals*	*Companies*	*Trusts*	*(PAYE)*	*VAT*	*Importers*	*Exporters*
31 Mar 2015	*18 185 538*	*2 935 385*	*331 584*	*429 691*	*679 274*	*280 953*	*254 108*
31 Mar 2016	*19 075 270*	*3 278 708*	*340 000*	*458 048*	*706 874*	*289 922*	*262 162*
31 Mar 2017	*19 980 110*	*3 732 416*	*345 048*	*489 445*	*742 388*	*301 746*	*272 951*
31 Mar 2018	*21 104 375*	*3 202 007*	*351 564*	*520 918*	*773 783*	*312 241*	*282 243*
31 Mar 2019	*22 170 513*	*2 020 759*	*357 859*	*552 611*	*802 957*	*319 949*	*288 604*
Percentage year on year growth							
31 Mar 2016	*4.9%*	*11.7%*	*2.5%*	*6.6%*	*4.1%*	*3.2%*	*3.2%*
31 Mar 2017	*4.7%*	*13.8%*	*1.5%*	*6.9%*	*5.0%*	*4.1%*	*4.1%*
31 Mar 2018	*5.6%*	*-14.2%*	*1.9%*	*6.4%*	*4.2%*	*3.5%*	*3.4%*
31 Mar 2019	*5.1%*	*-36.9%*	*1.8%*	*6.1%*	*3.8%*	*2.5%*	*2.3%* "[245]

> *"While PIT, CIT and VAT account for a percentage of about 80 in respect of the total tax revenue, the contribution of PIT to the total amount of tax revenue collection increased from 35.9% in 2014/15 to 38.3% in 2018/19. The coverage of this shift is supported by the fact that when PIT contributed R167.3 billion more to tax revenue compared to CIT in 2014/15, this almost ended up in the double digits in 2018/19, providing R279.4 billion more than CIT".*[246]

In addition, the current company tax rate sits at 28%, which is low when compared to international and historic standards.[247] This rate must be reviewed so an effective tax on companies is levied which should not take into account how many allowances and exemptions a company qualifies for or what mechanisms that company utilises to reduce its burden for tax.[248] One way to achieve this effective tax rate would be to include a minimum tax which is based on company's profits, or a minimum tax which is based on declared dividends.[249] This approach to attempt a minimum tax on companies has been widely supported in South Africa.[250] It was recommended by the Margo Commission of Inquiry which looked into South Africa's tax structure. The Commission stated that:

[245] Ibid, 3.
[246] Ibid, 10.
[247] 'SACTWU and COSATU submission to the Davis Tax Committee' 7 February 2014, 21.
[248] Ibid.
[249] Ibid.
[250] Ibid.

> *"if the remaining incentives and concessions prove difficult to remove from the tax system, a simplified form of minimum taxation for companies could be considered for South Africa".*[251]

This minimum tax would not only increase funds for revenue but will also contribute heavily to equity.[252]

4.3 Increasing the VAT rate:

Despite the increase in the VAT rate, VAT is still below the global average.[253] Some perceive that the alternative of increasing the VAT rate would require dual VAT rates applying in respect of people living in high income earning households and low income earning households.[254] The Davis Tax Committee commented on this in its final report where it made a recommendation that multiple rates of taxing VAT for affluent and poor households would not be appropriate for South Africa.[255] The Committee was of the view that the option for affluent households to bear a higher VAT burden on goods and services consumed by them would not only create an administrative and complex tax burden but, there was also no evidence to suggest that higher rates on luxury goods addressed equity in the VAT system in any significant way.[256] Rather, the imposition of *ad valorem* excise duties on various luxury items currently addresses to a degree any equity concerns being perceived.[257] It seems clear that to have a uniform VAT rate applying to all individuals reduces the administrative and compliance costs of the tax system and assists to circumvent any legal disputes over the classification of goods.[258]

