An analysis into improving the negative distortion of VAT on income-based equity

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ABSTRACT

Taxes are used by governments around the world to generate government revenue. The most important principle of taxes is that they should be fair to taxpayers and taxpayers should pay tax in accordance with their income earning levels. Taxes are structured in a manner that allows citizens to pay in accordance with what their income earning levels are, promoting equity and fairness. Value-Added Tax (VAT) is a consumption tax that is used by over 200 countries around the world and is paid on consumption, the more you consume, the more tax you pay. This places an unfair burden on taxpayers as it does not consider the taxpayer's ability to afford the tax, which is determined by their income. The way VAT is levied and paid by taxpayers creates a negative distortion on income -based equity for different households.

The purpose of this study is to evaluate VAT around the world by selecting three distinct countries, namely South Africa, New Zealand, and France. The study provides an evaluation and comparison of the relief provisions provided by the different countries' VAT models and additional government relief provisions to alleviate the burden placed by VAT on different households. A qualitative research method with a focus on the literature review was applied in this study, existing literature reviewed included but was not limited to Tax Acts, studies performed on VAT and other publications on government's social development programmes. The study shows that relief provisions provided by the various VAT models do not improve the impact VAT has on income-based equity between the different households, it only reduces the burden of the tax in certain instances. Various government social development programmes are more sustainable in terms of improving the negative distortion of VAT on income-based equity as they consist of income redistribution programmes that have a positive impact on the income-based equity of the different households.

The study concludes that when VAT is in existence, it will always create a negative distortion on income-based equity and the different exclusions and provisions on certain goods and services do not address or improve the negative distortion. Income redistribution programmes are an effective way for government to address or improve the negative distortion and is proven to be the most effective way according to literature reviewed in this study. It is important to provide a quantitative analysis of this fact and further research on the quantitative effects of VAT exclusions and income redistribution programmes on income-based equity could provide a more conclusive understanding of the relationship between income-based equity and the different relief provisions evaluated in this study. Further research is likely to provide a better comprehension of VAT exclusions and the effects for both taxpayers and the various governments.

Keywords: Value-Added Tax, income-based equity, zero-rating, income redistribution, Value-Added Tax distortion, social development programmes, Goods Sales Tax

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List of Abbreviations

EU	European Union
GDP	Gross Domestic Product
GST Act	Goods and Services Tax Act No. 141 of 1985
GST	Goods and Services Tax
OECD	Organisation for Economic Co-operation and Development
VAT Act	Value-Added Tax Act No. 89 of 1991
VAT	Value-added Tax

Chapter 1: Introduction

1.1. Background to the research area

Value-added tax (VAT) or goods and services tax (GST), as applicable to some countries, was introduced by German industrialist Wilhelm Von Siemens in the 1920s as an idea. It was not until 1954 that VAT was formally introduced in France by Maurice Laure, who was the joint director of the French tax authorities (Charlet & Owens, 2010). Taxes on sales have been in existence for centuries, dating back to 2000 BC (Fox, 2002) and since the early 20th century VAT has been adopted by over 200 countries worldwide and contributes over 20 percent of worldwide tax revenue (James, 2011).

Despite the name, VAT is not intended to be a tax on value-added goods as such, but to be a tax on consumption. This has resulted in differing opinions over the distortion caused by this tax in different sectors of the economy (Ebril *et al.*, 2001). Prior to the introduction of VAT there were other taxes limited to defined products, i.e., excise taxes, sin taxes and other types of consumption taxes. Worldwide pressure to raise revenue prompted the introduction of VAT as a revenue generating tax that is clearly defined and could be collected during all points of production (Ebril *et al.,* 2001*).*

Taxes are meant to raise funds for government to provide goods and services to a country's citizens. Taxes assist with the distribution of income, because for most tax types, high income earners pay higher taxes when compared to low-income earners (Howell & Tanzi, 2001). VAT is a consumption tax and individuals pay the same amount of tax, based on consumption, this causes a distortion in the income distribution effects of the tax, particularly on households.

Globally, there are two main groups of countries in terms of the implementation and application of VAT. There are countries that have a VAT model based on the European and French Model and countries that have implemented a different VAT model (Charlet & Owens, 2010). The French and European Model, which is followed by most countries who are members of the European Union (EU), apply several reduced rates to ensure that the standard rate is limited. The main reason for the different rate structure was to ensure that the poorest households are not negatively affected by the tax on goods and services that form part of their main expenditure (Charlet & Owens, 2010).

Interestingly, some countries in the EU group apply a higher rate of tax to luxury products which are accessible by higher income earning households as a mechanism to create equal distribution of benefits from this tax (Charlet & Owens, 2010). The tax applied in this model has been met with higher administrative costs for businesses and government. Many EU countries began seeking alternative rates or models to lessen the administrative burden, whilst ensuring that the poorest of households are not affected by this. This has seen a few EU countries moving towards a single standard rate system (Andrejovská & Mihóková, 2015).

The second group of countries apply a broad-based VAT with a single rate (Charlet & Owens, 2010). Applying a single rate, entails that all goods and services are levied VAT at a standard pre-determined rate. Countries included in the second group are, but not limited to Australia, Canada, New Zealand, Korea, Singapore, and most developing African countries, including South Africa. South Africa implemented a VAT model in 1991 that resembles the New Zealand VAT model. To alleviate the impact of taxes on the poorest of households and to encourage economic investment, zero-rating was introduced in South Africa's VAT model. Zero-rating refers to a zero rate of tax being levied on certain goods and services (Ebril *et al*., 2001), particularly essential household goods of which the poorest of households spend most of their income on when compared to high income earning households as the absence of these provisions can result in the tax creating income distribution distortions for households.

1.1.2. Overview of VAT in South Africa

South Africa introduced VAT at a rate of 10 percent in 1991 to replace the previously used General Sales Tax. The main aim as evident in all countries that adopted VAT was to increase government revenue in a policy led manner (Go *et al.,* 2004). The VAT rate was increased to 14 percent in 1993 and further increased to 15 percent on 1 April 2018. In South Africa, VAT is levied on the supply of goods and services as well as the importation of any goods and services. Exported goods and services are however mainly zero rated with some exceptions. The government views VAT as a dependable broad-based revenue source and data has shown that the VAT base is broad and is steadily increasing (OECD, 2021).

When VAT was introduced in South Africa a list of basic food products that are zero-rated was included in the legislation, which has been reviewed and expanded with more products over the years, to lessen the burden on the poorest of households. The introduction of VAT was to increase government revenue and to lessen the administrative burden on the government and businesses. However, there were concerns over its ability to contribute to revenue as General Sales Tax did previously. Over the past years VAT has proven to hold its position as the second largest revenue contributor after income taxes (National Treasury, 2022). Globally it is also one of the largest revenue contributors in governments that have implemented VAT in their tax structure (Mooij & Swistak, 2022).

This form of tax, however, comes with a lot of controversies as a lot of policy makers and political structures have questioned the income distribution effects of the implementation of VAT. Some have called it regressive in nature (Jansen *et al.*, 2012). A regressive tax is a tax applied uniformly, taking a larger percentage of income from low-income earners than from middle- and high-income earners as all taxpayers pay the same amount of tax, regardless of their income (Tax and Transfer Policy Institute, 2016). This type of tax therefore has an impact on lower income earning households. South

Africa is a country that has a severe political history, and this is one of the main reasons that South Africa has an unequal distribution of income and wealth (IMF, 2020). It can therefore be seriously argued that taxes should assist with the redistribution of income.

