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The power of politics:

The performance of the South
African Revenue Service and
some of its implications

Dr Laïla Smith

Senior researcher, CPS

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Centre for Policy Studies
9 Wellington Avenue
Parktown
Johannesburg, South Africa

P O Box 16488
Doornfontein 2028
Johannesburg, South Africa

Tel (011) 402-4308
Fax (011) 402-7755
e-mail: admin@cps.org.za

www.cps.org.za

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Introduction

The South African Revenue Service (SARS) appears to be one of the success stories of post-apartheid government: in a context in which the failure of the state to elicit citizens' compliance with public obligations is seen as a central weakness of the new democracy, and in which the efficiency of government is seen by many analysts to be wanting, the statutory tax collecting agency has substantially increased its revenues.¹

This alone would make SARS's performance an interesting area of study for those interested in understanding the ingredients of effective post-apartheid government. But the story of revenue-raising in South Africa's new democracy has a significance beyond this – domestically and abroad.

Discussion of the changing role of the state in general, and in the global south in particular, is common in academic and policy-oriented literature. Much of it has focused on the demise of the welfare model and the rise of neo-liberal regimes that have devolved core functions of the state to the private sector. This has tended to emphasise the limits of the state in providing effective governance and development. This literature has been very useful in charting the market-oriented nature of state transformation, but has overshadowed scholarship documenting the processes and challenges of state-building. Since it is widely agreed across ideological divides that the countries of the south cannot build peace and development without an effective state,² it is crucial to understand the processes of state-building that are being developed – and which may counteract the drivers that are eroding the traditional roles and responsibilities of the state towards the citizen. The tax collection or extractive function is a crucial indicator of the state's capacity because it indicates both how effective governments are in raising the revenues they need to perform their functions, and the degree to which they are able to ensure that their citizens meet their public obligations – and are therefore incorporated within a set of rules meant to be applied by the state to all citizens. The tax relationship could be seen as a core element in the 'social contract' between citizens and the state: tax-payers directly meet an obligation to the political authority and may, in theory, be more inclined to demand rights from it in return. Higher levels of revenue collection may therefore not only indicate that states have the resources they require to fulfil their function, but also that they have established a relationship with citizens which may allow them to govern effectively.

In South Africa, revenue-raising takes on a specific importance: it is a crucial measure of the new democratic state's ability to fund its development challenges, and a test of the degree to which citizens are willing to demonstrate compliance with a key state function, given the possibility that those in the racial minority may feel alienated from democratic government – and those in the majority may feel reluctant to pay on the grounds that the burden should fall on those who benefited from racial privilege in the past.

¹ For details of this enhanced performance, see Dumisani Hlophe and Steven Friedman, ... And their hearts and minds will follow? Tax collection, authority and legitimacy in democratic South Africa, *IDS Bulletin*, 33 (3), 2002, pp 67–76.

² See, for example, World Bank, *The state in a changing world: world development report 1997*, New York: Oxford University Press

Given this context, understanding SARS's performance is an important contribution to current attempts to understand the revenue-raising function in states of the south – and to the debate on effective government and development in South Africa. Despite that, little if any research has been conducted on revenue-raising in South Africa as a political and social phenomenon. This paper is a first attempt to open discussion on the question. It raises more questions than it answers, and is aimed primarily at stimulating debate and suggesting avenues for further research. Its chief aim is to analyse SARS's performance, which has been widely discussed but has not, as noted earlier, been thoroughly researched and analysed.

Key findings

Although, as noted earlier, the research is at an early stage, three key findings have emerged from an initial analysis of SARS's performance.

The main thrust of this study is to challenge a common understanding of the preconditions for effective tax collection in states of the south. The international financial institutions, such as the World Bank and International Monetary Fund (IMF), as well as literature on taxation, have propagated a conventional wisdom that revenue collection authorities are more effective when they operate autonomously from the state, as a commercialised entity at arms length from government rather than as a department within the government administration.³ This autonomy, it is suggested, protects revenue authorities from political interference. Countries such as Uganda, Zambia, and Tanzania have pursued this policy direction, establishing executive revenue agencies in the 1990s.⁴ On the surface, SARS's performance seems to vindicate this argument – its success follows its institutional separation from the department of finance. But a brief review of its experience proves quite the contrary. In the post-apartheid period, the co-operative approach of the political authority, in the form of the treasury, has created an enabling environment for SARS and has contributed to its impressive performance in extracting resources from the tax-paying public. It is also worth noting that SARS's enhanced performance has made it easier for the government to achieve some of its budgetary goals. This suggests that a mutually supportive relationship between the legislature and a government department on the one hand and revenue-raising authorities on the other can improve the state's extractive capacity.