Any restructuring of VAT which tries to address the VAT rate would require that other aspects also be addressed.[259] The first of these is the regressivity of VAT where the view is that the shift from income taxes to VAT will produce larger income and wealth inequality.[260] The tax system in its entirety needs to be evaluated as a whole, its impact on the South

[251] Ibid.
[252] Ibid.
[253] Fenns Incorporated Chartered Accountants *'The Impact of Increased VAT ''The Impact of Increased VAT'* https://www.fenns.co.za/impact-increased-vat/ accessed on 20 July 2020.
[254] Ibid.
[255] D Davis & I Woolard (note 24 above), 5.
[256] Ibid.
[257] Ibid.
[258] Ibid, 12.
[259] C De Wet (note 30 above), 3.
[260] Ibid.

African economy, all growth and development drivers, together with social security assistance will need to be considered, rather than putting focus on individual aspects.[261]

Four different scenarios were explored which considered the impact that changes in the tax structure would have on public welfare and government income. The table below shows the outcomes of such analysis:

"Table 3: Model scenarios

Scenario	*Description*
Remove VAT	*Remove VAT and replace lost government revenue with a proportional increase in direct taxes; sector-specific capital and high-skilled labour; endogenous supply of semi-skilled and unskilled labour at a constant wage.*
Increase VAT by 50%	*Increase the VAT rate by 50%; balanced savings and investment closure with fixed absorption shares for government and investment demand; sector-specific capital and high-skilled labour; endogenous supply of semi-skilled and unskilled labour at a constant wage.*
0 VAT for food	*Zero VAT tax for food and agriculture; balanced savings and investment closure with fixed absorption shares for government and investment demand; sector-specific capital and high-skilled labour; endogenous supply of semi-skilled and unskilled labour at a constant wage.*
Replace tariff with uniform VAT increase	*Remove tariffs and replace lost government revenue with a uniform increase in the VAT rate; balanced savings and investment closure with fixed absorption shares for government and investment demand; sector-specific capital and high-skilled labour; endogenous supply of semi-skilled and unskilled labour at a constant wage."*[262]

[261] Ibid.
[262] Note 18 above, 17.

The conclusions drawn from these scenarios were that, the elimination of some commodities from the VAT base introduced a proficiency loss.[263] While most of the exclusions were intended to reduce the regressive impact of VAT, VAT in South Africa is ultimately still regressive.[264] The efficiency of VAT analysed using a CGE model and simulated by eliminating VAT from the tax system and replacing the loss of revenue with a proportionate increase in direct taxes resulted in VAT reducing the total progressiveness of the tax structure.[265] The overall welfare of low income earning households is impacted by VAT and with no VAT system, the cost of living for the poor is significantly affected.[266]

The existence of VAT in the South African tax structure has harsh effects on the welfare of the poor which suggests that more effort has to been made to lower the VAT burden on low income earning households.[267]

4.4 Zero-rating more basic foodstuffs and exempt supplies:

Zero rating VAT, results in a decrease of the tax paid by all households, not only for low income earning households.[268] This then becomes a less effective instrument in the pursuit of equity objectives.[269] The bluntness visible in VAT is built from the fact that tax relief efforts implemented by zero rating mostly benefit, in Rand amounts, those who consume the most which are individuals who are part of high income earning households in the expenditure distribution range.[270]

VAT zero rating is an exact alternative non-targeted subsidy.[271] This is the case because the current zero-rating is equal to a subsidy which favours the more affluent sectors of South Africa's population at a high cost for public revenue.[272] As a result*, "zero rating is a very blunt device for the detection of equity purposes."* To assist the indigent, more of the

[263] Ibid, 22.
[264] Ibid.
[265] Ibid.
[266] Ibid.
[267] Ibid.
[268] *'Recommendations on Zero Ratings in the Value-Added Tax System'* Independent Panel of Experts for the Review of zero-rating in South Africa: Recommendations to the Minister of Finance 6 August 2018, 66.
[269] Ibid.
[270] Ibid.
[271] Ibid.
[272] D Davis & I Woolard (note 24 above).