Regressive taxes create inequality in the distribution of income amongst households as all households tend to pay the same amount of tax, regardless of their income earning levels. Regressive taxes are widely rejected by political structures within the country and VAT has been under scrutiny for several years (Jansen *et al*., 2012). The government has tabled and accepted proposals to improve the administration and implementation of VAT over the years, thus encouraging studies over this form of tax.

1.1.3. Literature review of the topic/research area

Literature on VAT, as discussed below, indicates that countries have tried to improve and simplify VAT as a form of tax for years and to address all controversies or concerns over this form of tax. Some of the key issues that were addressed were the rate applied for this form of tax, the neutrality in the implementation of VAT and the administrative burden brought on by the implementation of VAT. Literature reviewed for the purposes of this research, has focused on specific regions, and has explored this tax on a broad aspect of identified issues. Some of the most prominent studies identified in the literature review, pertaining specifically to the shortcomings of the implementation of VAT are discussed in the next few paragraphs.

The Organisation for Economic Co-operation and Development (OECD) has considered the impact of the implementation of VAT and has published articles that provide guidelines on issues faced around the world. These issues are, but not limited to, the VAT impact on exports, the neutrality of VAT and the much-needed reform or improvements for VAT. Owens (2011) mentioned the need to improve VAT systems and performance in countries and stated that certain countries that have implemented VAT are considering improving their VAT models to improve the revenue generating ability of the tax and to tackle the current inefficiencies arising as a result of its implementation. This urges the need to evaluate the inefficiencies faced by the different countries and identify common themes. Furthermore, in another article, the different VAT systems applied in a country were considered and it was determined that the existence of multiple VAT rates will affect the efficiency of a VAT system and will increase complexity (Charlet & Owens, 2010). Keen and Lockwood (2010) *e*xplored the causes and consequences of VAT and how its adoption has proven to be an effective form of taxation. They argue that the introduction of VAT has led to governments improving the tax ratio as VAT has become a large source of revenue contribution for countries that have chosen to adopt VAT. It was determined that countries that have adopted VAT have gained a more effective tax instrument. This was however less apparent in sub-Saharan Africa due to the complexities in the implementation of this form of tax on the region’s economic and political climates.

Samimi (2011) explored the impact of implementing VAT on the export of goods and services in selected countries and it was determined that the impact of VAT on exports is positive in all four countries. This indicates that there are areas of VAT that have proven to yield positive reform to some tax systems and these systems could be analysed further for evaluation into other aspects of the tax.

Another study published in the journal of development studies by Alavuotunki *et al.* (2019) examined the effects of VAT on revenue and inequality across different regions in the world. The findings of the study have indicated that VAT has been able to generate government revenue for countries that adopted VAT in the earlier 1970s. It further argued that how the concept of inequality is measured affects the observed effects of VAT on inequality. When inequality is measured on disposable income, inequality increased when VAT was adopted but when inequality is measured on a consumption basis then VAT adoption does not increase inequality. This study was conducted on a macro level analysis, and it would be beneficial if country level studies are performed on the distortive effects of VAT, taking into consideration the income earning levels of each country.

Kearney (2003) published research on the analysis of general equity in South Africa and how South Africa can restructure its VAT structure to achieve economic equity when consideration is given to the South African context and the landscape of literature concerning the implementation of VAT. The research considered feasible options that could be applied by the government, including lowering the tax rate, zero rating food items and the zero rating of financial services. Kearney (2003) argued that poverty, inequality, and unemployment are realities within South Africa and that one of the options in which these can be addressed is policy intervention, of which one is the restructuring of VAT. This research is focused on the South African landscape and solutions derived from an analysis of government revenue, the Gross Domestic Product (GDP) and policies South Africa implemented to achieve equity. This indicates that there is an ongoing issue with the achievement of general equity in South Africa and the income distribution distortion caused by VAT.

Jansen *et al.* (2012) published a paper on the effect of zero-rated basic foodstuffs. The paper highlighted the importance of exemptions and zero-rating and how it can help avoid a regressive tax. Vegetables were used to conduct an analysis that compared the relative burden of VAT on vegetables for various income groups and whether zero-rating in South Africa is appropriately targeted. The paper concluded that zero-rating is not an effective solution to the equity concerns, but it is currently an option that can be improved. This indicates that there are options that can be explored by the country to ensure that VAT is a more progressive tax that promotes fairness and equity. A progressive tax is where the tax paid as a percentage of income increases as the taxpayer's income increases. When a tax is progressive, high-income earners pay a higher tax rate when compared to low-income earners (Tax and Transfer Policy Institute, 2016).

From the above it is deduced that there might be a lack of research into the comparison of VAT rates or models applied by different countries when compared to South Africa and how they achieve fairness and equity for the poorest of households. Studies concerning the policies and legislation regarding South Africa's VAT model have concluded on the regressive nature of the tax and how the poorest of households benefit from the zero-rating provisions of the model, however the high-income earning households benefited more (Jansen *et al.*, 2012). This results in an unequal benefit and burden derived from the tax. Furthermore, studies conducted in other countries, particularly developed countries, focused more on the effectiveness and implementation of the tax, rather than the effects on equal and fair economic distribution.

1.1.4. Motivation of topic actuality

South Africa increased the VAT rate from 14 percent to 15 percent on 1 April 2018 following the February 2018 Annual Budget Speech (National Treasury, 2018a). The Minister of Finance appointed an independent committee chaired by the Davis Tax Committee to review the list of zero-rated items to ensure that the VAT increase still provides a certain level of relief to low income earning households (National Treasury, 2018b). The committee considered a total of 66 items and only eight items were added to the list. On 1 April 2019 three more items were added to the list, which indicates that there may be further items to be considered in addition to the ones currently included in the list of zero-rated goods. The committee recommended that the National Treasury perform further work to ensure that the benefits of zero-rating accrue to consumers and are not captured by producers due to elevated levels of concentration in product markets (National Treasury, 2018b). Due to the suggestion tabled by the independent committee further work is to be performed with regards to zero-rating and how the benefits can better accrue to low income earning households.