This finding may have more general application. As implied above, it is often argued that independence from politicians and the political process is a prerequisite for performing key governance tasks – prospects for success are said to depend on the degree to which political authorities allow institutions performing public functions to operate without interference. However, the recent history of South African revenue-raising suggests

³ A Sindzingre, Political economy of taxation and international financial institutions in sub-Saharan Africa: reforms as problems and solutions. Paper presented at a workshop entitled 'Taxation, aid, and democracy', Namibian Economic Policy Research Unit (NEPRU), Windhoek, 4-5 April 2002, Chr Michelson Institute Working Paper, Bergen, Norway.

⁴ Sri Gloppen and Lise Rakner, Accountability through tax reform? Reflections from sub-Saharan Africa, *IDS Bulletin*, 2002, 33 (3), p 39.

that active political support for the institution – and a co-operative relationship between the revenue service and the relevant government department - may be a precondition for success.

The second point is that SARS has achieved technical efficiency gains in its revenue-raising activities, but in doing so has, at least until recently, compromised procedural equity. In 1995 the directorates of inland revenue and customs and excise in the department of finance (now the national treasury) were restructured as an autonomous revenue collection agency known as the South African Revenue Service (SARS). This entity was charged with extracting resources from the public, and has enjoyed the freedom to decide how it should go about this task. SARS initially chose to prioritise enhanced revenue-raising over creating a perception among taxpayers that it is concerned about their rights. It is argued here that SARS performance has certainly improved, but that it has achieved mixed results on the equity scorecard. The aggressive method of enforcement used to increase revenues over the period under review (1998-2002) raises procedural equity concerns about the lack of protection of taxpayers' rights. SARS has recently taken steps to redress some of these problems, but it faces the challenge of continuing to collect high levels of revenue under circumstances in which taxpayers' rights will place new constraints on it. On the other hand, the outcome of SARS's increased ability to raise government revenues have made it possible for the government to introduce distributive equity gains, shifting the tax burden in favour of the lower income strata and choosing to use the proceeds of SARS's enhanced performance to give increased attention to improving the public good.

The third point emphasises that SARS's improved performance in revenue-raising has been achieved in the formal sector only – the evidence suggests that there has been little improvement in its capacity to collect revenues from informal businesses. Greater analysis of new entrants into the tax-system at the lower end of the income scale may be a starting point for gaining insight into the workings of the informal economy. But this remains a barely explored area by SARS, in part because of the cost of collections in the informal sector. Nevertheless, it has yet to expand its extractive capacities to this untapped area of economic activity.⁵

This qualification means that SARS's performance thus far may be of very limited relevance as an example to states elsewhere in sub-Saharan Africa, where most economic activity is informal. It also means that many South Africans remain outside the tax net, a reality which may not harm revenue-raising performance unduly but which means that there are many citizens who are yet to be incorporated into the relationship between government and citizens suggested by the payment of taxes.

⁵ An official in the commissioner's office has indicated in a personal communication that some inroads have been made into the taxi industry, but the results of this initiative have not yet been placed in the public domain.

Analysing SARS's performance

While SARS's improved performance is often discussed, little is known about the nature of this improvement. In what ways has its performance improved? Has it been more successful in extracting revenue from some sources than others? If so, is there anything we can learn from this? More specifically, is improved performance a result purely of SARS becoming more technically proficient? Or could it also stem from a reliance on a culture of compliance and historically inherited understandings of taxpayers' behaviour, which have helped to build the legitimacy of the tax-collecting function?

SARS's performance in raising revenues can certainly be attributed to increased technical efficiency. This not a novel observation. How SARS has become more efficient, however, has barely been explored. Its increased efficiencies have come from a combined strategy of widening the tax net and simultaneously reducing the tax gap, the difference between the tax which should be collected if all taxpayers fully meet their statutory obligations and that actually paid. But what areas of tax collections have contributed the largest gains? And what are the implications of increased performance in certain areas of tax collections over others?

Widening the tax net

First, SARS's efforts to widen the tax net by increasing the total number of persons and companies registered for income tax are substantial.

Table 1: Number of taxpayers registered with SARS over the past four years

	Total				% increase
	1998--9	1999/2000	2000--1	2001--2	
Persons registered for income tax*	2 485 703	2 798 126	3 187 072	3 556 023	43
Companies registered for income tax	774 864	839 591	976 720	1 081 788	40
paye-registered entities	202 806	213 202	211 425	219 732	8
vendors (registered for vat)	478 002	424, 020	450 630	479 666	0

Source: SARS national office.

