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**SOCIAL PROTECTION SERIES POLICY BRIEF #2**

# FINANCING OPTIONS FOR A UNIVERSAL BASIC INCOME GUARANTEE IN SOUTH AFRICA

## 1. INTRODUCTION

It is within the context of structural unemployment, deep poverty, and inequality that a Universal Basic Income Guarantee (UBIG) is being put forward. The latest Quarterly Labour Force Survey (QLFS) from Statistics South Africa (Stats SA) illustrated this deepening unemployment crisis, with 7.2 million people unemployed.<sup>1</sup>

Despite this, apart from the COVID-19 Social Relief of Distress (SRD) Grant that ended in April 2021, most individuals aged between 18 and 59 in South Africa are currently without any form of state income support,<sup>2</sup> with the main exception being those receiving disability grants. A UBIG would close this gap in the social security system but is not the only change needed. The Child Support Grant (CSG), which is already implemented in South Africa, falls below the Food Poverty Line (FPL). It is also necessary to increase the CSG if eliminating food poverty is deemed a priority.

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Since the merits of a UBIG have already garnered significant attention and discussion, the focus of this Policy Brief is to summarise the financing proposals needed to ensure the implementation and sustainability of a UBIG. This Policy Brief serves as a supplement to an [earlier Policy Brief on UBIG](#) published by the IEJ in March 2021 as well as a summary of [further research](#) produced for the IEJ by DNA Economics. The estimates provided below are therefore updated and revised from the IEJ UBIG Policy Brief released in March 2021. Some of these, and accompanying text and tables, are drawn directly from the DNA Economics research referred to. This is not presented as quotations as the DNA Economics research is considered background research to serve as an input into this brief.

Table 1 details the total annual cost of a UBIG for targeted groups by different levels of monthly payments. The amounts are based on the National Poverty Lines measured by Stats SA and they are chosen because of their direct linkage to poverty reduction.<sup>3</sup> Two higher allocations, R2 500 and R3 500, are included for illustrative purposes. It is unlikely that all eligible people will self-select into receiving the grant, so uptake scenarios of 80% and 60% are included in the calculations. Informal sector workers are included because of the precarity and vulnerability which characterises this group. The not formally employed (NFE) group includes the unemployed, those not in the labour force (for example, caregivers), and informal sector workers. Lines 2, 3 and 7, and their associated costing, are noted as being most relevant.

**Table 1: Total annual cost of UBIG at different levels (R billion)**

GROUPS (18 – 59)	NUMBER OF PEOPLE	FPL (R585 PM)	LBPL (R840 PM)	UBPL (R1268 PM)	R2500 PM	R3500 PM
All	34.1m	239	343	519	1 023	1 432
All (80%)	27.3m	192	275	415	818	1 146
All (60%)	20.5m	144	206	311	614	859
Informal Workers <sup>4</sup>	2.5m	18	25	38	76	106
Unemployed <sup>5</sup>	11m	78	111	168	332	464
NEA <sup>6</sup>	13.4m	94	135	203	401	561
NFE <sup>7</sup>	22.4m	157	226	341	672	940

Note: The Food Poverty Line (FPL), Lower-bound Poverty Line (LBPL), and Upper-bound Poverty Line (UBPL) listed are from 2020.<sup>8</sup> Updated poverty lines should be used when determining the cost in the short to medium term.<sup>9</sup>

The proposals to finance the UBIG focus on tax increases as a form of revenue generation. Often, when tax increases are proposed, it is met with resistance followed by rebuttals around the high tax “burden” in South Africa. It is important to recognise that those in the middle of the income distribution have experienced negative growth in earnings over time,<sup>10</sup> and that the growth in income has been disproportionately captured by the top income percentile.<sup>11</sup> However, legitimate concerns around the “middle-class squeeze” are often used to shield top earners. The financing proposals therefore aim to remove or limit fiscal measures that currently disproportionately benefit the wealthy, thus promoting greater redistribution.

Table 2 on the next page shows a summary of the financing options. The options are grouped according to category.

**Table 2: Summary of financing options**

	2022/23 (billions)	2023/24 (billions)	2024/25 (billions)	NOTES
<b>INCOME TAXES</b>				
Social Security Tax (SST)	R67.29	R69.10	R70.97	<ul style="list-style-type: none"> <li>• 1.5% of taxable income for income between R0 and R80 000 per annum;</li> <li>• 2% of taxable income between R80 000 and R350 000 per annum;</li> <li>• 2.5% of taxable income between R350 000 and R1 million per annum;</li> <li>• 3% of taxable income more than R1 million per annum.</li> </ul>
Resource Rent Tax	R38.80	R38.40	R38.30	Assuming a tax that can extract 25% of the Natural Resource Rent value in South Africa in line with Ghana and Zambia.
Selective removal of pension fund contribution deduction	R22.04	R22.64	R23.25	Removal of deduction for those with taxable income of more than R1 000 000 per annum.
Selective removal of Medical Aid Tax Credit	R6.03	R6.23	R6.36	Removal of tax credit for main member & main dependent for those with taxable income > R500 000 per annum.
Dividends Tax	R7.70	R8.10	R8.60	Increase rate from 20% to 25%.
<b>CONSUMPTION TAXES</b>				
Implementing a Luxury VAT	R8.41	R8.78	R9.17	25% VAT rate on luxury goods.
Increase in Excise duties	R3.36	R3.56	-	14% annual increase; temporary measure.
Carbon Tax	R2	R2	R2	Increase to one-quarter of EU standard.
<b>WEALTH AND PROPERTY TAXES</b>				
Wealth Tax	-	-	R59	1% tax rate for top 1% and 3% tax rate for top 0.1%. Evasion rate of 30% and 20% stock depreciation assumed.
Estate Duty Tax	R1.79	R1.87	R1.93	<ul style="list-style-type: none"> <li>• Estates valued between R3.5 million and R30 million are taxed at a rate of 36%.</li> <li>• Estates valued between R30 million and R146.89 million are taxed at a rate of 41%.</li> <li>• Estates above R146.89 million are taxed at a rate of 45%.</li> </ul>
Currency Transaction Tax <sup>12</sup>	R3.68	R3.75	R3.88	0.005% tax on all onshore currency transactions.
Securities Transfer Tax (STT)	R1.37	R1.41	R1.45	Increase rate from 0.25% to 0.3%
Financial Transaction Tax (FTT)	R41	R41	R41	0.1% tax rate.
<b>REMOVAL OF CORPORATE TAX BREAKS</b>				
Reduce profit shifting of MNCs	R5.75	R5.75	R5.75	Target of 25% reduction.
Cancel Employment Tax Incentive (ETI)	R4.8	R4.93	R5.06	
Reverse Corporate Income Tax (CIT) reduction proposal	R7.6	R8.2	R8.2	Reverse proposed reduction of CIT from 28-27%.
<b>REDUCE WASTEFUL AND IRREGULAR EXPENDITURE</b>				
Reduce irregular expenditure	R36.4	R42.5	R48.5	Target of 30% of R121.3 billion, reported by Auditor-General in 2021.
Reduce wasteful expenditure	R1.85	R1.85	R1.85	A further 2.7% reduction of R68.4 billion spent on "General Public Services".
<b>TOTAL</b>	<b>R259.87</b>	<b>R270.02</b>	<b>R335.27</b>	
Recouped via VAT	R24.2	R24.85	R25.52	12% of total expenditure on UBIG. Average provided, but this depends on amount of UBIG. See table 24.