assistance flows to the rich rather than the poor.[273] The Katz Commission notes that, "it is of more significance to collect revenue from tax, then any additional revenue can be redistributed through a targeted transfer to the poor."[274] An imperative question then becomes whether the government is able to follow up on its circulating objectives through exploring other means.[275]

However, it seems that VAT would be more regressive in the absence of zero-rated food items.[276] The recommendations of the Davis Committee contained in its first report, as discussed in Chapter 1, and in its final report, are that further zero-ratings should not be permitted.[277] Even with such skeptics, the recent increase to the VAT rate has adversely affected some individuals in the country more than others. The selection of food items in the zero-rated and exempt supplies category was a large task when it was done at the inception of VAT.[278] The addition of more food items into the zero-rated category and allowing more exemptions, is an avenue worth exploring, in an effort to curb the effects of VAT in favour of low-income earning households. In a big stride to work towards the above efforts, the then Finance Minister Nhlanhla Nene,[279] commissioned an independent panel of experts[280] to consider further zero-rating options which would have a low impact for low income earning households.[281] The amended terms of reference for the Panel's appointment was published on the 25th April 2018 and the avenues to be considered were not confined to only food items but the panel could widen the scope and consider non-food items.[282] This not only broadened the spectrum of zero-rating, but it also influenced the fiscal budget framework for the years to come.[283] The Panel submitted its report to the Minister of Finance which stipulated recommendations in respect of their mandate. In order to achieve its mandate, the Panel had to consider 3 broad issues with zero-rating for VAT namely to:

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[273] Ibid.
[274] Ibid.
[275] Ibid.
[276] Ibid, 14.
[277] Ibid.
[278] M Silver & C Beneke (note 10 above), 6.
[279] Mr Nhlanhla Nene has served as Minister of Finance from May 2014 to December 2015 and thereafter he further served as the Finance Minister under President Cyril Ramaphosa from February 2018 until his resignation in October 2018.
[280] The panel of experts was made up of 9 professional and capable individuals.
[281] Note 215 above.
[282] Ibid.
[283] Ibid.

i. Examine the list of the 19 zero rated food items to determine whether they meet the objectives which they were intended for and to also explore targeting to determine if that would be a better solution to benefit low income earning households;[284]
ii. Consider including additional zero-rated food items to the zero-rated category;[285] and
iii. Consider other mitigating factors.[286]

The Panel considered the above 3 issues by analysing consumption data and statistics to establish the spend trend amongst high- and low-income earning households. After considering 66 submissions in total from the public,[287] the Panel recommended the following:

a) Bread: It was identified that spending trends for low income earning households went towards purchasing bread or making home-made bread.[288] Zero-rating white bread in addition to brown bread which is already zero-rated and also zero-rating white bread flour and cake flour would alleviate pressure on low income earning households.[289]

b) Sanitary Pads: The panel agreed that zero-rating sanitary products will help provide aid for young girls and women in low income earning households.[290] The Panel acknowledged that, *"zero-rating sanitary products would have a restricted impact on improving access to sanitary products for women in low income households therefore the zero-rating efforts of sanitary products should work in tandem with social programmes put together to provide free access to women who are indigent."*[291] The Panel further submitted that,

> *"Providing an average of 20 sanitary pads every month for woman aged 13 to 55 in households in the poorest 50% of households would cost around R240 per household, or a total of R2,6 billion. For the poorest 70%, the cost would come to a total of R3,2 billion. The average relief per household would*

[284] Note 247 above.
[285] Ibid, 10.
[286] Ibid.
[287] Note 247 above, 7.
[288] M Kamdar *'VAT – The current discourse in the public domain'* Tax Advisor, SAIPA, 10.
[289] Ibid.
[290] Ibid, 11.
[291] Ibid.