The table reveals a 43 per cent increase in persons registered for income tax over the past four years. The widening of the tax net for individuals has been achieved through several initiatives: the treasury has introduced legislative changes to tighten loopholes that have brought company directors into the PAYE system, as well as a change in the definition of labour brokers to make PAYE more effective.

Broadening the tax register does not necessarily increase revenue substantially, but it does deepen state penetration of society by bringing more people into the tax-paying relationship between state and citizens. In principle, this should also enable the authorities to gain information on the demographic profile of the tax-paying public, thus making government in general, and tax collection in particular, more effective.

An initial glance at the profile of this expanded tax base shows that about 57 per cent of taxpayers earn less than R60 000 a year, meaning that they only pay SITE (standard income tax of employees); they are subject to monthly deductions, and do not have to file returns. The bulk of new entrants to the tax system are thus in the low- to lower-middle income brackets and, as a whole, contribute 22 per cent of total revenues collected by SARS.⁶ But this only scratches the surface. What we do not know is the socio-economic profile of the new entrants who only pay SITE. For example, what proportion of these new taxpayers were previously liable for tax but were outside the system? What is the racial breakdown of these new taxpayers? This information may be important to understandings of likely trends in tax-collecting performance.

On the first score, an understanding of whether SARS is bringing more citizens who should be paying tax into the system – or merely widening the net in response to changes in legislation – would give us some idea of its capacity to bring new sections of society into the tax system rather than solely or largely relying on extracting more from those already in the system, or on implementing legislative changes.

On the second, the issue of race and compliance is important considering South Africa's history of tax payments. An examination of the racial profile of new taxpayers could shed light on new patterns of compliance in a country that has taxed widely but granted representation narrowly. The history of taxation in South Africa coincides with the racialised historical patterns of exclusion from, and inclusion in, the formal economy. Most white participants in the formal economy are middle- to high-income earners, schooled in a culture of compliance.⁷ It is only in the post-apartheid period that large-scale formal economic opportunities have opened up to the black majority. While a highly skilled new black elite has developed, the bulk of the new black entrants to the formal economy are matriculants whose pay scales are still at the bottom end.⁸ This could be a plausible hypothesis for explaining why 57 per cent of new tax entrants since 1998 only pay SITE, and may indicate that black South Africans are increasingly becoming part of the tax-paying public in a way that does not yet require them to relate directly to the revenue-collecting authority by submitting returns. Whether this form of incorporation into the tax system indicates any changes in new taxpayers' approach to citizenship is a question for further research. It would throw new light on whether, if at all, the regular payment of tax enhances citizens' belief that they need to meet obligations to the state – and demand rights and services from it in return.

During the same period (1998-2002) companies registered increased by 40 per cent. The treasury has helped SARS to widen the tax base for companies by drafting legislation

⁶ The 43 per cent of the taxpaying public who earn more than R60 000, file returns, and pay taxes monthly through PAYE contribute some 78 per cent of all personal income tax.

⁷ Evan Lieberman, National political community and the politics of income taxation in Brazil and South Africa in the 20th century, *Politics & Society*, 29 (4), 2001, 515–55. The perception of high levels of compliance within the white community must be qualified by a widespread perception, which emerged in interviews with specialists, that there were high levels of avoidance due to low level of enforcement from the revenue services during the apartheid years.

⁸ Laura Poswell, The post-apartheid South African labour market – a status report. Development Research Policy Unit (DPRU), University of Cape Town, 2002, p 5.

which closes loopholes in respect of the valuation of insurance reserves. SARS has also increased corporate compliance via several other measures. It has matched data sets from different tax entries by the same company in order to follow up on inconsistencies – this is a result of a computerisation of its tax files through the creation of the New Integrated Tax System (NITS), which allows different databases to speak to each other, serving as an important check and balance on the administrative system. It has also taken steps to ensure that provisional payments are in line with actual profit positions, and has conducted industry-focused audits through special investigative units.⁹ Finally, SARS's intensive self-marketing and use of the media to highlight its successes, as well as shame high-profile tax defaulters, may have had the demonstrated effect of enhancing tax compliance by companies as well as individuals. This is certainly the effect which was intended.

Sources of increased revenue collection

SARS's capacity to raise revenue has indeed varied significantly, depending on the type of tax it has sought to collect.

Gains in efficiency in collecting tax revenue from the corporate sector have been the most impressive. Since 1998 company tax receipts have increased from R22,5 billion to R42,3 billion—an increase of 88,5 per cent, even though the tax rate has remained the same at roughly 30 per cent. However, this figure is not an accurate measure of gains in efficiency, since company profits have increased due to a more robust economy since the mid-1990s.¹⁰ This is provided by noting that company tax receipts during the past three financial years have increased by 60,5 percentage points more than company profits, with an annual efficiency gain, calculated as improvements in collections adjusted to take into account of increased profits, of some 20 per cent on average each year.