## 2. INCOME TAXES

Income taxes refer to taxes on both personal and corporate income.

### 2.1 SOCIAL SECURITY TAX

The introduction of a Social Security Tax (SST) is one of the primary mechanisms that can be used to finance a UBIG. This tax is a ring-fenced tax on income, dedicated to financing an extension of social security. It aims to operate in a similar fashion to Unemployment Insurance Fund (UIF) contributions, and consideration should be given as to whether employers and workers each contribute 50% towards this tax. The proposal is for the SST to be progressively levied upon all income earners – ranging between 1.5 to 3% of taxable personal income. The tax revenues collected should be ring-fenced to provide funding specifically for a UBIG. Importantly, all those who earn below the R350 000 will receive more from the UBIG than they contribute in terms of the SST, therefore they will be net beneficiaries. Higher income earners, by contrast, will be net contributors.

The following rate structure is proposed:

- 1.5% of taxable income between R0 and R80 000 per annum;<sup>13</sup>
- 2% of taxable income between R80 000 and R350 000 per annum;
- 2.5% of taxable income between R350 000 and R 1 million per annum; and
- 3% of taxable income more than R1 million per annum.

Table 3 shows the tax revenue for 2022/23 when various SST rates are applied to the respective income brackets. Without considering the elasticity of taxable income (ETI), a total of R68.24 billion can be raised using the proposed rate structure. The tax base is calculated by increasing 2020 taxable income by the same rate as the Treasury's forecast of national compensation of employees.

**Table 3: SST options by income bracket for 2022/23 (R billion)**

EARNINGS (R)	NUMBER OF TAXPAYERS	TAXABLE INCOME	1.50%	2%	2.50%	3%
0 - 80k	6 822 326	230.8	3.46	4.62	5.77	6.92
80k - 350k	4 927 667	957.7	14.37	19.15	23.94	28.73
350k - 1m	1 910 855	1073.7	16.11	21.47	26.84	32.21
1m +	307 912	626.1	9.39	12.52	15.65	18.78

Source: Own calculations based off IEJ Policy Brief. 2021. Introducing a Universal Basic Income Guarantee for South Africa.

Table 4 shows that even if low-income earners were to contribute in the form of the SST, they would still be net beneficiaries of the UBIG. For example, someone earning

R7 000 may contribute R1 050 but receive a benefit of R7 020 or R10 080 (depending on the level of the UBIG), thus ensuring a net benefit.

**Table 4: Net benefit / contribution for SST by income**

EARNINGS PER YEAR	35 000	70 000	150 000	250 000	340 000	500 000	1 000 000
SST rate (%)	1.5%	1.5%	2.0%	2.0%	2.0%	2.5%	3.0%
SST tax paid (R)	525	1 050	3 000	5 000	6 800	12 500	30 000
Total UBI received (R585 pm)	7 020	7 020	7 020	7 020	7 020	7 020	7 020
Net benefit / contribution	6 495	5 970	4 020	2 020	220	-5 480	-22 980
Total UBI received (R840 pm)	10 080	10 080	10 080	10 080	10 080	10 080	10 080
Net benefit / contribution	9 555	9 030	7 080	5 080	3 280	-2 420	-19 920

Source: Own calculations

From an administrative perspective, introducing the SST is easily implementable since the tax base is already identified under the current tax system.

Some argue that earmarking limits fiscal flexibility by reducing the discretionary portion of the budget, which is argued to decrease the state's ability to deal with economic cycles. Earmarking, however, is beneficial since the increase in taxes directly and transparently results in the use of state expenditure for redistributive purposes.

The earmarking of taxes for specific public expenditure is argued to create increased stability in funding. It has also been shown to be a tool for strengthening the welfare state, as was the case in post-war Britain when the National Health Service (NHS) was introduced.<sup>14</sup>

Research indicates a non-negligible ETI<sup>15</sup> of 0.4 in South Africa.<sup>16</sup> This means that income will decrease by 1.4% when personal income tax rates are raised. Fortunately, the ETI is low, and the impact of an increase in the average

income tax rate is consequently marginal. Taking ETI into account decreases potential revenue by only 1.4%, that is, if revenue equals R100 when assuming ETI of zero, an ETI of 0.4 only decreases revenue by R1.40. The small difference is likely due to inelastic demand for labour, especially at the higher end of the income spectrum.

Table 5 summarises a forecast of the potential revenue that could be collected through an SST, considering an ETI of 0.4. The tax base is calculated by increasing 2020 taxable income by the same rate as the Treasury's forecast of national compensation of employees.<sup>17</sup>

**Table 5: SST Revenue Potential**

Additional revenue		
2022/23 (billions)	2023/24 (billions)	2024/25 (billions)
R67.29	R69.10	R70.97

Source: Own calculations using DNA Economics. 2021. *Universal Basic Income Guarantee: Financing options analysis and IEJ Policy Brief*. 2021. *Introducing a Universal Basic Income Guarantee for South Africa*.