> *average R315 per annum for the poorest 50% of households but the actual relief would vary depending on the number of women in a household."*[292]

In its conclusion, the Panel urged the prioritisation of ensuring free access to sanitary products to girls and woman in low income earning households, as zero-rating alone additionally benefits high income earning households.[293]

c) School Uniforms: The Panel acknowledged the difficulties that would be experienced to distinguish school uniforms as they comprise of different items namely, shirts, shoes, socks, pants etc. and these items further differ depending on the type of school.[294] Also, school uniform items can be purchased for other uses i.e. shoes, shirts etc. which would present problems for retail stores to distinguish the purpose of them.[295] The Panel was of the belief that although there are these upfront challenges, they can be overcome and zero-rating of school uniforms can be achieved. However, the Department of Basic Education would need to be more involved and look into implementing a policy which would promote a standardised uniform for public schools.[296]

d) Nappies: Zero-rating babies' nappies, cloth nappies and adult diapers was another recommendation by the Panel. However, this did not come to pass.[297]

If the government elected to support zero-rating for all the points discussed above, it was estimated that R4 billion in revenue would be lost.[298] However, this would provide VAT relief to low income earning households in an amount of R2,8 billion.[299] The loss of revenue for the recommended zero-ratings would thus stand at R1,2 billion.[300]

[292] Ibid.
[293] Ibid.
[294] Ibid.
[295] Ibid.
[296] Ibid.
[297] Ibid.
[298] Ibid.
[299] Ibid.
[300] Ibid.

With effect from 1 April 2019,[301] sanitary pads, tampons and panty liners, bread and cake flour joined the category of zero-rated items.[302]

4.5 Targeting of zero-rated basic foodstuffs under VAT:

There is a broad consensus that the approach of targeted relief measures to assist the poor is a more favourable option to address the regressive impact of VAT compared to exemptions/zero rating.[303] Targeting more basic food items particularly vegetables and fruit, is another option to consider. However, it cannot be disputed that any further zero-ratings cannot be achieved without the realisation that targeting itself will benefit the poor through social interventions, rather than a blanket approach which is clearly more inclined to favour high income earning households. Targeting in the form of government programmes is a more popular avenue to explore. The Panel was also tasked to consider as part of the Terms of Reference for its mandate whether:

i. the intended result of zero-rating food could not be attained to a great extent by putting focus on government expenditure programmes;[304]
ii. such government expenditure programmes would additionally be efficient and effective in targeting poor and lower income households as opposed to zero rating food items instead;[305] and
iii. the current government programmes currently in place could be more suitable to obtain the same or a much greater result than just zero-rating food items.[306]

The government has in place a number of pro poor initiatives which focus on improving nutrition and food security amongst the poor.[307] The level of effectiveness with regards to these programmes can be improved and a number of them could benefit from being up-scaled.[308] The South African government currently has well conceptualised initiatives which were created to reduce inequality and poverty which would benefit from being run in a proper manner.

[301] Minister of Finance announced this change in a medium-term policy statement which was held on the 24th October 2018.
[302] M Kamdar (note 288 above).
[303] D Davis & I Woolard (note 24 above), 21.
[304] Note 247 above, 66.
[305] Ibid.
[306] Ibid.
[307] Ibid, 67.
[308] Ibid.

An increase to the various social grants, the provision of food vouchers and upscaling the current feeding schemes in place are some of the interventions our government can take to reduce the effects of VAT.[309]

Moreover, these social programmes and cash-transfer systems although designed for the poor are not designed to reach effectively all poor households, especially the working poor for example, the Unemployment Insurance Fund.[310]

4.6 A multiple VAT rate system

One of the proposed avenues which can be followed and certainly one of the avenues which has been investigated by the different Commissions discussed in this dissertation, is the possible introduction of a multiple VAT rate system.[311] The Katz Commission in its first interim report was one such Commission which had to explore whether such multiple VAT rates would be suitable for South Africa. In its recommendations the Commission rejected that option as it was not seen as conceivable.[312] The Commission was of the view that an additional or multiple VAT rate would further erode the VAT base and targeting measures through social and developmental programmes needed to be prioritised.[313] Further, the Commission was against the implementation of a higher VAT rate for luxury goods.[314] The main argument posed was that such a system would not contribute much to combating the regressive nature of VAT and any benefits from such a system would be trivial and not make much of a difference.[315] This also meant that there would be high administration and compliance costs, and the proposed system would not contribute much revenue.[316] These recommendations were accepted by the Government at the time.[317]

