Zero-rated VAT items: how South Africa is going about expanding the list

South Africa is processing a new report produced by an independent panel that reviewed the current list of items exempted from value added tax (VAT). The review came after VAT was increased in the 2018/19 budget, from 14% to 15%, to help the country plug a huge budget hole. On the back of concerns that the VAT increase will hurt poor people, the country's minister of finance ordered the review to shield poor households. The Conversation Africa's Sibonelo Radebe asked Lee-Ann Steenkamp to unpack key issues from the report.

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What are the key findings of this report?

South Africa’s current VAT system allows for 19 basic food items to be taxed at a rate of zero percent (as opposed to the official rate of 15%). The zero rating of food items was originally introduced as a means of providing some relief to low-income households which spend a relatively high proportion of their income on zero rated items. Examples include brown bread, fresh fruit and vegetables, dried mealies and dried beans.

The panel made a number of recommendations which are now subject to public comment.

Six items were identified for possible inclusion in the list of zero rated items. These are:

- White bread
- White flour
- Cake flour
- Sanitary products
- School uniforms, and
- Nappies, including cloth and adult nappies.

In total, the zero rating effect would provide tax relief of R2.8 billion for the poorest households.

What are the high points of the report?

The VAT review process has been generally impressive as a transparent, consultative process that allowed concerned citizens to share their opinions.

Considering that the panel had to work through over 2 000 submissions and was under a tight deadline, I believe the list of six additional zero rated items provides a useful starting point for the follow-up public hearings.

The report itself is thorough and quite detailed (at 91 pages) and sets out the rationale for each recommendation.

The panel applied the basic principles of good tax policy design, namely equity, efficiency and ease of administration.

Were there any low points?

It's important to note that it would be impossible to please everyone.

The recommendation of the panel that baby formulae shouldn't be zero rated, will likely be considered a low point by many. But it should be pointed out that the panel based this decision on public health recommendations, particularly government's policy of promoting breastfeeding.

As with any group of experts, it's not surprising that the panel was unable to reach consensus on some issues. This included whether or not to recommend the zero rating of deep-frozen chicken parts sold loose in plastic bags. They have the lowest retail price compared with other chicken products.

The panel did note that chicken is the largest staple protein for low-income households. And that it's preferable to red meat and dairy from a nutritional and environmental point of view. Nevertheless, the majority of the panelists argued against including it on the list. The main reason for this is that a couple of producers dominate the local market and there were concerns that tax savings would not be passed on to consumers.

What needs to be done to ensure good results from this process

I'd like to draw attention to the panel's critical statement that the National Treasury must ensure that the benefits of zero rating accrue to consumers. In other words, authorities must ensure that producers actually pass on the tax benefits to consumers.

Participation and support by all stakeholders is a critical factor of success. So any person (whether an individual or a big corporate) unhappy with the panel's recommendations should take up their issue by responding to the minister's invitation to submit written comments.

Big VAT vendors might also consider subsidising certain basic items without waiting for government to get on board. One low cost retailer is already doing this by selling "tax-free" sanitary pads.

Any other thoughts?

Zero rating is not a silver bullet and civil society should pressure government to expand initiatives that would assist poor and low income households. These could include reducing transport costs, strengthening the school nutrition programme and increasing the child support grant and old age pension.

It should also be remembered that if tax relief is offered in one area, the resulting deficit has to be made up elsewhere. Any potential weakening of the tax base must be carefully considered. Tinkering with VAT rates and zero rating more items won't help the country much if it doesn't significantly reduce unemployment rates and boost economic growth. We should also bear in mind that national elections are looming. Ultimately, political factors could very well decide how VAT reform is to be implemented.

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This article was originally published on The Conversation. Read the original article.