Personal income tax collection has improved, but to a lesser degree than corporate tax collection. Since 1998–9 revenue from personal income tax has increased overall by about R12,5 billion. Rough calculations reveal that, in the period 1998–9 to 2000–1, the collection of personal income tax has shown an efficiency gain of about 7 per cent a year.¹¹

⁹ Ibid.

¹⁰ This level of economic growth can partly be attributed to a rapid rise in profits in mining and other export sectors, due to the increase in the price of platinum and the depreciation of the rand. See Ministry of finance, National Budget Review, 2002, p 72.

¹¹ This figure has been calculated by Steven Friedman. He could not calculate the efficiency of personal income tax collection by simply comparing each year's tax returns with those of the previous year, because the revenue available to SARS was reduced by tax cuts and increased by increases in personal income. Therefore, to derive a yearly efficiency gain, starting in 1998–9, he deducted the overall tax cuts from the previous year's income and added the percentage increase in employee compensation. (While there are four types of income for individuals – compensation, dividends, rent, and interest – employee compensation was the only source of information available to us to trace increases in personal income. Dividends are tax-free. Figures from rent from property were not separated out from SARS sources of personal income. The tax from interest has declined significantly as a source of revenue over the last three years as exemptions increased R3000 to R10 000. Finally, the capital gains tax has only been recently introduced and will not really affect the period under review. We are therefore confident that compensation of employees is a reliable measure of personal in-

SARS's collection of value added tax (VAT) has also improved, but the efficiency gain in this area has not been as great as those for the other two taxes, amounting to 10,8 per cent over the same period, or 3,6 per cent on average each year. Here the efficiency gain can be calculated with some confidence. Over the period 1998–2002, VAT collection as a proportion of gross domestic product (GDP) increased by 0,46 per cent, equivalent to about R5 billion.¹² Clearly, if VAT increases as a proportion of the sum of economic activity in society, this must represent an efficiency gain. If that gain is then expressed as a percentage of VAT receipts at the beginning of the period, we are able to generate a measure of efficiency equivalent to that for the other two taxes. Over this period, the rate remained unchanged and there were no changes in exemptions, nor did the number of registered vendors increase significantly. This suggests that a R5 billion increase in revenues from VAT is due to better compliance by existing registered vendors—the result of improvements in enforcement rather than an increase in the number of registered vendors.¹³ Therefore, the gains are not a consequence of an increased SARS penetration of the informal economy.

Reducing the tax gap

How do we explain these differences in SARS's performance? Part of the explanation lies in how SARS has gone about reducing the tax gap. It has anticipated that the returns from its enforcement efforts will wield higher returns if it tackles fewer entities that earn more -- high net worth corporations as well as individuals. Most of the high-income companies that SARS has targeted are located in the corporate sector.

SARS's widening of the tax net by 40 per cent in the corporate sector of tax revenues has not only increased the number of companies from whom revenue can be collected. It has also provided a windfall of information that has helped it to select companies for intensive auditing. SARS has developed 17 special investigative units, several of which concentrate on improving its understanding of the inner workings of selected industries that may be complicit in evasion. For instance, the Woodmead project was set up in 2000 specifically to perform in-depth investigative audits in clusters of industries, such as the music, electronic and banking sectors, in order to deepen SARS's understanding of how they work.

The special investigations initiative has had numerous notable outcomes. First, in just two years, the Woodmead project has brought in R4,6 billion in additional revenue. Second, its experiences in carrying out special investigations and widening the tax net has broadened and deepened SARS's knowledge of the corporate sector in general, which has

come.) Using this method, Friedman derived a crude estimate of an efficiency gain of 7,7 per cent for 1999–2000, 6,4 per cent for 2000–1, and 7,1 per cent for 2001–2. A SARS official has indicated that it includes inflation as part of its efficiency rate in personal income tax collections, resulting in a lower efficiency rate of 1 per cent a year on average. Broken down by year, this is equivalent to 1,3 per cent for 1999–2000, 1,5 per cent for 2000–1, and 0,4 per cent for 2001–2. Personal correspondence with Andrew Fisher, SARS commissioner's office, 30 April 2003.

¹² Calculation by J P Landman.

¹³ Personal correspondence with J P Landman, 25 March 2003.

enabled it to improve its tax collection in other sectors as well.¹⁴ Synthesising information from newly registered corporations with the insights it has gathered through in-depth audits has allowed SARS to reach a behavioural understanding. This, in turn, has enabled it to develop a system for improving corporate enforcement. Besides increased technical efficiency, SARS has been able to rely on a knowledge of the organisations from which it is collecting revenue by building from an existing institutional understanding of how the corporate sector operates.