With the significant years of experience gained in South Africa through the implementation of the VAT system, and on the collection of revenue by vendors, there is some confidence that the introduction of another higher VAT rate even if complex, would be much more likely to succeed now.[318] Extending zero rated and exempt items would merely extend

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309 Ibid.
310 Ibid, 74.
311 Note 229 above, 27.
312 Ibid.
313 Ibid.
314 Ibid.
315 Ibid.
316 Ibid.
317 Ibid.
318 Ibid.

administrative measures which are in place, and it would not likely produce substantial additional collection charges.[319]

The higher VAT rate on luxury consumption habits, could be introduced at 20% rather than a further increase to the VAT rate being introduced.[320] Factoring in such a VAT rate would result in fairly neutral effects on VAT revenues.[321] This luxury VAT rate will be most effective if it is levied on luxury items consumed by affluent households.[322]

Specific items which can be categorised to qualify as luxury items would need to be identified and the percentage of the amount of income spent on acquiring such goods amongst the various income groups would need to be considered.[323] The introduction of two lists of goods has previously been proposed by SACTWU and COSATU, with one list containing items that *prima facie*, qualify for a luxury tax and the other listing those that are suitable because of the specific price threshold they fall under.[324]

The two Unions proposed that the first list could include goods such as:

> *"cameras, video cameras and recorders, decoders, satellite dishes, furs, binoculars, lawn trimmers, air conditioners, cordless telephone sets, smart phones, caravans, yachts and other water leisure equipment, dishwashers, tumble dryers and certain other electric kitchen appliances."*[325]

The second list of goods used by the different income groups, limited to only goods that are above a certain price range, would be classified as luxury goods.[326] This list could include:

> *"cars, motorcycles, fridges, freezers, stoves, microwave ovens, radios, TVs, watches, jewellery, sunglasses, cosmetics and furniture."*[327]

A cap would be established for each item included in the second list and an annual escalation of the price would need to be catered for.[328] The item would be classified as a qualifying

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319 Ibid.
320 M Hermann *'VAT as a revenue generation tool: choose luxury VAT, not a VAT increase'* Bowmans https://www.bowmanslaw.com/insights/tax/vat-as-a-revenue-generation-tool-choose-luxury-vat-not-a-vat-increase/ accessed on 16 November 2020.
321 Note 229 above.
322 Ibid.
323 Ibid.
324 Ibid.
325 Ibid.
326 Ibid.
327 Ibid.
328 Ibid.

luxury good for the higher VAT rate to apply.[329] This would ensure the exclusion of *'white goods'*[330] consumed by the working class, resulting in these not being subjected to the luxury tax rate.[331]

It is expected that where an increase or a higher VAT rate for luxury items is applied, the administrative load would also rise, though it is not conceived that any administrative costs would create a substantial share of further revenue collected.[332] There is currently more knowledge and understanding of the administration requirements for luxury taxes so the Unions were of the opinion that such luxury taxes could be imposed in South Africa and be a worthwhile option.[333]

The Union's belief, and one which could be argued is practical, was that,

> *"the combination of increased VAT zero-rating and increased VAT on luxury goods, as proposed, should mitigate the regressive burden of VAT and should aim at making VAT more progressive or at least distributionally neutral."*[334]

In this regard by levying an excise tax on luxury items commonly consumed by higher income earning households is a strong redistribution indication.[335]

The only way to balance the approach of imposing any tax relief, for example. zero-rating would be to ensure a form of compensation by other taxes, which will of course have different distributional features.[336]

4.7 Conclusion:

Without even focusing on targeting foods, it is clear from the recommendations of the report submitted to the Minister of Finance that some foods are utilised in the majority by individuals from high income earning households in contrast to low income earning households. It is a strong recommendation to focus on social interventions to improve pro-poor policies. However, with the government's weakness in implementing social programmes, and its ineffective policies, a lot more interventions need to be realised.