From the above background information and the analysis into previous research, it seems that numerous studies have been performed on VAT and most studies have concluded that VAT should promote, or at least not distort, fairness and equity and the absence of the fore-mentioned could render the VAT a regressive tax. The increase in the VAT rate in 2018 was met with a lot of dismay from political structures and taxpayers as it caused an increase in the price of goods and services due to the 1 percent increase that needed to be recouped through a price increase. It should be noted that the increase in VAT is due to the government's rising expenditure requirements, of which a sizeable portion of government revenue is tabled to be spent on redistributing income to the poorest of households through grants and other social development initiatives (National Treasury, 2018a). The level of inequality in South Africa remains one of the highest in the world (Sulla *et al*., 2022) regardless of the numerous programmes targeted at income redistribution. This poses the question of the relation between the country's level of inequality and the regressive effect of VAT. Keen and Lockwood (2010) concluded that countries who implemented VAT were able to gain effective tax instruments. However, this was not apparent in countries in sub-Saharan Africa as the

implementation had various complications. It is important to highlight that these countries in sub-Saharan Africa struggle with elevated levels of income inequality. This is a common factor in the assessment of the effectiveness of the tax, as countries with elevated levels of income inequality will struggle with a tax such as VAT as its effectiveness will be measured on disposable income. An effective tax is characterised by fairness, adequacy, simplicity, transparency, and administrative ease and when the effectiveness of VAT is measured on the basis of disposable, the fairness of the tax is questionable (Alavuotunki *et al.*, 2019). Considering the afore mentioned, the most important aspect of determining whether VAT increases inequality is to consider the following question: *Is VAT in South Africa only considered regressive because South Africa is still a developing country that has a high level of income inequality, high levels of unemployment and poverty or are there fundamental issues in the VAT model and its implementation thereof?*

Comparative studies performed on income distribution or equity pertaining to VAT have been performed across sub-regions and conclusions made on sub-regional results. It would be worthwhile to perform an analysis into the different VAT models applied by different countries and how they provide relief to lower income earning households and evaluate the income distribution impact of those models when compared to South Africa's model. As mentioned in the background information, there are two groups of countries in terms of the implementation of VAT and these groups apply distinct VAT models. South Africa falls within the same group as New Zealand as South Africa's VAT model resembles New Zealand's model (Charlet & Owens, 2010). It could therefore be beneficial to compare these two countries' VAT models. Furthermore, due to the similarities of New Zeeland's VAT model to South Africa's VAT model, there is a gap to perform further analysis between South Africa and a country that implements the French and European Model. France is one of the few European countries that have undergone numerous VAT reforms over the last 20 years. Their standard rate has been changed four times (Kalyva *et al.*, 2016). It could be worthwhile to understand the reforms made and how these reforms contributed towards providing relief to low income earning households. This study serves to perform an analysis into South Africa's VAT model with a specific focus on relief provisions available to lower income earning households, when compared to other countries in the different groups as highlighted in the background information and to possibly identify ways in which the relief provisions can effectively accrue to low income earning households to create a tax that is fairer and promotes an equal distribution of income.

1.2. Problem statement and research question

Countries that have adopted VAT have produced provisions to enhance the fairness of the tax, including South Africa, which introduced a zero-rated items list. However, when previous research was performed on the South African VAT model as mentioned in the literature review section, it was identified by numerous authors that the current model does not seem to entirely promote fairness, and some have described the tax as regressive in nature. South Africa struggles with elevated levels

of income inequality and research performed into the VAT model suggests that the current VAT model creates a distortion in the distribution of income amongst households as all households pay the same amount of tax, therefore the equity and fairness of the tax is questioned. Zero-rating was introduced as a mechanism to lessen the burden on the poorest of households, however high-income earning households are also significantly less burdened through zero-rating, creating an income-based equity problem. The aforementioned leads to the following question, *how does South Africa's VAT model compare to New Zealand's and France's in terms of relief provided to low income earning households and improves VAT's distortional effect on income-based equity?*

1.3. Research objectives

1.3.1. Main objective

The main objective of this study is to determine how South Africa compares to New Zealand and France in terms of relief provided to low income earning households in the light of improving VAT's distortional effect on income-based equity.

1.3.2. Secondary objectives

The following secondary objectives are performed to address the main objective of the study:

i. To analyse South Africa's VAT model and determine how relief is currently provided to lower income earning households to improve its negative impact on income-based equity.
ii. To briefly analyse the current VAT models in place for New Zealand and France, and how these countries provide relief to low income earning households and improve its negative impact on income-based equity.
iii. To identify areas of improvement or suggestions when evaluating the relief provided by New Zealand and France that could be implemented in South Africa to improve the current VAT model and reliefs in place and, enhance income-based equity.

1.4. Research methodology

1.4.1. Research paradigms

1.4.1.1. Ontological assumptions

Ontological assumptions can be described as the assumptions researchers make to believe that something makes sense or is real (Kuyini & Kivunja, 2017). For a researcher to form assumptions, data needs to be connected to a meaning. The analysis of data collected for a study and

interpretation thereof can be referred to as an interpretivist paradigm (Kuyini & Kivunja, 2017). This paradigm is discussed further.

An interpretivist paradigm can provide an in-depth understanding of certain contexts through collection and interpretation of qualitative data (Alharahsheh & Pius, 2020). An interpretive researcher is most likely to rely on qualitative data collection methods and analysis (Knipe & Mackenzie, 2006). The positivist paradigm often views the world through observable and measurable facts and often supports quantitative methods (Alharahsheh & Pius, 2020), however an interpretivist paradigm can also partly rely on quantitative data collection methods to provide an in-depth understanding of data. This study entails an evaluation of different VAT models and how they provide relief to lower income earning households. This study relies on the collection of existing literature and its interpretation thereof to respond to a problem statement and make assumptions on the data collected to better understand the problem. The appropriateness of following an interpretivist paradigm is that the study is focused on qualitative data collection and analysis methods and requires a thorough understanding and interpretation of the various VAT models that exist in the selected countries.

1.4.1.2. Epistemological assumptions

Epistemology is a way of understanding and explaining how we know what we know according to Crotty (cited by Abdelhamid, 2008). This study evaluates different VAT models and how more benefits can accrue to lower income earning groups, this is performed by evaluating existing literature.

1.4.1.3. Methodological assumptions

This assumption refers to the methods and approaches used in a study (Kuyini & Kivunja, 2017). Methodological assumptions on how data, to conduct research, is obtained and how it assists in answering and achieving the objective of the study. This study requires the interpretation of existing data and relies on the interpretation of existing data to form assumptions and conclusions.

1.4.2. Research methodology

Research methodologies can be categorised into two broad categories, i.e., qualitative research and quantitative research methods. Qualitative research is the in-depth analysis of data and relies on information and data collected for the research. Quantitative research is the analysis of numerical data (Almeida *et al*., 2017). As mentioned above, this study will be conducting qualitative research and the following methods will be used.

1.4.2.1. Literature review and document analysis

This study is performed using a literature review as well as a document analysis. A literature review is a research method of collecting and arranging previous data to share knowledge and develop new theory (Snyder, 2019). A document analysis is a method of analysing data and interpreting it to obtain understanding and develop empirical knowledge (Bowen, 2009). The study is performed using existing literature to obtain the knowledge, interpret the data and information collected to develop new theory to address the objective of this study. This study serves to evaluate the current VAT models applied by South Africa, New Zealand, and France and how these models provide relief to lower income earning groups. The literature review and document analysis include the analysis of the various data sources, these sources include, but are not limited to:

- Current tax provisions of each country, specifically relating to relief provisions;
- Applicable text, journals, articles, and other publications on the internet; and
- Previous studies performed on VAT for the selected countries.

New Zealand was selected based on similarity as the South African VAT model was modelled off New Zealand's model. It is expected that there should be numerous distinctions between the two since implementation, however the fundamental principles are still similar between the two countries. Furthermore, New Zealand's VAT model is considered the "pure" model and has been used as a starting point for many countries that implemented GST after 1986 (Sawyer & Maples, 2014).

