

Research Summary #6 - The Power of Politics: The Performance of the South African Revenue Service and Some of its Implications

By Laila Smith (2003)

This paper forms part of a five year research programme under the Centre for the Future State, based at the Institute of Development Studies. Below is a summary of principal findings. Further details are available at www.ids.ac.uk/gdr/cfs/index.html

Introduction

This paper explores what lies behind the success of the South African Revenue Service (SARS) in substantially increasing tax revenue between 1998 and 2002. A major finding is that, contrary to received wisdom which advocates increasing the autonomy of revenue authorities, political support, and shared values and objectives between government and the revenue authority may in fact be a precondition for enhancing the latter's performance. The paper also raises concerns that aggressive enforcement by SARS, which has contributed to its success in increasing revenue, may have been at the expense of upholding taxpayers' rights, and that this could undermine compliance.

Analysing SARS' Performance

SARS' success is in part attributable to increases in technical efficiency. It widened the tax net, increasing the number of individuals registered for income tax by 43% between 1998 and 2002, and the number of companies registered by 40%. It also increased compliance by legislating to close loopholes, and by other measures such as the computerisation of tax files to allow better identification of inconsistencies in corporate tax entries. The biggest revenue increases have come from the corporate sector, with efficiency gains (i.e. over and above increases due to growth in profits) of 20% a year between 1998 and 2002. Efficiency gains from personal taxpayers amounted to 7.7% a year; and gains from VAT were 3.6% a year. There were no significant increases in registrations for VAT, suggesting that there was little increased penetration by SARS of the informal economy.

What Factors Contributed to SARS' Success?

The paper identifies three main factors: Firstly, SARS adopted a strategy of targeting high net worth companies and individuals. Seventeen special investigative units were set up to conduct intensive audits of selective industries. These not only increased revenue, but gave SARS an in-depth understanding of corporate behaviour and practices. This led to improved enforcement efforts, and informed the design of legislative changes. SARS' successful enforcement activities may have had a demonstration effect which encouraged compliance by companies within the same industry, even though they were not directly targeted by SARS. Gaining an understanding of individual taxpayer behaviour has been more problematic, but the paper suggests that tax practitioners can be an important channel of communication, and can influence compliance. Secondly, despite much recent emphasis on the importance of autonomy for revenue authorities, a major factor in the success of SARS appears to have been a supportive political environment, and close working relations with the National Treasury – which allowed SARS, for example, to get proposals for legislative changes accepted. SARS does enjoy a measure of administrative autonomy which is important in protecting it

from political interference in day to day decisions. But it has also enjoyed political support: SARS senior executives and the political leadership (including the legislature) share common values and objectives. In particular, increased revenues have allowed government to raise spending in the social sectors without increasing the fiscal deficit, and thus to address the legacy of apartheid without compromising fiscal discipline. Thirdly, in addition to improving technical efficiency, SARS was able to build on an existing culture of tax compliance. This may have had its origins in support by affluent White South Africans for the apartheid state; but a culture of compliance seems to have survived the political transition, suggesting that it is embedded and may not be directly linked to approval of state policies (this issue is explored further in other components of the Centre for the Future State research – see for example, summary #7 “Sending Them a Message: Culture, Tax Collection and Governance in South Africa”).

Equity Outcomes

SARS’ success in increasing revenue has contributed to gains in distributive equity, including a more progressive tax system, with a shift in the burden of taxation towards the corporate sector, and relief for taxpayers on lower incomes. Redistribution has also taken place through increases in social sector spending of 8.5% between 1998 and 2002. But the aggressive enforcement measures adopted by SARS, including an assumption of guilt when it comes to irregularities in tax assessments, may be compromising procedural equity, and risks undermining the culture of compliance. A dearth of expertise in administrative law adds to the difficulty of mounting a successful challenge to a faulty assessment, putting taxpayers’ rights in jeopardy. SARS has started to address the issue but it remains a significant future challenge. SARS has as yet done little to extend its reach into the informal sector. Although the potential revenue gains may be modest, incorporating a large number of citizens into a formal relationship with the state based on taxation could be politically significant, as well as reassuring those paying tax that the burden is fairly shared.

Conclusion

This paper looks at revenue-raising as a political and social issue, as well as a technical issue. It highlights the importance of understanding the basis of compliance; and it shows that revenue collection can be enhanced by an active political role – but only where the political authority shares the revenue authority’s interest in compliance. This raises serious doubts about the autonomous agency model: where the political leadership is not committed to the goals of the revenue agency, its independence is unlikely to be respected; where it is committed, mutual support rather than independence is the key to effectiveness.