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329 Ibid.
330 Ibid.
331 Ibid.
332 Ibid.
333 Ibid.
334 Ibid.
335 Note 214 above, 4.
336 Ibid.

The Panel made strong concessions of what it recommended should be zero-rated and that plays a role in alleviating the strain on low income earning households. It is submitted that the submissions put forward are convincing. However, even considering the benefits of zero-rating basic foodstuffs as well as exemptions or any other items which cannot be consumed it cannot be denied that poor households are accommodated modestly in monetary value as compared to high income earning households.[337]

The reports cited above all argue that, the poor would be better served if zero-ratings were not increased or better yet, eliminated and the additional revenue collected from VAT utilised to increase pro-poor policies and spending on the expenditure side of the budget.[338] It is submitted that the suggestion made is to be accepted. Having considered the avenues which could be applicable and which would better accommodate low income earning households, the further zero-rated items go far in reducing VAT pressure, but to achieve beneficial circumstances for all individuals involved, targeting in the sense of fine tuning the processes intertwined with social programmes will give a better result than what is currently implemented.

Notwithstanding their very general application, the items considered to be zero-rated go a long way in alleviating strain of VAT on poor households, but with additional measures, its impact will have a far greater reach on the income of individuals in a poor income earning household.

Further, the arguments that a luxury VAT tax rate will be more successful now versus when it was first proposed has a greater bearing because South Africa has had the experience of operating the VAT system for a number of years. It is notable that the Government keeps making efforts to consider the poorest of the poor on a welfare level when it comes to tax imposition, but with the points that have been put forward in this dissertation, the loud voice is that more needs to be done in an attempt to even out the wealth inequality and poverty scales, although it may never be achievable to the full extent.

[337] D Davis & I Woolard (note 24 above), 20.
[338] Ibid, 21.

Chapter 5

5.1 Conclusion:

South Africa is one of the countries whose VAT rate has not increased aggressively in the past few years compared with other countries. An increase occurred in the two year period when VAT was first introduced[339] and thereafter it remained stagnant at the same rate for a number of years.[340] It was finally increased again in 2018.[341] With some reprieve for various taxpayers across the spectrum, some argue that the increase was long overdue because the rates of the other forms of tax had been stretched over the years and continue to be strained. Since inception, VAT remains at a low rate in comparison to other developing countries in the world.[342] Although any increase to tax is up for a debate, it stands that, tax in general is a burden on every taxpayer and there will be the constant argument that an increase to the VAT rate or an increase in direct taxes will put more burden on already suffering taxpayers.

As has been discussed in this dissertation, a reduction in the regressivity of VAT is imperative to help support low income earning households. The Government has made efforts to a great extent since the beginning of VAT in the country with efforts designed to reduce the impact of VAT to those most affected.

The transitioning to VAT from GST meant a more robust tax collection system would be used which levied tax on each point of sale rather than only at the final point of sale. This has since resulted in better yields of revenue for the fiscus. Further, the formation of SARS strengthened tax collection as this meant an improved administrative mechanism was put in place to assist with revenue collection.

The regressivity of VAT is a contentious point with differing views on this subject. The impact of VAT cannot be treated in isolation without the effects of poverty, inequality and unemployment being redressed. These are points that go hand in hand with how the effects of VAT are strenuous to a society which is barely coping with paying tax. It is evident that poor households feel the impact of VAT more because they spend the majority of their income on the purchase of food.[343] Many South Africans still fall well below the poverty line and it has

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339 M Silver & C Beneke (note 10 above), 5.
340 Ibid.
341 Note 152 above.
342 Note 172 above.
343 E Watkinson & N Makgetla (note 83 above).

been established that VAT affects the people who have very little compared to the people who have a lot more even with zero rating intervention in place.