To broaden the body of knowledge and information required in this study and provide an in-depth analysis into distinction, with the possibility of identifying new principles and methods of accruing benefits to lower income households, a completely distinct country is selected for the study. France is a member of the EU; they apply a VAT model that is distinct from South Africa and New Zealand. Furthermore, France is a developed country that has a different economic landscape to the current economic landscape in South Africa (Kalyva *et al*., 2016). The main basis of selection is the apparent distinction from all the units of comparison as well as the country's history of VAT. France was one of the few countries in Europe to implement a GST in the early 20th century and numerous reforms have been implemented to improve the tax. The different countries selected for the study provide an insight into the different VAT models used worldwide. The New Zealand model is the base of most VAT models whilst France's model represents the model implemented by most countries in the EU. This insight is beneficial in understanding the issue South Africa faces with the distortion of VAT and the identification of measures that could be implemented to improve the current VAT model in place.

1.5. Limitations of study

It is mentioned in previous sections that this study is performed using a literature review and document analysis, and existing data is used to achieve the desired objective of the study. There

are some possible limitations for this study. The analysis of relief provisions available or accruing to lower income earning households in the different countries selected for the study are subject to biases based on the country's demographic, economic landscape, geographical location, and other influencing factors due to the research methods used. This is also more prevalent when assessing the effectiveness of these provisions on the low-income earning households as the collection of data will be performed through a review and analysis of existing literature. Due to the above-mentioned limitation, this study will not include quantifiable information as this information will carry subjectivity and other biases that might affect how the desired objective of the study is achieved. No human beings will be interviewed for this study and the effectiveness of the relief provisions will only be determined using existing literature with a further development of the theory. To mitigate existing biases due to the different landscapes of the selected countries the study will only focus on relief provisions available in the countries, other aspects of VAT will not be dealt with in this study. It would be beneficial for a study of this nature to be conducted using quantifiable information and human interaction to add on to the body of knowledge and possibly identify other factors that need to be addressed, this study is however limited to only a qualitative literature review.

1.6. Ethical considerations

This study will be performed in the form of a literature review, the data used has been made available for the public through various channels and all authors are acknowledged for their publications used in this study. Furthermore, no direct contact with human beings is made for purposes of conducting this study and the study is approved by the North-West University's ethics committee. Therefore, there are limited ethical considerations for this study.

1.7. Chapter Overview

This study is performed in four chapters to achieve the main objective of the study.

Chapter 1: Introduction

This chapter provides an overview and background to the relevant area of study, which includes literature reviewed to support the area of study. The relevance and importance of the study area is also highlighted. Furthermore, the first chapter provides an overview of the problem statement and the primary and secondary objectives of the research conducted. Finally, the research methodology used to conduct the research is highlighted.

Chapter 2: An analysis of South Africa's VAT model

This chapter addresses the first secondary objective of the study and provides a literature review and document analysis of relief provisions available to lower income earning households considering

improving VAT's distortional effect on income-based equity, specifically within the South African context. This chapter provides an overview of the relief provisions in South Africa from the date of implementation to date. Finally, a conclusion is provided on the findings obtained from the literature analysis performed in this chapter.

Chapter 3: An analysis of New Zealand and France's VAT models

This chapter focuses on the current VAT models applied by New Zealand and France, specifically focusing on provisions in place to offer relief to lower income earning households and how they improve the distortive effect of VAT on income-based equity. Finally, this chapter also highlights similarities and distinctions in the different VAT models and relief provisions available in the country.

Chapter 4: Conclusion and recommendations

The concluding chapter provides the findings on the analysis performed on the VAT models of the different countries selected for the study. It further provides a conclusion into the hypothetical question of the study; *how do the different VAT models provide relief to low income earning households and improve the distortive effects of VAT on income-based equity when compared to South Africa's VAT model?* Finally, recommendations from the evaluation of France and New Zealand's VAT model are tabled to address the third secondary objective of the study.

Chapter 2: An analysis of South Africa's VAT model

2.1. Introduction

To get an understanding of the negative distortion of VAT on income-based equity it is important to consider the VAT model in South Africa and the relevant legislation and government programmes in place that affects it.

This chapter therefore focuses on the landscape of VAT in South Africa and provides a review of the current VAT model in place and an analysis of the relief provisions provided by the VAT model and government to lessen the burden placed by VAT on lower income earning households. The first secondary research objective as identified in par 1.3.2(i) is addressed in this chapter.

Attention is placed on the relevant provisions of the Value-Added Tax Act No. 89 of 1991 (''VAT Act'') from date of inception to date, and other relief programmes provided by the government.

2.2. Background and current VAT landscape in South Africa

South Africa introduced VAT in 1991, prior to that the country had administered a General Sales Tax, since 1978 (Kearney, 2003). VAT was initially introduced at a rate of 10 percent; this was increased to 14 percent in 1993 and it further increased to 15 percent in April 2018. South Africa now administers VAT at a standard rate of 15 percent. As per section 7 (1) of the VAT Act, VAT is levied on the supply of goods, services, and the importation of goods into the country. The VAT system makes provision for exempt goods and services and zero-rated services that offer relief in certain circumstances, i.e., lessening the burden of tax or encouraging domestic economic investment. VAT is an important contributor to the country's revenue and has received criticism due to its regressive nature (Jansen & Calitz, 2015b). The next few paragraphs highlight the regressive nature of the tax and how it contributes to the negative distortion of income-based equity.

In a democratic economy, tax systems can be used to promote growth and income redistribution with reference to the government's revenue capabilities and budget constraints. A country's tax system cannot be divorced from the country's broader economic policy; hence issues of unemployment, poverty and inequality are recurring themes when tax systems are evaluated. Thus, constant tax redress and evaluation of a tax system is required in addressing the unacceptably elevated levels of poverty, unemployment, and inequality in South Africa (Davis Tax Committee, 2014).

The continent of Africa suffers immensely from big inequality gaps because of its history and emphasis is placed on addressing inequality to eradicate poverty in the continent (Sulla, *et al*., 2022). South Africa is no stranger to the issues faced by the African continent, the elevated levels of

unemployment, poverty and inequality have been topics of discussion in the past few decades. Economic growth and addressing economic inequality are a major focus for the government and the tax system and macro-economic policies are tools that government uses to address them (SARB, 2020).

When the VAT rate was increased to 15 percent in 2018, the increase was followed by a widened scope of additional possible zero-rated items to alleviate the effects of the increase on households. Concerns over the VAT hike were raised through public submissions and the South African Human Rights Commission argued that the increase in the VAT rate threatened the human rights of the poor (SAHRC, 2018). It is unjustifiable to expect the poor to effectively finance radical socio-economic transformation and the achievement of socio-economic equality (National Treasury, 2018b). The independent panel of experts appointed by the Minister of Finance to evaluate the tax rate increase highlighted that VAT as a tax places a burden on lower income households who have a low ability to pay the tax. The panel put forth suggested solutions to be implemented to reduce the material impact of the tax rate increase on lower income households. These methods will be evaluated further in this chapter.

2.3. Review of the Value-Added Tax Act

2.3.1. VAT Act provisions

VAT was set at a rate of 10 percent, and soon after its introduction, there was a need to replace the revenue generated by the previous General Sales Tax, consequently the rate was increased to 14 percent. The increase was coupled with a lot of dismay and the regressive nature of the tax was questioned (Jansen & Calitz, 2015b), this prompted government to include a list of zero-rated basic food items to accompany the increase in the VAT rate. The list of zero-rated food included basic food items that are considered essential products that form a major part of a household's food basket. However, there is no way to differentiate between foods consumed by lower income earning households and other households, as basic household food items are similar. Thus, government's attempt at addressing and alleviating the burden on lower income earning households was coupled with more concerns over the proportionate benefits received by lower income earning households versus higher income earning households when items are zero-rated (Jansen & Calitz, 2015a).