Third, this knowledge of the daily and seasonal activities of the corporate sector has helped to provide SARS with the information it needs to determine what legislation could tighten enforcement activities. This puts it in a position in its bi-weekly meetings with the national treasury to offer concrete suggestions for legislative changes that can help it to induce compliance in areas where it suspects systematic corporate avoidance and evasion. Fourth, the success of SARS enforcement tactics in certain industries may have had a demonstration effect, encouraging compliance by companies within the same industries despite the fact that these firms were not targeted directly.¹⁵ SARS's improved performance in the corporate sector may also be due to the fact that it is easier to target a number of corporations that operate along similar lines in relation to tax than it is to target a large number of people with very different taxpaying habits.

The knowledge that SARS has acquired about corporate practices may be more difficult to translate into the individual realm, as the information required for understanding individual taxpayer behaviour is varied. SARS's efforts to target high net worth individuals as a means of reducing the tax gap have entailed certain administrative innovations; *inter alia*, it has introduced lifestyle questionnaires to examine discrepancies between tax returns and an individual's standard of living. Another effort has involved setting up a special investigative unit to randomly audit home owners who have recently bought a house worth more than R750 000. SARS has also engaged with the banking sector to track individual non-disclosure of interest on investments.

Despite these efforts to cull new information and increase auditing measures, the nature of the information gathered by SARS may still be too varied and chaotic for it to synthesise in order to analyse individual taxpayer behaviour. Without this analysis it is difficult for SARS to translate information into a patterned set of activities to assist its enforcement strategies for individual tax evaders. However, despite these constraints, the tax practitioner or consultant may constitute an important channel for reducing the impact of these constraints. While practitioners are, at first glance, obstacles to collection since they are required to advise their clients on the most effective forms of avoidance, they also play an important role in enforcement since it is they who serve as a conduit for SARS by passing information to the taxpayer which may influence decisions about compliance – where practitioners become convinced that SARS effectiveness has increased (or, of course, decreased), this will inevitably affect the way in which they advise their clients. Since the use of practitioners probably increases with income level, we may expect them

¹⁴ Personal communication with senior SARS personnel as well as a former auditor of the Woodmead project.

¹⁵ *Ibid.*

to be a channel to the most affluent taxpayers and thus to be an important potential source of increased compliance. The extent to which this is actually happening is not yet known, and is an important area for future research. However, despite the important mediating role played by practitioners, SARS's differential capabilities in understanding individual and corporate taxpayer behaviour presents one plausible explanation of the different efficiency gains for the two taxes.

As noted earlier, the impressive improvement in SARS's performance can also partly be attributed to active collaboration with the national treasury and, through it, the legislature. This is significant in offering an insight into the inner workings of legislative change, and in challenging the view that separation from political intervention is crucial to effective revenue-raising. Political intervention is clearly not always a recipe for effectiveness: where political authorities act to undermine the tax-collecting authority by siding with influential individuals, or interests which do not want effective tax collection,¹⁶ collection capacity will clearly be undermined—SARS has, according to its senior executives, benefited considerably from the absence of this sort of interference from politicians.¹⁷ But SARS's experience shows that, where the political and revenue-raising authorities have a common interest in enhanced collection, their collaboration is an important source of effectiveness.

The government has used legislation in two ways to enhance the state's administrative capacities to collect revenues. First, the national treasury has developed legislation to help SARS widen the tax net. This has not necessarily enhanced performance, as a large proportion of new people entering the tax system are in the low-income strata, and their combined income contributions are therefore marginal. Nevertheless, this widening of the tax net deepens state penetration: besides indicating enhanced government effectiveness generally, this has potential benefits for the tax collecting agency because it may improve its understanding of tax-paying behaviour. The national treasury has also played a role in improving SARS's performance by passing legislation designed to make it easier for SARS to enhance revenue collection. These measures often serve a dual function: they enhance the capacity of the revenue-raising authorities, and also enable the government to be seen to be operating in support of distributive justice. Thus sharp reductions in the fringe benefits which may be extended by companies to avoid tax on employees has prevented firms from using loopholes which make revenue-raising more difficult. But they can also be presented as a means of preventing the affluent from using expense accounts or sports club membership to avoid taxes in ways which are obviously not available to poorer people. The efficiency gains for SARS are complemented by a political gain for the legislature.

However, it is probably inappropriate to see these mutual gains as a symptom of interest calculation by a legislature concerned with political gain, and a revenue collection agency interested in efficiency. The political leadership and SARS senior executives share

¹⁶ Marios Obwona and Abdu Muwonge, Tax reforms, structure and recent trends of revenue performance in Uganda, paper presented at the workshop entitled 'Taxation, aid, and democracy', 2002.