## 2.2 RESOURCE RENT TAX

A Resource Rent Tax (RRT) is an additional tax levied on the economic rent of extractive industries. This tax is about how to redistribute the gains of booms within extractive industries while at the same time preserving the incentives for investors. An economic rent is produced by firms when firms price outputs at levels greater than which is necessary to cover their inputs and a required profit margin, that is, 'that portion of value-added which exceeds the costs of all

the factors of production, including the required return on capital'.<sup>18</sup> The economic rent is essentially an additional profit arising from factors beyond the firm's influence. The resource tax therefore, by definition, will have no impact on investment decisions as it will theoretically only be levied on the portion of profit above the investors' required rate of return.<sup>19</sup> In South Africa, a Resource Rent Tax would be particularly relevant given the presence of highly extractive and privatised sectors such as mining.

In 2012, an African National Congress (ANC) Policy discussion document comprehensively reviewed options for South Africa to increase the developmental impact of the mining industry, including a RRT. While the ANC's report is specific that the RRT revenue should be used to fund a Sovereign Wealth Fund, which will 'invest in long-term projects and instruments', there is precedent for revenues from such a fund being used for a citizens' dividend, such as in the case of Alaska.<sup>20</sup>

A RRT could be levied on any of the following:<sup>21</sup>

- **The price of the resource.** This approach is not popular given that commodities prices are volatile.
- **Profitability of the resource-based company.** This approach requires that profits are defined ex-ante, and taxes are then levied on changes in such profits.
- **Link tax rates to the return on resource-based investment.** Key features of such an approach include:
  - The tax base being the resource project (that is, fully ring-fenced);
  - A threshold rate of return on investment is specified at which the RRT would apply; and
  - A specified rate is applied to net profits.

Various versions of the RRT are already applied in several countries. Table 6 summarises a few examples:

**Table 6: Classification of rent taxes across the globe<sup>22</sup>**

TAX BASE	BASIS FOR TAX RATE
REVENUES	(Price level) <ul style="list-style-type: none"> <li>• China – oil sales taxed at 20% if the oil price &gt; \$40/bbl rising to 40% &gt; \$60/bbl</li> <li>• Zambia – copper sales taxed at 25% once copper &gt; \$2.5/lb rising to 75% &gt; \$3.5/lb</li> </ul>
	(Period) <ul style="list-style-type: none"> <li>• New South Wales – oil sales taxed at 6% starting in year 6 of a project and rising by 1% to 10% in year 10.</li> </ul>
PROFITS	(Price level) <ul style="list-style-type: none"> <li>• Alaska – oil profits taxed at 25% until oil price exceeds \$30/bbl., thereafter rising by 0.4% for every \$1/bbl &gt; \$30/bbl</li> </ul>
	(Output level) <ul style="list-style-type: none"> <li>• Uganda – company share of profit oil is 50% @ low output falling to 15% @ high output</li> </ul>
	(Annual profit margin) <ul style="list-style-type: none"> <li>• Botswana – mine profits taxed at the higher of 25% or 70-1500/x, where x (%) = taxable income/gross income</li> </ul>
	(Annual return on capital) <ul style="list-style-type: none"> <li>• Olympic Dam copper-uranium mine – after-tax profits taxed at 0% to 15% depending on return on capital employed in that tax year.</li> <li>• Bougainville copper-gold mine – after-tax profits taxed at 70% once return on capital base exceeds 15%</li> </ul>
	<b>Project rate of return (Resource Rent Tax)</b> <ul style="list-style-type: none"> <li>• Timor Leste RRT – pre-tax oil profits taxed at 22.5% once project IRR &gt; 16.5%.</li> <li>• India – company share of profit oil is x% @ IM &lt; 1.5 falling to y% @ IM &gt; 3.5, where IM = ratio of cumulative Net Income to Total Investment.</li> </ul>

Source: DNA Economics. 2021. *Universal Basic Income Guarantee: Financing options analysis*.

Accurately identifying the rent portion of the profit is a significant hurdle. If this can be overcome, an RRT is a strong option.

Although the data required to estimate the revenue impact of applying an RRT is unavailable, natural resources rent amounted to 3.9% of GDP in 2019 for South Africa (or R 202 billion).<sup>23</sup> Because natural resource values are so volatile and the tax-base impact of imposing a resource rent tax is not explored in the literature, forecasting these amounts is extremely difficult. However, naïve forecasts suggest that the value of resource rents could fluctuate between R150 and R160 billion between 2022 and 2025.<sup>24</sup>

Assuming a tax rate of 25% on the value of total resource rents,<sup>25</sup> the potential revenue generated from a resource rent tax could be as follows:

**Table 7: Resource Rent Tax**

Additional revenue		
2022/23 (billions)	2023/24 (billions)	2024/25 (billions)
R38.80	R38.40	R38.30

Source: DNA Economics. 2021. *Universal Basic Income Guarantee: Financing options analysis.*

## 2.3 SELECTIVE REMOVAL OF PENSION FUND CONTRIBUTION DEDUCTION

The pension fund contribution deduction allows individuals to lower their PIT tax contributions. This deduction disproportionately benefits individuals at the upper end of the income distribution who would otherwise be able to comfortably save for retirement without having to rely on the saving incentive. The rationale for this deduction is to redistribute income across individuals' lifecycles, that is, incentivise individuals to make sufficient provision for retirement.<sup>26</sup> However, some research has shown that tax breaks for retirement fund contributions regressively benefit higher-income individuals and, therefore, 'reduce the overall progressivity of the personal income tax system'.<sup>27</sup> The proposal is to remove the retirement fund contribution deduction for individuals who earn above R1 million per annum.

South Africans can deduct up to 27.5% from their income up to a maximum of R350 000 based on their annual contributions to retirement funds. If you exceed the 27.5% contribution limit, the excess may be rolled over to reduce tax liability in future years. In this way, the more an individual tops up their retirement contributions for the tax year, the greater the tax deduction over the individual's lifetime.<sup>28</sup>

**Table 8: Selective removal of retirement fund contribution deduction (taxable income > R 1 000 000)**

Increase in income tax revenue		
2022/23 (billions)	2023/24 (billions)	2024/25 (billions)
R22.04	R22.64	R23.25

Source: DNA Economics. 2021. *Universal Basic Income Guarantee: Financing options analysis.*

Importantly, although pension fund contributions are deductible, the pension benefit is still taxed if it exceeds the annual tax thresholds. The effective tax rate is, however, still lower than the income tax rate due to the lower tax rate on the lump-sum amount withdrawn. Thus, if the deductible is removed and the benefit is taxed, the income is first taxed as part of income and then again as part of the pension benefit,<sup>29</sup> albeit at a lower rate. It would, therefore, be right to only tax the capital gained, not the capital invested – an administratively burdensome requirement. An alternative would be to reduce, rather than remove, the tax benefit. Using this approach, the benefit could be reduced progressively across a sliding scale of incomes – that is, the more you earn, the lower the benefit. This may have two advantages: mitigating the risk of double taxation, and not introducing sharp discontinuities in the tax structure; the latter referring to a large change in the taxation of income when one reaches a particular income threshold. While these alternative approaches would reduce the revenue intake, this would still be significant.