In 1995, the Minister of Finance requested the Joint Standing Committee on Finance to provide a report on the current tax system, this would have been the third report provided by the committee. The report highlighted that should government undertake any VAT reform, whether by increasing the VAT rate or limiting the zero-rating of items, the scope for necessary poverty relief should be set out to support it (JSCOF, 1996). The South African government has not undergone any major VAT reforms since 1993, except for the rate increase and additional zero-rated basic food items. It did

however contribute to numerous poverty relief and income distribution programmes between the years 1995 and 2021. The social initiatives undertaken by government will be detailed further on in this chapter.

As mentioned above, a limited number of items were added to the list over the years due to further pressure from the public. When the VAT rate was increased to 15 percent from 14 percent in 2018, the minister appointed the independent panel of experts to review the current VAT structure and identify areas where government could possibly lessen the burden of the increase on the poorest of households. This review resulted in the addition of three new items to the zero-rated items list, (white bread flour, wheat cake flour and sanitary pads). The public's commentary on these items was that government could have added more items and that all eight items proposed for addition could have been added onto the list. However, the panel considered the loss to government's revenue as a result of zero-rating all the proposed items and the revenue loss amounted to approximately 2,8 billion rands in the long run (National Treasury, 2018b), thus impacting the value of funds that can be used by government for income redistribution and the provision of initiatives that benefit lower income earning households.

2.3.2. Literature review on zero-rating provisions

To understand how government provides relief to lower income earning households, it is important to review the impact of zero-rating provisions as contained in the VAT Act on different households and to understand the distortion caused by VAT on income-based equity. This will be done through a literature review of studies that have performed an extensive review of these provisions and how they affect the different households, particularly lower income earning households. VAT has been a steady major contributor towards government revenue, it has contributed billions towards government revenue in the past and continues to. Table 2-1 and Figure 2-1 below demonstrate the quantitative contribution of VAT on government revenue. Table 2-1 below shows the amount in rands contributed by VAT for the fiscal years 2017 to 2021, VAT has contributed billions of rands in the past five fiscal years under consideration. The table shows a slight decrease in VAT revenue collected in 2021, which is mainly because of COVID-19.

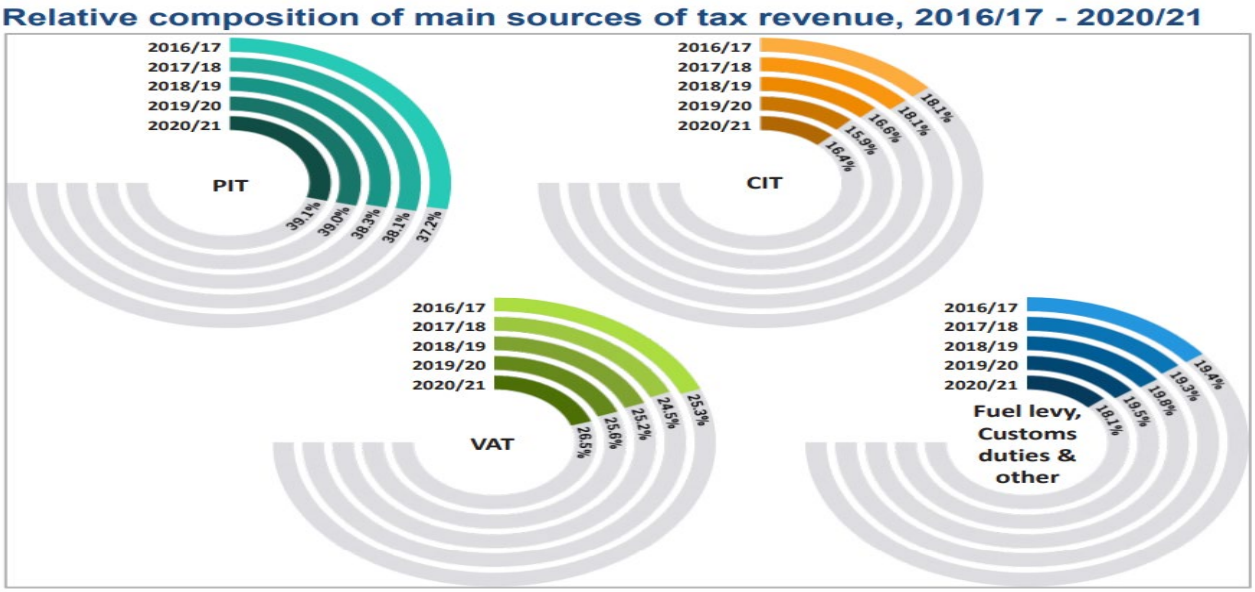
Table 2- 1: Net VAT Revenue for the years ended 2017,2021

Vendors per annualised turnover (payments and refunds), 2017/18 – 2020/21

	2017/18	2018/19	2019/20	2020/21
Number of vendors	434 981	448 710	449 597	448 361
Turnover (R million)	13 308 025	13 698 161	14 687 969	13 811 788
Payments (R million)	336 964	377 675	398 735	394 351
Refunds (R million)	-190 969	-229 957	-232 862	-229 774
Net VAT	**145 995**	**147 719**	**165 873**	**164 577**
Net VAT as % turnorver	1.1%	1.1%	1.1%	1.2%

Source: SARS (2022).

Figure 2- 1: Tax revenue composition for the fiscal years 2017-2021



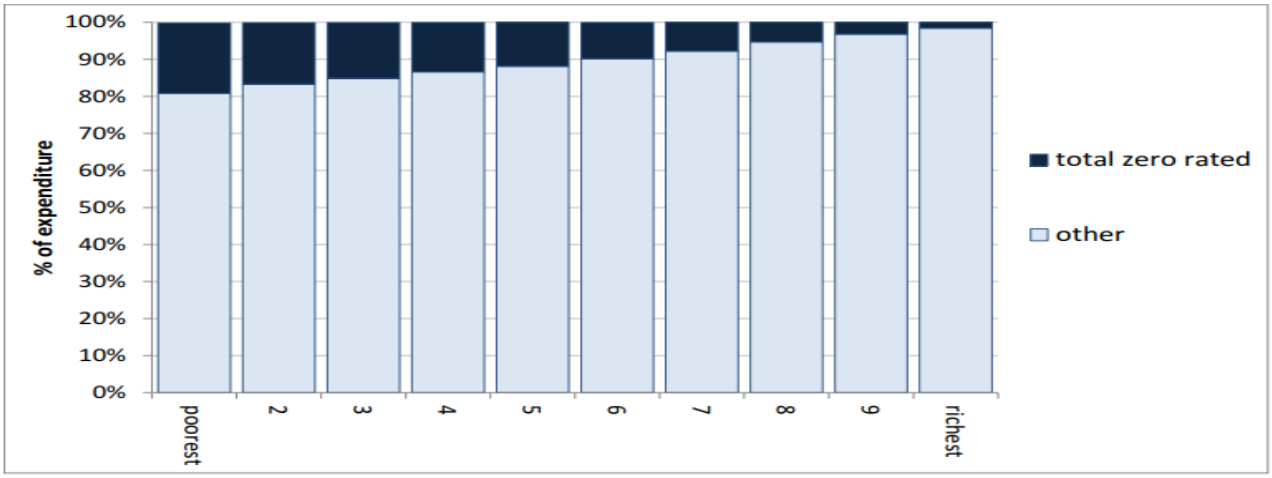
Source: SARS (2022).