¹⁷ Personal communication with Pravin Gordhan, commissioner of SARS, and Mfundo Nkunlu, general manager for strategy and planning at SARS, 12 March 2003.

a common objective in enhancing revenue collection and closing loopholes, based on a shared set of values, and this common understanding is the root of the mutually supportive collaboration. So revenue collection can be positively affected by an active political role, but only where the political authority shares the revenue-raising agency's interest in compliance. This raises serious doubts about the model which proposes independence from politics as the key to revenue-raising agencies' success: where the political leadership is not committed to the aims of the revenue collecting institution, independence is unlikely to be respected – where it does, mutual support, not independence, is the key to effectiveness.

That said, the evidence does suggest that the overall improvement in SARS's performance has offered significant political gains for the government, enabling it to make some progress towards its stated commitment to greater equity while not compromising its concern for fiscal discipline.

Equity outcomes of tax performance

SARS's performance and the manner in which it has been achieved may have compromised procedural equity – but has prompted distributive equity gains.

The first of these is a shift in contributions to tax. Significantly larger proportions of the state's resources are now being raised from the corporate sector rather than from individuals. Among companies and individuals, the stress on high net worth taxpayers should ensure that the burden of enhanced compliance is borne mainly by the more affluent. This trend may be further strengthened by the fact that tax cuts, while they have benefited higher-income earners too, have been weighted towards taxpayers at the lower end of the income spectrum. The marginal income tax rate has declined from 45 per cent to 40 per cent in the post-apartheid period – this may offer significant benefits to higher earners in the top income bracket, but a large proportion of these income tax cuts have been targeted to benefit the lower- to middle-income earners in an attempt to improve their household savings.¹⁸ Thus the tax floor – the annual income amount below which people do not have to pay income tax – has been gradually increased from R17 000 in 1998 to R30 000 in 2003 -- an increase in real terms of 37,4 per cent over this five-year period—with the aim of reducing the tax burden of the lower- and middle-income strata.

During the same period (1998-2002), legislated tax cuts have led to an 8 per cent (R26,8 billion) decrease in the contribution of personal income tax to total tax revenue. At the same time, the corporate tax rate has remained constant at 30 per cent, but, because of more efficient collection, its contribution to revenue has increased by 7 per cent (R22 billion). These figures suggest a redistribution of the tax contribution from individuals, largely through a reduction in personal income tax, to businesses, through more effective ways of extracting resources from company profits.

A second distributive equity outcome of SARS's improved performance has been that it has enabled the government to improve its social spending, which may work to redistrib-

¹⁸ Ferial Haffajee, *Financial Mail*, 29 February 2003, p 29.

ute wealth. Since 1998 SARS's efforts have increased the fiscus by R67,455 billion, giving the national treasury the space to allocate more resources to the poor; the latter has allocated an 8,5 per cent increase in its non-interest expenditure to social services, moving from 49,8 per cent in 1997--8¹⁹ to 58,3 per cent in 2002--3. While SARS does not decide how the revenue it raises is spent, its performance has allowed the government to increase its social spending within its general commitment to hold down the budget deficit.

These trends raise questions. Mick Moore²⁰ has argued that, internationally, enhanced performance in the delivery of services by states could enhance tax compliance, but this proposition has not been tested in South Africa. Does, for example, the state's attention to providing free lifeline services (water and electricity) persuade the taxpaying public that there is greater merit in paying taxes because the proceeds are likely to benefit the public good?²¹ Further research is required to test whether a public perception of the state as an actor that is administratively capable of enforcement, and politically interested in using increased revenues to address real social challenges, improves taxpayer compliance.

The evidence suggests that tax changes can be redistributive if the political and administrative will exists to ensure that they do have this effect. The politics of revenue enhancement in South Africa rests on the congruity of SARS's goals and those of the national treasury, and the extent to which these agencies collaborate in achieving a measure of redistribution both in collections and in spending patterns. SARS has been able to achieve greater efficiencies because it has been operating in a supportive political environment. This has enabled it to collect revenues through an increasingly progressive tax system as well as secure legislative reforms, which enhance its ability to tackle evasion and avoidance by high earners. To repeat: improvements in tax performance are not about insulating the tax authority from the political arm of the state – rather, they require that the two work towards common goals.

State legitimacy and tax collection

Thus far, this paper has stressed increased technical efficiency as an explanation for SARS's improved performance in raising revenues. But to stress efficiency alone may be to tell only part of the story. It may well be that SARS's tightened enforcement measures have been successful only because they have been able to build on a culture of compliance among taxpayers.