## 2.4 SELECTIVE REMOVAL OF MEDICAL AID TAX CREDIT

A medical aid tax credit is a rebate that allows taxpayers to reduce the taxable income payable if they contribute toward a private medical aid scheme for themselves and their dependents. Currently, medical aid policyholders (that is, the main member) receive the following tax credits:<sup>30</sup>

- R332 per month for the taxpayer; or
- R332 per month for the taxpayer's main dependent; and
- R224 per month per dependent after that.

The proposal is to remove the medical aid tax credit for the main member and first beneficiary for individuals earning above R500 000 per annum as they can absorb the medical aid's full cost. The tax credit will remain in place for individuals beyond the first two members. This is to ensure that individuals who support and subsidise larger networks are not unduly financially constrained. Since medical aid tax credits are administered through SARS, the removal of the credit is easily implementable.

South Africa has a health system characterised by inequality – the public sector spends two-thirds of what the private sector does while serving nearly four times the population.<sup>31</sup> While it is true that the tax credit may relieve pressure on the public health sector by allowing individuals who, without it, would not be able to afford medical aid, this is not true at the higher income levels. Therefore, an important aspect of this option is that those from which the tax credit is removed should not have to abandon their private medical aid. If this does happen, removing the credit will inevitably add pressure to the public health sector – something it can ill-afford. This underpins the R500 000 threshold, ensuring that the system still supports individuals at the lower end of the income distribution, although the threshold could be set differently.

Taxpayers who earn more than R500 000 p.a. receive an average of R730 per month as a medical aid tax credit.<sup>32</sup> That is equivalent to each taxpayer having 1.2 dependents. Therefore, if the credit is removed from only the taxpayer and the taxpayer’s main dependent, this would only increase tax expense paid by 9%.<sup>33</sup> One option is provided in Table 9 – an elimination for only the main members and first dependent – with the second option being the suggested one. Both apply to main members for taxable income above R500 000.

**Table 9: Selective removal of Medical Aid Tax Credit (taxable income > R500 000)**

Decrease in tax spending (Only main member and first dependent)		
2022/23 (billions)	2023/24 (billions)	2024/25 (billions)
R6.03	R6.23	R6.36

Source: Own calculations

## 2.5 IMPACT OF TAX CHANGES ON THE EFFECTIVE TAX RATE

The proposals above will have a combined impact on the tax paid, and effective tax rate levied, on different brackets of income earners. This is shown in Table 10, illustrating the before and after impact of the three proposed changes to income taxes. Two examples are illustrated: a scenario where an individual earns R500 000 per annum and a scenario where an individual earns R1 000 000 per annum. The retirement fund contribution is given as 7.5% of total income.<sup>34</sup>

If all three proposals are implemented, then the effective rate changes between 4 and 7 percentage points. If only the SST is implemented then this increases the effective rate by 3 percentage points.

It is important to highlight that disposable income after the tax proposals is approximately 14 times higher than the national minimum wage, for those earning R1 000 000.

Furthermore, although the proposals result in a significant increase in the effective tax rate, this should be seen within the context of a historic downward trend in effective tax rates over the last two decades in South Africa.<sup>35</sup> The proposals, therefore, are a way of partially compensating for tax breaks for high-income earners. If only an SST is implemented, then the effective tax rate increases by 3 percentage points for both income categories.

**Table 10: Pre and post effective tax rates**

DEDUCTIBLES	R500 000 annual income		R1 000 000 annual income		IF ONLY SST IS IMPLEMENTED			
	Before	After	Before	After	Before	After	Before	After
Retirement Fund contributions								
Taxable income								
Medical Aid Tax Credit								
SST								
PIT tax	-101 221	-121 689	-279 669	-348 387	-101 221	-113 721	-279 669	-309 669
Effective tax rate	20%	24%	28%	35%	20%	23%	28%	31%
Annual disposable income	361 279	340 811	645 331	576 613	361 279	348 779	645 331	615 331

Source: Own calculations based on National Treasury (2021) Budget Review.

## 2.6 DIVIDEND TAX

A dividend tax is a tax levied on the dividends issued by companies. The tax base is simply the pool of all dividends issued by local companies to permanent and non-permanent residents, and by foreign companies to permanent residents.

It is estimated that an increase in the dividends tax rate from 20% to 25% will result in approximately R7.7 billion of additional revenue. In response to a tax rate hike, companies might be inclined to decrease dividend disbursements favouring building up retained earnings.

This process shifts some of the dividend tax base to the capital gains tax base as the increased retained earnings increases company value leaving increased room for investment and consequently growth and employment. The degree to which such a shift will occur and its impact on the different tax bases is unclear and often ambiguous in the literature.

Since the tax base is already identifiable, the increased rate is easily implementable. Potential revenue is calculated by growing baseline dividends tax revenue by forecasted GDP and increasing this by a fixed proportion representing the increase in the tax:<sup>36</sup>

**Table 12: Change in dividends tax (2014/15 – 2018/19)**

R MILLION	2014/15	2015/16	2016/17	2017/18	2018/19
Dividends tax	21 247.29	23 934.23	31 129.89	<b>27 894.32</b>	29 898.04
% Change		0.13	0.30	<b>-0.10</b>	0.07
% GDP	0.0056	0.0059	0.0090	<b>0.0060</b>	0.0061
% Revenue	0.0193	0.0196	0.0242	<b>0.0206</b>	0.0207

Source: Own calculations using data from Budget Review Chapter 4 (2015 – 2020)

## 3. CONSUMPTION TAXES

As the name implies, consumption taxes are taxes imposed upon various goods or services that are consumed by either businesses or the general population.

### 3.1 IMPLEMENTING A LUXURY VAT

A luxury VAT is a sales tax placed on goods and services that are considered accessible only to the wealthiest. A good or service is defined as luxury when at least 70% of its consumption is from the top 10% of income earners. The rationale for this option is its progressive revenue-raising potential. Generally, VAT is a regressive type of taxation, but by applying an increased tax rate only on luxury items, the problem of regressivity is circumvented. A comprehensive list of luxury items would need to be formulated to implement this proposal.