Figure 2-1 above indicates that VAT has been a major contributor of government revenue during the fiscal years 2017 to 2021 and this can be extended to the previous fiscal years as well. As seen above, VAT contributes on average at least 25 percent of government revenue per year. It is important to understand the effectiveness of VAT as an instrument for government revenue generation to understand its impact on income-based equity. Table 2-1 and Figure 2-1 provide a simple overview of the tax in South Africa.

2.3.2.1. The effects of zero-rating on lower income earning households

A study performed on the effectiveness of zero-rating in 2015, considered the appropriateness of zero-rating and how it affects lower income earning households. Expenditure on zero-rated items as a fraction of total expenditure decreases as income increases and as a result households with lower income are likely to spend a larger fraction of their income on zero-rated items (Jansen & Calitz, 2015b). However, the question is how much does zero-rating impact lower income earning households compared to higher income earning households and does this impact positively improve income-based equity between the two households? Figure 2-2 below demonstrates the level of expenditure between lower income earning households and higher income earning households. It highlights the percentage spent between zero-rated items and other expenditure for the different households. Lower income earning households spend a significantly larger portion of their income on items that are mostly zero-rated items, which are basic food items, and high-income earning households would spend a smaller portion of their income on zero-rated items (Stats SA, 2017). From this analysis, it can already be seen that the zero-rating of products does attempt to lessen the burden on the lower income earning households as in perfect circumstances they would be paying more had these products been standard rated or VAT levied at a rate of 15 percent. It should also be noted that the benefits of zero-rating are fully enjoyed by low income earning households when suppliers decrease the price of products because of the effects of zero-rating. This poses an issue with the direct accrual of zero-rating benefits to lower income earning households.

Figure 2- 2: Household expenditure in 2014/2015



Source: Stats SA (2017).

Lower income earning households usually consume products from local area supermarkets or stores, these are informal stores in the townships, villages, etc. These stores do not have stringent pricing rules and regulations that you would expect from a formal supermarket franchise. Pricing is not regulated and sometimes these stores are not reducing prices to reflect the effects of zero-rating (National Treasury, 2018b). A survey performed by Stats SA in 2014 and 2015 evaluated the

difference in the price of brown bread and white bread. These are two comparable products, brown bread is a zero-rated food item and white bread does not enjoy the same benefit, however the difference in price was not the expected difference. It would be expected that these two comparable products would have a price difference almost equal to the VAT rate if one enjoys the benefit of it being a zero-rated item. Brown bread was only less than white bread by an average of 12,3 percent for the fiscal years 2000-2015. It would be expected that brown bread is lower by at least 14 percent (the VAT rate at the time), however this was not the case. How and to what extent the benefits of zero-rating have accrued or will continue to accrue to lower income earning households cannot be easily determined (Stats SA, 2017). Previous literature on the effects of zero-rating on lower income earning households carries mixed views, with some considering zero-rating as having a positive impact on lower income earning households and some indicating that other initiatives could be used instead of zero-rating. Jansen and Calitz (2015b) argued that household expenditure constantly changes, and zero-rated items have been fixed with a few additions in the past two decades, therefore they do not necessarily give an accurate reflection of what households spend on these items. Attempts to promote income-based equity through tax will always have drawbacks and government should focus on income transfer initiatives, rather than a cost-effective measure such as zero-rating. Another study highlighted that zero-rating currently benefits lower income earning households, but the disproportion in the benefits between higher income earning households and lower income earning households could be combatted by the introduction of an increased VAT rate on luxury items as zero-rating on its own cannot improve the distortion VAT causes on income-based equity (Njozela, 2018). From the review performed above, zero-rating as a concept benefits lower income earning households and attempts to lessen the burden on the poorest of households. However, due to certain limitations of the provisions, the benefits of zero-rating can be disproportionate between the different households, causing a distortion in income-based equity. This brings us to another focus of this study, how zero-rating affects income-based equity.

2.3.2.2. The effects of zero-rating on income-based equity

When evaluating income-based equity from a tax perspective, vertical equity and horizontal equity are concepts that should be considered in the evaluation. Income-based equity is a concept derived from the principles of vertical equity in tax, vertical equity requires that taxpayers who earn more income should pay more tax, and allows for the classification of taxes as regressive or progressive .Horizontal equity is more concerned with fairness and requires that taxpayers with equal income pay the same amount of tax (Lambert, 2004).One of the central themes in evaluating taxes is to evaluate the distributional effects of the tax, which is the ability to pay taxes and the amount of taxes paid by the different households (Grown, 2010). As noted above in paragraph 1.1.3, taxes are progressive when the amount of tax paid increases in proportion to the increase in income.

As mentioned in paragraph 1.1.1, VAT is a tax on consumption and taxpayers pay VAT based on their average consumption spend. The main reason VAT is considered regressive is because the amount paid by taxpayers does not increase when income increases (Jansen *et al.*, 2012). On the other hand, zero-rating is the supply of goods and services at a rate of zero and has been used by the government to further manage the regressivity of the tax and lessen the burden on lower income earning households. However, zero-rating is not an exclusive provision. It is a provision that applies to all taxpayers, irrespective of their income earning levels, which further causes a distortion rather than an improvement on the negative distortion caused by the tax.

Table 2-2 below demonstrates the VAT savings that accrue to lower income earning households and higher income earning households because of zero-rating, expressed in millions, and performed with 2010/2011 data. Due to limited literature produced on zero-rating benefits for different households, the 2011 data is deemed appropriate and used for this evaluation. The table represents lower income earning households as Docile 1 and higher income earning households as Docile 10. As can be seen, higher income earning households receive more benefit in absolute monetary terms than lower income earning households due to zero-rating. This further highlights the negative distortion of the tax on income-based equity as higher income earning households benefit significantly from provisions that are meant to lessen the burden on lower income earning households. The table shows how disproportionate the effect of zero-rating is on the different households.

Table 2- 2: Zero-rating benefits by consumption level – 201/2011

2010/11												
Decile / Expenditure Item	1	2	3	4	Total: deciles 1 to 4	5	6	7	8	9	10	Total: deciles 5 to 10
Rice	60	95	103	98	355	100	92	85	71	62	51	461
Brown bread	123	144	152	152	572	151	146	135	120	97	79	728
Maize meal	155	220	213	183	770	170	151	117	88	49	26	601
Mealie Rice	0	0	1	0	2	0	0	0	0	1	0	3
Samp	12	17	15	12	56	14	10	8	5	3	2	41
Dried Beans	18	23	21	18	80	16	10	8	5	5	3	48
Dried Lentils	0	0	0	0	1	1	1	0	1	1	1	5
Canned Pilchards	17	25	27	26	96	25	31	28	23	16	10	133
Powdered milk	3	6	5	7	22	10	10	8	8	5	5	46
Sour milk	18	23	24	25	90	23	19	20	15	10	5	92
Milk	31	44	52	62	188	79	88	97	129	178	204	776
Cooking fat (Veg)	0	0	1	1	2	1	1	1	0	1	0	3
Edible Oils	47	67	71	67	252	66	59	56	47	38	32	298
Eggs	20	37	39	45	140	49	55	58	58	61	59	341
Fruit	13	21	23	27	85	31	36	42	58	99	164	430
Vegetables	113	145	155	153	565	164	163	166	174	211	292	1 171
Paraffin	25	31	33	31	119	30	23	18	13	4	2	89
Total	**657**	**899**	**934**	**906**	**3 396**	**930**	**896**	**847**	**817**	**842**	**934**	**5 265**

