Easy wins and pitfalls

By Patricia Williams

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In the 2020 budget tax proposals, it was stated that "substantial tax increases are unlikely to be effective... New tax increases at this time could harm the economy's ability to recover"... Within a few weeks of these statements, the country had entered a lockdown due to the Covid-19 pandemic, with severe and unanticipated economic consequences for the country, including tax revenue generation. These challenges place tax generation opportunities in an even more precarious position during Budget 2021. Put simply, how does one successfully generate tax revenues from constituents who are still trying to recover from a devastating 2020?

Patricia Williams, tax partner: Bowmans, and member of the South African Tax Administration Act committee

A glimmer of hope on the horizon for taxpayers is that the 2020 Medium-Term Budget Policy documents projected relatively low tax increases of R5bn for 2021/22.

This article sets out a few potential easy wins, and pitfalls facing government at this stage.

Easy win: Personal income tax “bracket creep”

While not done in 2020, government has previously raised significant additional tax revenue by not adjusting the personal income tax brackets fully, for inflation.

In 2019, for example, no changes were made to the personal income tax brackets, with only a moderate increase to the tax-free threshold. At the time, this was projected to raise an additional R12.8bn, more than twice what government has announced as the target tax increase for 2021.

Easy win: Legislation to improve tax reporting and interim collection

There can be little doubt that third-party tax reporting and interim collection improves the practical ability of taxpayers to comply with their tax obligations. Employees’ tax and financial institutions issuing interest income certificates are both relevant examples. There remains various opportunities to extend these measures.

One example for improved tax reporting and interim collection is within the legal sector, for counsel fees paid by attorneys to advocates or by advocates to one another.

Advocates practising through a bar association are ordinarily appointed through attorneys, with the attorneys making payment to the advocates for their services rendered. In addition, advocates frequently subcontract certain components of their legal work to other advocates.

Just as there is an employees' tax system, with tax withholding and electronic submission and reporting of amounts paid to employees by employers, there could be a similar system required by the South African Revenue Service (Sars) for withholding tax and reporting by attorneys of all amounts paid to advocates, and a reporting system for all amounts paid by advocates to other advocates.

Given that advocates do have certain tax deductible expenditure, the rate of withholding tax should not be set based on likely marginal tax rates, but should be a lower rate, say 20% (with the difference in taxes being paid through the provisional tax system as normal). As a step towards the "matching principle", it may be advisable that an income tax deduction is only available to any attorney or advocate for advocate fees if the relevant tax reporting is done.

A tax withholding and reporting system would facilitate simpler and more accurate tax reporting, as well as earlier collection of certain taxes so that provisional tax payments are less painful for the advocates concerned, and promote equality relative to other taxpayers, subject to tax withholding.

Other opportunities for improved third-party reporting and interim collection across different industries could be determined in a consultative manner, following the budget speech. The important aspect at budget stage, is the policy decision communicated to stakeholders, to improve third party reporting and interim tax collections.

Pitfall: Knee-jerk reactions

In times of difficulty, it is understandable that various stakeholders may default to targeting certain groups that the public "love to hate", calling for wealth taxes, or significant increases in excise taxes on products like alcohol or tobacco.

These calls mostly appear to be based on anecdotal evidence only, and without considering all relevant factors, such as the significant impact of the relevant industry players on GDP and job creation, and the associated tax revenues. In contrast, a successful tax system is one that is coherent, and well-considered.

It is critical that National Treasury carefully considers any proposal in its entirety, considering all relevant factors, and promoting the constitutional value of public participation, prior to reaching conclusions.

Pitfall: Incomplete solutions

When introducing new taxes, it is important to avoid incomplete solutions. This is a broader concept than trying to avoid loopholes in the existing legislation.

For example, estate duty within South Africa is arguably currently an incomplete solution, because of the lack of an estate duty exit tax (unlike the capital gains tax exit tax), if taxpayers emigrate shortly before the likely incidence of estate duties, and the lack of alternative taxes to mimic estate duty in the case of generation-skipping trusts.

In addition, increased taxes with a future effective date can encourage avoidance behaviour such as shifting businesses offshore or emigrating.

Should the government plan to introduce new taxes, this needs to be done carefully, to ensure that the new tax legislation does not inadvertently result in lower tax collections.

ABOUT THE AUTHOR

Patricia Williams, tax partner: Bowmans, and member of the South African Tax Administration Act committee.