There is a precedent for applying an additional tax on

**Table 11: Revenue generation potential of increasing dividend tax rate from 20 to 25%**

Additional revenue		
2022/23 (billions)	2023/24 (billions)	2024/25 (billions)
R7.70	R8.10	R8.60

Source: DNA Economics. 2021. Universal Basic Income Guarantee: Financing options analysis.

A previous change in dividends tax, from 15% to 20%, came into effect on 22 February 2017. There is a significant percentage increase prior to the policy change and a negative impact thereafter, as can be seen in Table 12. Although it begins to increase again in 2018/2019, this value is still below the 2016/2017 level. This alone implies a behaviour change as a result of the tax increase. It is important to note that when dividends are calculated as a percentage of GDP or government revenue, the percentages are still higher after the tax increase than before its implementation. The decrease in dividends therefore might be related to the economic climate rather than purely a behavioural change. If this is put forward as one of the proposals, then other additional measures might need to be put in place to mitigate any potential unintended impact of raising the dividends tax.

luxury items in middle income countries. India charges a 28% Goods and Services Tax (GST) on small cars, consumer durables such as air-conditioners and refrigerators, premium cars, and high-end motorcycles. Their standard GST rate is 18%. Chile adds 15 percentage points to their VAT rate for a range of luxury items. Thailand charges an excise duty ad valorem rate of up to 40% on vehicles, motorcycles, and cosmetic products. South Korea focuses their surcharge on the imports of luxury items adding a special excise tax of 10 to 20 percentage points on luxury item imports.

The proposal is to implement a VAT rate of 25% rather than 15% on luxury goods.<sup>37</sup> Using the consumption



data from the Living Conditions Survey, luxury goods were identified when 70% or more of expenditure on a particular item is spent by decile ten or more than 90% by deciles eight to ten. An additional VAT was applied to these goods assuming that consumption spending increases at the rate of CPI (2022/23 - 4.3%, 2023/24 - 4.4%, 2024/25 - 4.4%); the price elasticity of demand is -0.4; and the price increase of luxury items is 8.7% (the entire tax is transferred to the price).

**Table 13: Revenue generation potential of imposing a 25% luxury VAT on selected items**

Additional revenue		
2022/23 (billions)	2023/24 (billions)	2024/25 (billions)
R8.41	R8.78	R9.17

Source: DNA Economics. 2021. Universal Basic Income Guarantee: Financing options analysis.

Applying differential VAT rates can be administratively burdensome. However, South Africa already applies such a system and adding a third rate should only have a marginal impact on the administration. The most significant challenge will be to correctly identify the goods, that is, those for which the demand will not decrease to such a degree that it decreases total VAT income. Therefore, the aim would be to choose those non-essential goods for which elasticity is lowest.

### 3.2 INCREASING EXCISE DUTIES ON HARMFUL PRODUCTS

Excise duties, or “sin taxes”, are implemented to discourage the purchase of harmful products.<sup>38</sup> However, because their demand tends to be insensitive to price, these taxes are also resilient sources of state revenue. Despite the considerable pushback from the industry, these tax rates have been increased yearly, making such an increase straightforward to implement.

The biggest problem with these duties is, however, their regressive impact. The tax is disproportionately placed on

the poor. Moreover, the potential revenue generation is relatively small. An increase to excise taxes can therefore be seen as a short-term and temporary policy while other mechanisms, such as a wealth tax, come into effect.

The assumptions used for the calculation are as follows:

- Excise duties tax rates increase by 14% (double the average annual rate);
- A baseline 7% increase is assumed;
- The quantity demanded remains unchanged; and
- Excise duties average 0.85% of GDP, the historical buoyancy between GDP and excise duty revenue.

**Table 14: Revenue generation potential of increasing excise duties by 14% (double the baseline average)**

Annual increase of 14% in excise duties		
2022/23 (billions)	2023/24 (billions)	2024/25 (billions)
R 3.36	R 3.56	R 3.77

Source: DNA Economics. 2021. Universal Basic Income Guarantee: Financing options analysis (earlier draft).

### 3.3 CARBON TAX

South Africa ranks as the number one most carbon-intensive non-oil producing developing country.<sup>39</sup> Research shows that the average per capita emissions for the top decile of South African households is almost four times greater than the national average.<sup>40</sup> This proposal suggests a way to reduce carbon emissions through the imposition of higher carbon taxes. The proposal entails increasing carbon taxes to one quarter of the European Standard, which is estimated to bring in additional income of R2 billion. Although increased carbon taxes is presented as one of the many ways to generate additional revenue for financing a UBIG, some have argued that carbon taxes should be specifically ring-fenced for investment in sustainable energy production and environmental protection. It should also be noted that carbon taxes remain one, fairly limited, tool in reducing carbon emissions.

## 4. WEALTH AND PROPERTY TAXES

In addition to earning personal and corporate income, people and businesses also hold stocks of wealth, receiving income therefrom. They also benefit from the transaction associated with this wealth. Taxes upon such are grouped under this section.

### 4.1 WEALTH TAX

In South Africa wealth inequality is higher than income inequality, with 10% of the population owning 90-95% of the wealth.<sup>41</sup> Despite this high prevalence of wealth inequality, wealth remains largely untaxed. Income and consumption taxes alone ignore individuals who hold substantial wealth while having little taxable income.<sup>42</sup>

A high concentration of wealth, as is the case in South Africa, decreases the mobility of wealth and therefore restricts its productive use in society.<sup>43</sup> A wealth tax is therefore highlighted for its redistributive outcomes and revenue generation potential.

According to the 2021 Budget Review, SARS will focus on consolidating wealth data for taxpayers through

third-party information.<sup>44</sup> Although data is still a constraint, assessing the feasibility of a wealth tax is gradually gaining traction which is promising in comparison to the previous failure by government to take concrete steps in this regard. The implementation of a wealth tax will take time since current data collected is insufficient to track wealth ownership. While a wealth tax is not an immediate tool to finance UBIG, it does show significant potential as a viable funding mechanism in the medium to long-term.