Source: Jansen & Calitz (2015b)

From the paragraphs above and the data provided, it seems to conclude that zero-rating does not significantly improve the distortion caused by VAT on income-based equity, however it significantly lessens the burden of the tax on lower income earning households. The study by Jansen & Calitz

also evaluated the proportion of expenditure on zero-rated goods for lower income earning households versus higher income earning households. Lower income earning households spend a bigger portion of their income on zero-rated goods thus softening the regressiveness of the tax. This is expected and will be the case as the disposable income for this group is much lower than the disposable income of higher income earning households. The view expressed by the Joint Standing Committee of Finance in 1996 seem to echo this evaluation, government needs anti-poverty initiatives to alleviate the burden this tax places on lower income earning households and possibly improve the distortion caused by VAT (JSCOF, 1996). This is discussed in the next section of this chapter.

2.4. Review of government's social development initiatives

2.4.1. Background on the social development initiatives currently provided by government

As mentioned above, South Africa has elevated levels of unemployment, poverty, and inequality. The government's focus has been on the economic redistribution of wealth through the funding of public initiatives that benefit the poor. Some of these initiatives have been social grants, free public health care, free public education and other services that lessen the burden of living costs on low income earning households (Neven *et al*., 2009). For this study, the researcher will focus on social grants, which is the biggest direct assistance received by lower income earning households from government (National Treasury, 2022). Social grants in South Africa were introduced between 1910 and 1950 and underwent a significant reform in the early 1970s to the 1980s (Van der Berg *et al.,* 2010). Currently social development expenditure in South Africa, which comprises social grants, is one of the biggest expenditures for government (National Treasury, 2022).

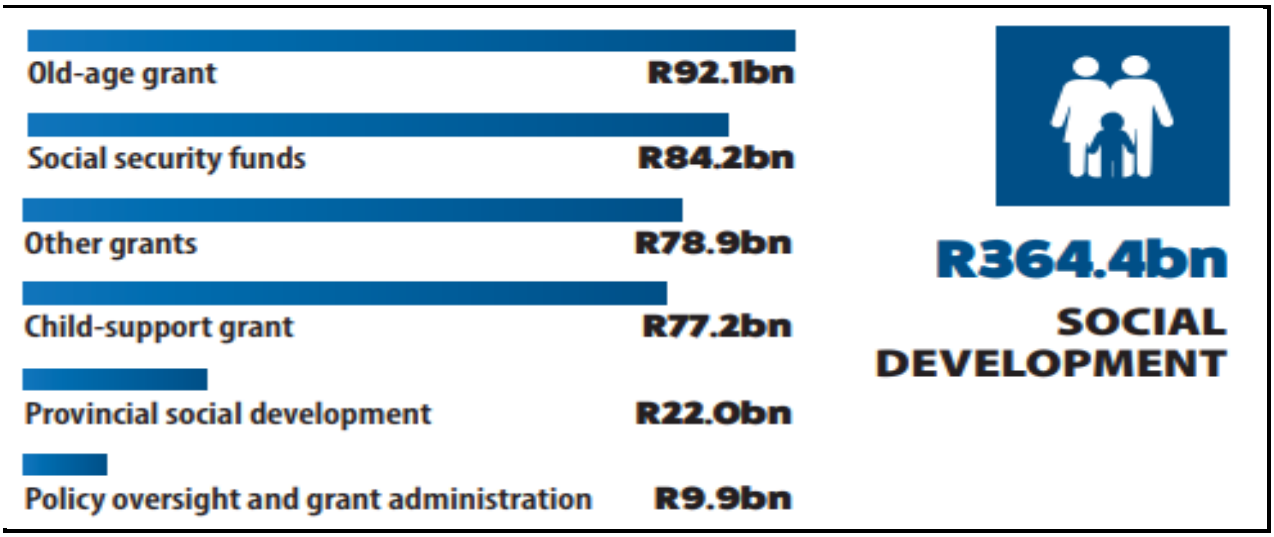
Table 2-3 below details government's total planned expenditure for the fiscal years 2022-2025. Social development which is government's income redistribution strategy by way of grants is the second biggest expenditure for government. The year 2021/2022 comprises almost 17 percent of the total consolidated expenditure. For the year 2024/2025 it is budgeted to comprise only 14 percent of the consolidated expenditure, which means a 3 percent reduction thereof. Table 2-3 also shows a projected increase in community development, which is an extension of social development, and targets people who currently do not benefit from the social development initiatives, which is an initiative that will further benefit lower income earning households. The community development is however budgeted to grow with 7 percent over the next five years.

Table 2- 3: Government's budgeted expenditure for fiscal years 2022-2025

CONSOLIDATED GOVERNMENT EXPENDITURE BY FUNCTION, 2021/22–2024/25					
R billion	2021/22	2022/23	2023/24	2024/25	2021/22–2024/25
	Estimate	Medium-term estimates			Average growth
Learning and culture	421.4	441.5	446.0	458.0	2.8%
Health	256.2	259.0	247.6	257.5	0.2%
Social development	352.7	364.4	317.6	322.2	-3.0%
Community development	212.5	236.3	252.2	266.7	7.9%
Economic development	201.0	227.1	237.4	256.8	8.5%
Peace and security	218.4	220.7	217.0	226.6	1.2%
General public services	71.9	69.2	69.3	70.5	-0.7%
Payments for financial assets	74.6	27.2	24.7	25.0	
Allocated expenditure	1 808.7	1 845.5	1 811.8	1 883.3	1.4%
Debt-service costs	268.3	301.8	335.0	363.5	10.7%
Contingency reserve	—	10.0	5.0	5.0	
Unallocated reserve	—	—	25.0	30.0	
Consolidated expenditure	**2 077.0**	**2 157.3**	**2 176.8**	**2 281.8**	**3.2%**

Source: National Treasury (2018a).

Figure 2-3: Government's budgeted social development expenditure for fiscal year 2022/2023



Source: National Treasury (2022).

The previous paragraph has considered government's total budgeted expenditure. Figure 2-3 above illustrates a breakdown of government social development expenditure for the fiscal years 2022/2023. South Africa's social development initiative currently offers the following grants (National Treasury, 2022):

- Old age grant;
- Foster care grant;
- Child support care grant;

- Disability care grant;
- War veterans' grant;
- Social relief of distress grant; and
- Dependency grant.

Grants are provided to people who are susceptible to a lower income or no income at all as part of government's efforts to alleviate poverty and redistribute income to the poorest of households (Neven *et al.*, 2009). From the budgeted data shown in Figure 2-3 and Table 2-3 government places a huge focus on these poverty alleviating initiatives, especially social grants to help alleviate poverty and improve the level of inequality in the country.