¹⁹ Ministry of finance, *National budget review, 1998*, p 25.

²⁰ Mick Moore, Death without taxes: democracy, state capacity and aid dependence in the fourth world, in M Robinson and G White (eds), *The democratic developmental state: politics and institutional design*, Oxford Studies in Democratisation, Oxford: Oxford University Press, 1998.

²¹ This does not imply an assumption that new money provided for social services is automatically used effectively to benefit the poor or that it is yet clear that providing lifeline services will deliver concrete material benefits to poor citizens. Nor does it endorse the service delivery policies of municipalities, many of whom remain committed to an ideology of cost recovery, which has negatively affected the poor. The question here is not whether official policy and practice offers concrete benefits to the poor but whether the perception that the government is committed to addressing social problems will increase propensity to comply among affluent tax payers.

By some accounts, South Africa has historically been relatively successful in inculcating a culture of compliance among a predominantly white and wealthy minority.²² Comparing South Africa's tax collection culture during the 20th century to that of Brazil, Lieberman has found that South Africa was able to raise significantly more revenues. He attributed this success to the particularities of how the 'national political community' was historically constructed and defined in this country. The reliance on racial solidarity, he argues, influenced the development of class relations, political strategies, and 'ultimately the willingness of upper-income groups to co-operate with state demands for tax payment'.²³ Commenting on Lieberman's analysis, Moore suggests that this level of compliance was due to the fact that rich white South Africans were willing to pay high levels of taxes because they perceived themselves to be a minority under threat. He claims that this constituency believed in financially contributing to the state's capacity through taxes in return for the state's support and defence of their interests.²⁴ While this analysis is open to debate – not least because, as noted earlier (see note 6), there is a widespread perception among tax specialists that apartheid-era tax collection was characterised by high levels of avoidance – it may well be that SARS has been able to build on a set of understandings and values among taxpayers which, while they were developed in another political context, make the affluent more inclined to pay than we might expect. The South African tax authorities developed, over decades, a set of institutional mechanisms to extract money from a compliant affluent minority. This culture of compliance, once embedded, may not have changed despite the fact that the post-apartheid government is no longer committed to advancing the interests of an affluent minority at the expense of the rest of society.

Recent trends in personal income tax returns offer tentative evidence in support of this hypothesis. If we disaggregate personal income tax trends over the past three years, the increase in returns from PAYE is 19,9 per cent, and that for provisional taxes 17,9 per cent. While the 2 per cent difference in performance could, over time, indicate a trend in which provisional tax payments decline as a percentage of the total, at this stage the difference does not seem overly significant particularly if we bear in mind that provisional taxpayers are generally in the upper income brackets and that, although lower-income taxpayers have benefited more from tax reductions in percentage terms, a lower percentage cut for taxpayers at the upper reaches of the system could still ensure that, in absolute terms, their payment levels drop more than those of lower-income people. The precise trend would need further research, but there is no evidence yet of a sharp move in the respective contributions to revenue of PAYE and provisional tax.

If there has indeed been little movement in the ratio between provisional tax and PAYE, this would be highly significant. PAYE and SITE are collected at source, and are

²² Lieberman, National political community and the politics of income taxation in Brazil and South Africa in the 20th century. For the argument that this applies in other parts of the society and endures into the post-apartheid era, see Hlophe and Friedman, ... And their hearts and minds will follow?

²³ Lieberman, National political community and the politics of income taxation in Brazil and South Africa in the 20th century, p 517.

²⁴ Mick Moore, When do the rich willingly pay income tax? IDS, January 2002, p 1, <http://www.ids.ac.uk/gdr/reviews/review-05.html>.

thus outside the control of the individual taxpayer. Provisional tax, by contrast, is paid by individuals who earn a significant portion of their income through self-employment, and who thus have a greater degree of latitude to avoid declaring all their income. Most of the taxpayers who pay provisional taxes are middle- or upper-middle-class professionals who can hire tax advisers to help them avoid tax. Compliance with paying provisional tax thus depends on a decision by the taxpayer (strongly influenced or determined by the consultant), and is far more dependent on decisions to comply or not to do so. Even given its improved efficiency, SARS's capacity to enforce compliance is more limited in this area. This is an area, therefore, where the taxpayer can show resistance to the state – or merely a desire to enhance personal income at the expense of the fiscus – by not complying, and run a smaller risk of being caught. This also means that, if provisional taxes have not declined as a proportion of personal income tax, this sector of the taxpaying population is complying without being directly compelled to do so. While much research is still needed to understand taxpayers' motives, this would suggest that decisions are motivated to a degree by a pre-existing culture of compliance.