Table 15 shows how much revenue could be generated from a wealth tax set between 1 and 5%, using a wealth tax simulator.<sup>45</sup> An evasion rate of 30% and a stock depreciation rate of 20% are assumed.<sup>46</sup> The stock depreciation rate is a parameter which accounts for the negative economic impact of the pandemic as well as the anticipated negative impact the wealth tax might have on financial asset prices.<sup>47</sup> The wealth tax would therefore only apply to individuals earning above the wealth threshold stated in Table 15.

**Table 15: Wealth Tax**

GROUP	THRESHOLD	1% TAX (billions)	3% TAX (billions)	5% TAX (billions)
Top 1%	R3 665 000	R31	R93	R155
Top 0.1%	R27 314 000	R14	R42	R69

Source: IEJ calculations based on wealth tax simulator by Chatterjee, Czajka and Gethin

## 4.2 ESTATE DUTY TAX

Estate duty is levied on property upon, and usually paid by the executor of, the deceased's will. It is currently taxed between 20 and 25%. These rates are lower than the tax rate the recipient would pay if this income was received as personal income (that is, below PIT rates), particularly for higher income earners. Having a tax rate on property which is lower than the tax rate on PIT allows for increasing asset accumulation and widening wealth inequality over time. The skewed distribution of wealth indicates an opportunity for a substantial increase in the progressivity of the tax. Currently, the following differentiated rates are applied to estates:<sup>49</sup>

- 20% of estates between the value of R3.5 million and R30 million, and
- 25% of estates above the value of R30 million.

The proposal is to adapt the tax rates to align with the top three marginal income tax rates and the wealth categories as described:

- Estates valued between R3.5 million and R30 million are taxed at a rate of 36%;
- Estates valued between R30 million and R146.89<sup>50</sup> million are taxed at a rate of 41%; and
- Estates above R146.89 million are taxed at a rate of 45%.

A wealth tax of 1% for the top 1% and a wealth tax rate of 3% for the top 0.1% is proposed. This will generate **R59 billion** in revenue.

Often, liquidity concerns are raised as an objection to wealth taxation. However, the rates proposed here should account for that. For example, a person who has a net worth above R3.7 million is likely to be able to pay R40 000 in wealth taxes per annum. When it comes to ultra-wealthy individuals, that is, the top 0.1%, it is argued that they often organise their own illiquidity in a manner that allows them to pay less income tax.<sup>48</sup> A wealth tax would therefore reduce the concentration of wealth and ensure greater fairness across the tax system by not allowing the ultra-wealthy to pay relatively less taxes.

The upper bound is provided in Table 15 to illustrate the extent of our ability to eradicate poverty, but a moderate tax structure is recommended to reduce liquidity concerns.

**Table 16: Revenue generation potential of altering estate duty brackets**

Tax revenue		
2022/23 (billions)	2023/24 (billions)	2024/25 (billions)
R1.79	R1.87	R1.93

Source: DNA Economics. 2021. Universal Basic Income Guarantee: Financing options analysis.

As can be seen, the impact on revenue is small. This is because estate duty tax contributes relatively little to total revenue, so even significant changes to the tax rates do not raise very large sums.

Including a maximum inheritance could enhance the revenue potential. In this case, the inheritance above a certain threshold would be taxed at 100%. It is, however, difficult to estimate how much of a difference this would make. Nevertheless, with or without a cap, increasing the progressivity of this tax instrument would enhance equity and bring tax on intergenerational wealth transfers more in line with taxes on other forms of income.

## 4.3 CURRENCY TRANSACTION TAX

A Currency Transaction Tax (CTT) is a tax on any transactions in which the buying and/or selling of foreign

currency for domestic currency are involved. The CTT can be collected at the point of settlement. While derivatives instruments may be used to try and evade the tax, this is not feasible on a large scale, as the derivative market cannot effectively operate in isolation. The tax would only apply to all transactions with the primary goal of raising revenues and reducing intraday volatility. South Africa does not currently have a CTT.

The proposal is a CTT of 0.005% on all over-the-counter foreign exchange (FX) rate instruments. These would apply to spot transactions, outright forwards, foreign-exchange swaps, currency swaps and foreign-exchange options. It is estimated that, at this rate, changes in spreads and transaction volumes would be trivial while revenue-raising potential would still be meaningful.<sup>51</sup>

The table shows a R3.68 billion per annum estimate of the potential revenue collected if South Africa implemented a CTT of 0.005% on all domestic over-the-counter foreign exchange (FX) rate instruments. A daily turnover of USD72 Billion is assumed, of which 16% occur domestically. These assumptions are based on data from the Bank of International Settlements (BIS, 2019). We assume that the turnover grows by 2% per annum, an USD/ZAR exchange rate of R14.00, and a price elasticity of currency trade of  $\epsilon=-5$ .<sup>52</sup>

**Table 17: Revenue generation potential of imposing a currency transaction tax of 0.005%**

Revenue raised		
2022/23 (billions)	2023/24 (billions)	2024/25 (billions)
R3.68	R3.75	R3.88

Source: DNA Economics. 2021. Universal Basic Income Guarantee: Financing options analysis.

## 4.4 SECURITIES TRANSFER TAX (STT)

An STT is a tax on the transfer value (sale/transfer/assignment/cession amount) of a securities transaction on the securities of a company listed on any securities

exchange in South Africa.<sup>53</sup> The current STT is set at 0.25% on all security transfers. The recommendation is to increase the tax rate to 0.3%. Because the tax base is already identified and all entities trading securities in South Africa must register on a South African stock exchange, the policy shift will be easy to implement.

Apart from the revenue-raising potential, the rationale for an STT is based on the argument that an STT decreases market volatility by curbing short-term, unproductive, and speculative trading. Of course, the decrease in speculative trading decreases the potential tax revenue, but this is to the benefit of the market.

In order to estimate the potential tax revenue from increasing the tax rate (five basis points), we assume a decrease in line with what has been observed in China where a five basis point increase was accompanied with a decrease in trade volume by 6.4%.<sup>54</sup>

**Table 18: Revenue generation potential of increasing securities transfer tax from 0.25 to 0.3% per transaction**

Additional revenue		
2022/23 (billions)	2023/24 (billions)	2024/25 (billions)
R1.37	R1.41	R1.45

Source: DNA Economics. 2021. Universal Basic Income Guarantee: Financing options analysis.

