

## ON MY MIND

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# Tax rise won't fly

**In affluent times it is easy** to follow universal tax principles; in lean times following principles becomes a challenge. For a number of years, finance minister Trevor Manuel has had the luxury of budget surpluses. The meltdown in the global economy

and the risk of a global recession have changed the playing field. Now Manuel is under pressure to deliver a budget based on a projected deficit. His reaction to this challenge is eagerly awaited.

In March 2008 Manuel announced that SA's tax policy was going back to the drawing board as he was not prepared to settle for anything but the best. He indicated that he was determined that SA remain "on the cutting edge" of tax policy.

One of the earliest tax principles that is still supported is the principle of equity. Equity entails that taxpayers should bear the overall tax burden in proportion to their respective abilities to pay such taxes.

The most significant global and local development in tax policy in recent decades has been a shift from direct to indirect taxes (mainly Vat). The tax base for indirect taxes is generally very broad and exemptions are introduced to benefit the poor. As such, Vat is generally perceived as an equitable tax. It has often been proposed by advocates of Vat that it should replace income tax on individuals.

The collection of indirect taxes is directly linked to consumer spending. A reduction in consumer spending therefore poses a direct threat to the amount of Vat the SA Revenue Service is likely to collect. National treasury has already reported a marked decline in Vat collections for the 2008/2009 fiscal year. This should come as no surprise, given the current state of the local and global economy. One option available to Manuel in setting his 2009/2010 budget is to view the decline in Vat collections as merely a symptom of the current financial crisis that does not require any specific immediate action.

Should he take the view that a budget deficit cannot be tolerated, he has three options at his disposal. He could increase the

Vat rate or he could increase the rate of income tax on companies and individuals. Increasing Vat shortly before a national election is not an option. Increasing the company tax rate is also not a feasible option as it will likely deter international investors. The only feasible option remaining is an increase in income tax on individuals.

In SA, the distribution of the tax liability among individuals is already skewed — a small proportion of the population bears a significant proportion of the tax liability. To support the equity principle at the lower end of earnings, any increase in tax rates will need to be targeted at the upper level of earners. This is unlikely to be well received by the higher income earners, where the marginal rate of tax is already at the level of 40%. Any further increase (whether an increase in the marginal rate or a surcharge of some sort) may give further impetus to the current brain drain in SA.

Over the past few years SA has taken giant steps towards aligning itself with international best practice as far as tax policy goes. Under the leadership of Manuel and Pravin Gordhan, Sars has become a formidable force ensuring effective revenue collection in SA through the development of modern tax systems and human resource development. In conjunction with national treasury it has also commenced a process of open consultation with commerce and industry before major tax amendments are proposed. This is a healthy development establishing a platform for public/private-sector collaboration. It would be unwise to take any rash actions now. It is therefore unlikely that Manuel will announce any radical tax reforms or increases in current tax rates. ■

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Which, if any, taxes might Manuel be tempted to raise in the budget given the marked decline in Vat collections for 2008/2009?