When the Government had to be faced with the question of which option would increase revenue and not affect the fiscus to a great degree, interventions to make VAT progressive saw the Government applying an increase to the VAT rate and further zero-rating VAT which was a good progressive step. The fact that the increase to zero-rated items was not limited to only food items, broadened the number of factors to consider when making a decision of what would benefit low income earning households. This action coupled with the increased VAT rate has gone a long way to reduce the impact to poor households. The further zero rating of items to provide reprieve for the poor as considered in the Independent Panel of Experts report has aided in a great degree of relief for the poor but as highlighted below, has some downfalls.

It is an important recommendation from the report by the Independent Panel of Experts[344] to employ targeting interventions to further assistance the poor households. However, essentially selecting those zero-rated food items to go towards that basket will largely be a lost effort because most affluent households already utilise the same food consumed by low income earning households with the exception of very few. Further, the magnitude of revenue loss for the fiscus would have far reaching implications if more than just the poor would be benefitting. The argument that social programmes and grants must be structured to specifically target poor households[345] coupled with zero-rating is a solution which will reduce pressure on low income earning households and it is a route which I am strongly in support of. These social programmes and grants being focussed on the poor leave no room to benefit the rich in any way and this means that poor household income's will be better spread out for other needs that are required.

The Government has to also actively cut its spending by reducing its expenditure in order to rely less on the fiscal budget,[346] for their day to day activities and any other further activities required to execute their mandate. It will require an active introspection by the Government to admit what is creating a VAT gap and addressing such problems. This needs to be curbed

[344] Note 238 above.
[345] Ibid.
[346] Note 192 above.

more to give an impactful outcome and it has to be carefully watched in the years to come so that it does not revert back to adding to the fiscal deficit.

Exploring a further increase to the VAT rate will lead to more revenue for the fiscus. However, this must be measured against, the impact it will have on both the rich and the poor, as well as how well the other forms of tax are helping to somewhat balance the scales in respect of the levying of tax. South Africa may look to other tax systems employed in other countries of how to better balance the levying of VAT and other taxes to decide which tax structure works for the country and our revenue demands.

It is submitted that our tax structure is capable of successfully implementing a multiple VAT rate system and with the proper mechanisms in place, this multiple VAT rate system could prove to fast track a progressive tax atmosphere accommodating all people in South Africa.

None of these interventions mentioned in this dissertation will be achievable if the Government does not keep playing its role by continuing to establish good efforts to maximise South Africa's tax structure in a manner that will be favourable to the majority having to deal with tax levying. Further, examining how developed countries maximise VAT tax collection will greatly benefit our tax system, because while we inherited the VAT tax system to begin with, South Africa still has a lot to learn to yield good benefits from it.

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Miss Wandisa Mjindi (207508911)
School Of Law
Howard College

Dear Miss Wandisa Mjindi,

Protocol reference number: 00007371
Project title: The analysis of Value Added Tax, the effects of zero-rated VAT and exempt supplies and a look into who benefits more, the rich or the poor

Exemption from Ethics Review

In response to your application received on 16 July 2020, your school has indicated that the protocol has been granted **EXEMPTION FROM ETHICS REVIEW.**

Any alteration/s to the exempted research protocol, e.g., Title of the Project, Location of the Study, Research Approach and Methods must be reviewed and approved through an amendment/modification prior to its implementation. The original exemption number must be cited.

For any changes that could result in potential risk, an ethics application including the proposed amendments must be submitted to the relevant UKZN Research Ethics Committee. The original exemption number must be cited.

In case you have further queries, please quote the above reference number.

PLEASE NOTE:
Research data should be securely stored in the discipline/department for a period of 5 years.

I take this opportunity of wishing you everything of the best with your study.

Yours sincerely,

[redacted]

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