Opponents of an STT argue that an STT or an increase in the STT rate increases rather than decreases market volatility. This is because the increased transaction costs decrease market liquidity, which increases the bid-ask spread and, thereby, volatility.<sup>55</sup>

The most appropriate response to this ambiguity is to lower the tax rate but increase the tax base, that is, include a broader set of financial transactions. Table 19 sets out the value of trades across a wide range of financial instruments traded on the JSE.<sup>56</sup> It also shows the revenue potential of implementing a Financial Transactions Tax (FTT) with a rate of 0.1% on all types of financial transactions of the value traded in the final column (R40.1 billion p.a.).

**Table 19: Potential tax base for broad FTT (Millions)**

MARKET	INSTRUMENT	WEEK ENDED 28 MAY 2021	FULL-YEAR ESTIMATE	FTT OF 0.1%
Equity market	Central Book and Reported Trades	R2 314.5	R5 470.5	R5.5
Interest rate market	Bonds	R14 002.2	R33 096.2	R33.1
Interest rate derivatives market	Futures	R593.6	R1 403.1	R1.4
	Options	R0.5	R1.3	R0.001
Commodity derivatives market	Futures	R419.0	R990.4	R1.0
	Options	R2.6	R6.2	R0.01
<b>TOTAL</b>		<b>R17 332.5</b>	<b>R40 967.7</b>	<b>R41.0</b>

Source: DNA Economics. 2021. Universal Basic Income Guarantee: Financing options analysis.

This revenue is included in the analysis but it is important to note some caveats. The imposition of the FTT will impact the tax base by reducing the number of transactions available to be taxed, that is, elasticity is negative. Although empirical studies estimate the elasticity, we do not know by how much the tax would

increase total transaction costs and cannot, therefore, reliably estimate the actual revenue potential. Although this makes estimating the tax difficult, reducing such transaction may be beneficial overall, due to a reduction in market speculation. An in-depth study would be required to improve on the above calculations.

## 5. REMOVAL OF CORPORATE TAX BREAKS

Corporations receive various tax deductions. These are either legal, and planned, for example tax deductions for hiring young people, or unplanned and potentially illegal, for example, profit shifting. The former are supposed to incentivise perceived positive behaviours. However, the effectiveness of these should be reviewed periodically and removed if they are not serving their stated purposes so that they do not simply become an unwarranted subsidy to businesses.

### 5.1 REDUCE PROFIT SHIFTING OF MNCs

Profit shifting is when companies shift payments and strategies from jurisdictions with higher tax rates to jurisdictions with lower tax rates, thus resulting in less revenue for the state. The recommendation is to reduce profit shifting by Multinational Corporations (MNCs) at a target of 25%. Although this is an important aspect of strengthening the tax system, it is not deemed a short-term solution for revenue collection because of the complexities in identifying firms which are involved in profit shifting and the capacity that needs to be built in order to achieve this reduction. This proposal will create an additional estimated R5.75 billion of revenue.<sup>57</sup>

Table 20: Reduction of profit shifting of MNCs

Additional revenue		
2022/23 (billions)	2023/24 (billions)	2024/25 (billions)
R5.75	R5.75	R5.75

Source: Own calculations based on Torslov, Weir and Zucman. 2018.

### 5.2 CANCEL EMPLOYMENT TAX INCENTIVE

The Employment Tax Incentive (ETI) was introduced in 2014 to address the high rate of youth unemployment by decreasing the cost of hiring young employees. There is insufficient evidence to suggest that the ETI did fulfil its objective of increasing youth employment.<sup>58</sup> The ETI acts as a subsidy in the form of a tax credit to firms that already

hire young workers. Scrapping the ETI is administratively easy as the current beneficiaries of the ETI are already identified under the tax system. This proposal will free up at least R4.8 billion in 2022/23.

Table 21: Cancel ETI

Additional revenue		
2022/23 (billions)	2023/24 (billions)	2024/25 (billions)
R4.8	R4.93	R5.06

Source: Own calculations based on National Treasury 2021 Budget Review.

### 5.3 REVERSE THE PROPOSED REDUCTION IN THE CORPORATE INCOME TAX (CIT) RATE

During the 2021 Budget Speech,<sup>59</sup> a reduction in the CIT rate from 28 to 27% percent was announced. While there is a meagre increase in social grants (below food inflation) because of alleged financial constraints, private companies are being offered additional benefits at the expense of reducing the deficit and strengthening long-term welfare. Using 2021/22 CIT revenue in the 2021 Budget Review, a reduction of the CIT rate from 28 to 27% percent equates to a R7.6 billion tax break for corporations collectively. CIT was considerably lower in 2021/22 compared to levels prior to the pandemic. As the economy hopefully bounces back, the tax break for corporations is thus estimated to be larger than R7.6 billion per year. For the 2023/24 financial year, we assume that corporate income resembles what it was in 2019.

Table 22: CIT estimated losses

	2022/23	2023/24	2024/25
Estimated corporate income (billions)	R761	R821	R821
Proposed tax rate by NT	27%	27%	27%
Amount lost to businesses (billions)	R7.6	R8.2	R8.2

Source: Own calculations based on National Treasury 2021 Budget Review

The justification behind reducing the CIT was prompted by reductions in the US and UK.<sup>60</sup> However, given the climate of austerity, allowing big corporations to benefit from tax cuts while failing to provide adequate support for the poorest individuals during a humanitarian crisis is particularly abhorrent. Further, there has been a global shift away from this tax “race to the bottom”. There is no serious effort to set an international minimum corporate tax rate to reduce incentives to not pay corporate income taxes under jurisdictions

where rates are higher. The global minimum CIT has been proposed at 15%.<sup>61</sup> This is expected to bring in an additional £600 million (R11.9 billion) for South Africa.<sup>62</sup> While efforts to set a national minimum rate are welcomed, it should be noted that a higher minimum threshold of 25% and 30% would allow South Africa to gain an additional £3 (R59 billion) and £4.3 billion (R85 billion), respectively.<sup>63</sup> The design of such a measure is also critical and the current proposal has been widely criticised for benefiting wealthier countries.<sup>64</sup>

## 6. REDUCE WASTEFUL AND IRREGULAR EXPENDITURE

Unfortunately, it has become well documented that the South African government is misspending funds. However, not all irregular and wasteful expenditure is corruption. Irregular expenditure refers to expenditure that is non-compliant with relevant legislation in place to manage the processes leading up to that expenditure. This could occur due to corruption, or simply because departments or municipalities don’t have the skills necessary or rigorous processes in place to follow the sometimes complex requirements. Fruitless and wasteful expenditure is expenditure which was made in vain and would have been avoided had reasonable care been exercised. Given these definitions, we focus on reducing only a portion of this expenditure.

