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MEDIA STATEMENT:

CLARIFICATION OF POINTS IN THE FIRST INTERIM REPORT ON VAT

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The Committee's attention has been drawn to commentary on its First Interim Report on VAT which suggests that the DTC explicitly recommends that the VAT rate be increased.

Such commentary has, unfortunately, not been based on a thorough reading of the DTC's report. With regard to possible increases in tax rates, the finding of the report is clearly stated in the following quoted paragraph:

> *4.7 Macroeconomic impact of raising VAT*
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> *It is evident that an increase in the present standard rate of VAT (14%) would be somewhat inflationary in the short-run. This is to be expected given that prices of standard-rated consumer items would rise overnight. In contrast, an increase in personal or corporate tax rates would be much less inflationary. While there would be a negative impact on real gross domestic product (GDP) and employment – particularly in the short-run – the impact of a VAT increase on these two variables would be far less severe than that of a rise in personal income tax (PIT) or corporate income tax (CIT). It is thus clear that from a purely macroeconomic standpoint, an increase in VAT is less distortionary than an increase in direct taxes.*
>
> *However, an increase in VAT would have a greater negative impact on inequality than an increase in PIT or CIT. Should it be necessary to increase the standard rate of VAT, it will be important for the fiscal authorities to think carefully about compensatory mechanisms for the poor who will be adversely affected by the increase. A range of measures should be considered, such as increases in social grants or the strengthening of the school nutrition programme.*

Again at 7.7 in the report, the DTC discusses the macroeconomic impact of raising VAT but this time through economic modelling. It does not prescribe a three percent increase in VAT but merely uses this figure for illustration and modelling purposes to compare VAT with PIT and CIT as revenue-raising tools. The preamble to the tabulated analysis reads as follows:

7.7 Macroeconomic impact of raising VAT

For comparative purposes, the Committee asked the Treasury to simulate an "across the board" increase in personal income tax (PIT) rates and an increase in the headline corporate income tax (CIT) rate, such that each of these taxes individually raised tax revenue by the same amount as the three percentage point increase in VAT, i.e. to generate an additional R45 billion. The increase in PIT would need to be 6.1 percentage points and the increase in CIT would need to be 5.2 percentage points in order to realise the same revenue as a 3 percentage point increase in VAT. The results are shown in Table 5.

This summation of the Committee's interim position should make it manifestly clear that no explicit recommendations were made to increase the VAT rate and reports to that effect are simply inaccurate.

To the extent that the economic evidence points to VAT being the most effective source of additional revenue, apart from a range of measures suggested in other reports (e.g. estate duty and BEPS), the DTC emphasised that a VAT increase without a significant measure of recycling of revenue in favour of poorer people is inherently retrogressive. Hence were government to consider an increase in the VAT rate, then the increase would have to be accompanied by sustainable measures that mitigate the retrogressive effects.

This clarification is released with the express purpose of encouraging debate about an appropriate tax system for the South Africa of the future. To this end the Committee welcomes and indeed invites public comment on these questions so that its final VAT and Macro Analysis reports can make recommendations that can sustain an appropriate tax structure for the needs of the country.

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