There is however, a danger that SARS's increased efficiencies, partly achieved through aggressive enforcement tactics, may have negative procedural equity implications, and threaten to undo any goodwill it has accrued through its efficiency increases. Until recently, SARS's approach to the taxpayer has been to assume that she or he is guilty until proven innocent when it comes to irregularities in tax assessments. This approach is embedded in tax legislation that has increasingly favoured SARS over the taxpayer through the 'pay now, explain later' proviso; section 36 of the Income Tax Act empowers SARS to enforce payment of an amount before the individual or business has had the opportunity to appeal against the claim in court.²⁵

A second point that constrains the ability of the taxpayer to defend him- or herself against faulty tax assessments is that there is simply insufficient administrative legal capacity within South Africa to do so. Should a case against SARS move beyond the tax court to the constitutional court, the tax issue moves into the realm of administrative law. Few tax lawyers are sufficiently trained to defend their client's case in this realm, whereas SARS has the resources to hire a battalion of appropriately trained legal administrative experts. This creates an inequality in ability to access and interpret the law. If elite taxpayers cannot defend their rights against SARS, there are far greater challenges for average taxpayers with meagre resources to be able to leverage the legal capabilities to defend their case when they have been wrongly assessed by SARS. In short, the average taxpayer can hardly afford to contest an assessment by SARS.²⁶ Part of the social contract with the state is that in agreeing to pay taxes, the citizen must have access to the vehicles

²⁵ For example, in 2002 SARS assessed Metcash for the payment of VAT and obtained a judgement against it even though Metcash claimed the assessment was faulty. Metcash took SARS to court, but the court ruled that SARS had the right to recover the VAT and that the provisions of the VAT Act were not unconstitutional. In the recent Singh case, however, the 'pay now, argue later' right has been overturned since the court ordered that SARS can no longer obtain judgement against a taxpayer without first providing an assessment. See *Sowetan*, 08/04/2003.

²⁶ Personal communication with Judge Dennis Davis, 17 February 2003.

of justice for holding the state accountable. SARS's well deserved institutional legitimacy may reach its threshold through growing non-compliance, if its aggressive enforcement tactics are perceived by the public to be applied unfairly to individuals who have no recourse through the justice system.²⁷ SARS has begun to address these issues, but has admitted that it remains a significant challenge to ensure both equity and efficient collection.²⁸

To sum up, SARS has made significant strides over the past few years in both widening the tax net and reducing the tax gap. The reasons for this improved performance are varied and complex, and have much to do with SARS's internal restructuring processes. One result of this restructuring that stands out is its increased capacity to extract resources from the corporate sector. Part of this success has been through the deepening of SARS's understanding of corporate taxpayer behaviour, which has allowed the institution to steer compliance more effectively. By targeting specific industries for in-depth audits, SARS has gained insights into the inner workings of how these sectors operate within the formal economy. The question is whether this impressive performance has been the consequence of direct enforcement or the result of demonstration effects. Clearly, SARS's intent is to reduce the cost of enforcement by increasing the demonstration effect of the cases with which it chooses to go to battle. Nevertheless, its acquisition of insights into corporate behaviour, sustained over time, can build the institutional knowledge and set of practices that can improve the enforcement of the tax laws, thereby inviting uncoerced compliance. Further research may show that the trade-offs of tax evasion are no longer worth it considering the punitive measures enforced by SARS, should corporations choose not to comply and be caught.

The gains made to date have predominantly focused on the formal economy. The challenge remains for SARS to take its investigative techniques into the informal areas of the economy in order to understand the possibilities and limits of expanding the state's extractive capacity. This has been the area least explored by SARS, and is illustrated by the lack of new VAT registrants over the last four years - the most likely area for SARS to gain an insight into informal sector activities. One of the difficulties SARS may encounter in trying to understand informal economic activities is that the benefits for a participant in the informal economy in choosing not to comply might far outweigh the incentives for complying. This is a problem that faces revenue-raising authorities in most if not all sub-Saharan countries, and in this area - if not in any others - SARS's performance is characterised far more by its similarities with other countries on the continent than by the differences. If revenue-raising is to begin to penetrate those vast reaches of South African economic life beyond the formal economy, SARS has much work to do, both in understanding this complex and vital sector of the economy, and in learning how to ensure that those who operate within it join the tax-paying citizenry.

²⁷ SARS has addressed this inequity. A complaints office has been set up in Pretoria to respond to growing concerns about administrative difficulties in dealing with changes to the tax laws. This office is also beginning to handle a dispute resolution process that will permit taxpayers to negotiate with the revenue service, rather than going to court.

²⁸ Interview with Pravin Gordhan, commissioner of SARS, 12 March 2003.