### 6.1 REDUCE IRREGULAR EXPENDITURE

It is important to recognise wasteful and irregular expenditure under the current fiscal system, which if adequately addressed, could fund pro-poor policies. Irregular expenditure by national and provincial departments was reported by the Auditor General for 2020 to be R54.3 billion.<sup>65</sup> This value excludes irregular expenditure by Transnet and Eskom of R56 billion and R11 billion, respectively.<sup>66</sup> Reducing irregular expenditure by a target of 30% at national

and provincial departments and SOEs will free up R36.4 billion per year. This figure is likely to be underestimated because of incomplete and unknown amounts of irregular expenditure.<sup>67</sup> Assuming that total irregular expenditure in the medium-term will resemble current reported values, by progressively increasing the reduction in irregular expenditure over time, the potential additional revenue from this proposal will increase over the medium-term. Below is an illustrative suggestion of how the targeted clawback can be increased every year.

Table 23: Reduction of irregular expenditure

	2022/23	2023/24	2024/25
Total irregular expenditure ( <i>billions</i> )	R121.3	R121.3	R121.3
Targeted reduction (%)	30%	35%	40%
Revenue freed up ( <i>billions</i> )	R36.4	R42.5	R48.5

Source: Own calculations based off Auditor General of South Africa. 2021 and Opperman. 2021.

### 6.2 REDUCE WASTEFUL EXPENDITURE

Reduce Cabinet size, departmental duplication, expenditures on conferences, travel, and overall wasteful expenditure. The previous IEJ policy brief suggested a

reduction in “General Public Services” by 5%.<sup>68</sup> Between 2020 and 2021, expenditure on “General Public Services” decreased by 2.3% to R68.4 billion. Although the decrease in wasteful expenditure is promising, a further reduction by 2.7% will free up an additional R1.85 billion.

## 7. RECOUPMENT VIA VAT

Since the lowest spending 70% of the population spends 81% of disposable income on VAT-related items, around 12% of UBIG expenditure will be recouped back into the fiscus via VAT. Table 24 assumes 80% of disposable income is spent on VAT-related items and shows the amounts recouped for different levels and groups of the UBIG.

**Table 24: VAT recoupment amounts for different categories of UBIG expenditure (R billion)**

GROUPS (18 – 59)	NUMBER OF PEOPLE	FPL (R585 pm) (R billion)	LBPL (R840 pm) (R billion)	UBPL (R1268 pm) (R billion)
All	34.1m	28.7	41.2	62.3
All (80%)	27.3m	23.0	33.0	49.8
All (60%)	20.5m	17.3	24.7	37.3
Informal Workers <sup>69</sup>	2.5m	2.2	3.0	4.6
Unemployed <sup>70</sup>	11m	9.4	13.3	20.2
NEA <sup>71</sup>	13.4m	11.3	16.2	24.4
NFE <sup>72</sup>	22.4m	18.8	27.1	40.9

Source: IEJ Policy Brief. 2021. *Introducing a Universal Basic Income Guarantee for South Africa.*

## 8. OVERALL AFFORDABILITY

The above financing scenarios consider direct financing from tax revenue, without considering additional financing from borrowing. When VAT and tax measures are considered, a UBIG at the FPL, LBPL, and UBPL in almost all scenarios, becomes more easily affordable.

As Table 25 below shows, 17 of the UBIG scenarios at the FPL, LBPL, and UBPL highlighted in green - are immediately affordable without borrowing, with revenue of R250bn. When VAT collection is considered, an additional scenario is affordable in the short-term as noted by the asterisk. In the long-term (highlighted in purple), because of the redistributive potential of

a wealth tax, it is possible to lift 60% of adults to the UBPL. The potential of poverty eradication is significant, although expansion in social security should also entail an increase in the CSG to at least the level of the food poverty line. If the revenue generated from a wealth tax is considered together with VAT recoupment, then a BIG for the adult population at the LBPL becomes feasible.

**Table 25: Feasible options**

GROUPS (18 – 59)	NUMBER OF PEOPLE (millions)	FPL (R585 pm) (R billion)	LBPL (R840 pm) (R billion)	UBPL (R1268 pm) (R billion)	R2500 pm (R billion)	R3500 pm (R billion)
All	34.1	239	343*	519	1023	1432
All (80%)	27.3	192	275*	415	818	1146
All (60%)	20.5	144	206	311	614	859
Informal Workers <sup>73</sup>	2.5	18	25	38	76	106
Unemployed <sup>74</sup>	11	78	111	168	332	464
NEA <sup>75</sup>	13.4	94	135	203	401	561
NFE <sup>76</sup>	22.4	157	226	341*	672	940

Source: Own calculations based off IEJ Policy Brief. 2021. *Introducing a Universal Basic Income Guarantee for South Africa.*

## 9. CONCLUSION

This Brief has put forward several financing options for the implementation of a UBIG. The array presented is not necessarily a package, allowing for further consideration and subsequent selection. While this Policy Brief's purpose was to unpack the financing options, the urgency of the moment, in addition to the longstanding persisting patterns of poverty and inequality, need to be echoed.

A UBIG is an immediate solution to mitigating the most extreme levels of poverty. A further Policy Brief looking at the impact of a UBIG on poverty, inequality, and macroeconomic indicators will be released by the IEJ, further elaborating on the merits of expanding social services. Since there are a number of pathways to ensure the financing of UBIG, its implementation now rests on the political will to immediately address the most extreme levels of poverty.

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# 10. NOTES

1. Statistics South Africa. 2021. Media Release: QLFS Q1 2021.
2. 'Income support' is used in place of the more commonly used term 'social grants'.
3. Poverty Lines are contested internationally. The allocations provided in Table 1 do not constitute a dignified or living wage, but they are still a viable mechanism for addressing the depth of poverty.
4. This refers to informal sector workers only (not domestics, precariously employed etc.)
5. Expanded definition
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68. General Public Services include public administration and fiscal affairs; executive and legislative organs; and external affairs
69. This refers to informal sector workers only (not domestics, precariously employed etc.)
70. Expanded definition
71. Not Economically Active
72. Not Formally Employed
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