2.4.2. Literature review on how government's social development initiatives improve income-based equity

South Africa has a social security system that has been internationally recognised as a tool to alleviate poverty due to the comprehensive nature of the system (Winchester *et al.,* 2021). Social grants are South Africa's plan at reducing poverty amongst groups who are prone to a low income, the elderly, children, and those with disabilities. There are also other initiatives that aim to support and simultaneously increase economic investment, i.e., skills training, free education, investing in employment creation and others. These grants are funded from tax revenue collected by the government and the amount of expenditure has increased since the introduction of some of the various grants. Grants are an important source of income for lower income earning households and they have managed to help reduce poverty levels in households who are the recipients of the grants (Macket, 2020).

When one considers how comprehensive South Africa's social grant system is, they would expect to see decreased levels of inequality or rather improved levels of equality since the introduction of the grants. However, South Africa's elevated level of inequality has not improved since the introduction and reform of government grants post 1994 (Merriono, 2021). Income-based equity is however a different concept from inequality, to eradicate inequality, all individuals would be given the same resources and opportunities, which is a struggle in most modern societies. Equity is realising that people have different circumstances and allocating the same resources to reach the same outcome (Zagonari, 2018). In this study it is lower income earning households paying less VAT as a proportion of their income when compared to higher income earning households. Social grants play a different role in income-based equity namely the direct transfer of income from taxes collected from higher income earning households to lower income earning households.

When government increased the VAT rate from 14 percent to 15 percent in 2015, they subsequently increased the social grants, i.e., child grants were increased from 380 rands to 410 rands in 2018.

This was an attempt to combat the increased burden of a VAT rate change on consumer spending, particularly on lower income earning households (Gardiner, 2019). The only issue with using social grants as an effective way to combat the negative distortion of income-based equity brought on by tax is that social grants in South Africa are mainly targeted grants, i.e., they target specific people (the elderly, children, those who live with disabilities, etc.) and this results in the exclusion of other poor individuals (Van der Berg *et al.,* 2010).

Furthermore, it can be argued that there are other social security programmes that can benefit the poor people who are currently excluded from the direct benefit of social grants. However, government spending has been under scrutiny in the past decade, due to government's misallocation of funds (Gardiner, 2019). It becomes difficult to determine whether funds set aside for the development of people, the alleviation of poverty and the improvement of income inequality were expended for that purpose. Therefore, the distortion caused by VAT is not necessarily improved by government social development programmes in certain instances (Macket, 2020).

From the VAT revenue data provided above in Table 2-1, VAT contributed approximately R150 billion towards tax revenue in the 2020/2021 fiscal year, the budgeted expenditure as depicted in Figure 2-3 is 364 billion rands, this excludes other initiatives not covered in this paper, which are also budgeted at billions of rands. Since government grants are mainly funded from tax revenue, a portion of VAT collected is indirectly distributed to lower income earning households through grants and other initiatives. It should be highlighted that not all lower income earning households receive social grants. However, due to government spending on so many initiatives that benefit lower income earning households, it can be argued that there is a level of improvement on the distortion, even if it cannot be detailed or quantified.

2.5. Conclusion

This chapter focused on the VAT landscape in South Africa and outlined all the available provisions used by the South African government to lessen the burden of tax on lower income earning households and thereby addressed the first secondary objective of this study as identified in paragraph 1.3.2(i).

The literature review and the data brought forth in this chapter has managed to highlight the provisions available as per the VAT Act, which are zero-rating provisions. Zero-rating provisions were evaluated for their impact on lower income earning households and the literature reviewed suggests that zero-rating provisions do lessen the burden on lower income earning households. However, the benefits received are disproportionate when compared to the benefits received by higher income earning households. The studies suggest that the distortion caused by VAT does not significantly improve when zero-rating is introduced.

This chapter also considered other methods by which government attempts to improve the negative distortion caused by VAT on income-based equity. Social development initiatives were highlighted as one of the programmes used by government to not only improve income-based equity but alleviate poverty and develop communities. The studies reviewed above suggest that government attempts to improve income-based equity for households who are recipients of government's social development grants. However, for households who are not recipients, it is the exact opposite.

It can be argued that the negative distortion caused by VAT is to a certain extent bearable when zero-rating is introduced to lessen the burden on lower income earning households and that government grants improve income-based equity by redistributing government income to lower income earning households.

The next chapter evaluates the VAT landscape in New Zealand and France and outlines the relevant provisions available in their respective legislations to alleviate the burden on lower income earning households.

Chapter 3: An analysis of New Zealand and France's VAT models

3.1. Introduction

The previous chapter provided an analysis of South Africa's VAT model and how relief is provided to lower income earning households to improve the negative distortion of VAT on income-based equity. This chapter will provide a similar analysis; however, focus will be given to two different countries, New Zealand, and France. The second objective as detailed in paragraph 1.3.2(ii) will be addressed in this chapter and an evaluation of the current VAT models applied by the two different countries and other initiatives that contribute to the improvement of the negative distortion of VAT on income-based equity will be provided. The evaluation of the VAT models and provisions provided by the respective countries will be used to determine how the negative distortion of VAT on income-based equity can be improved and provide suggestions to assist in the further improvement of the negative distortion in South Africa.

3.2. Background of VAT internationally

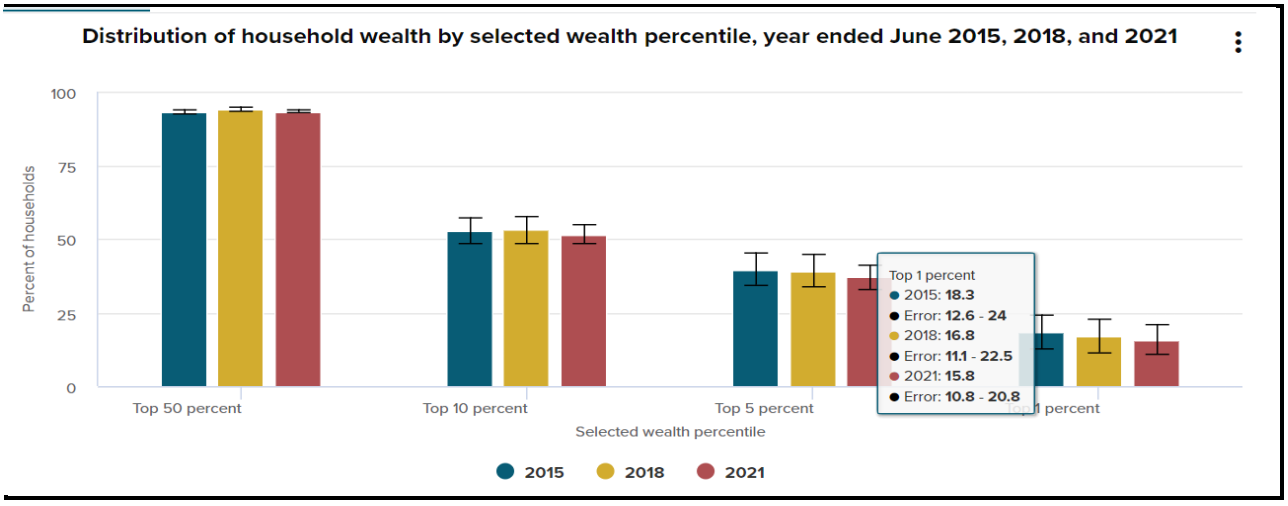
VAT is a worldwide tax that has been implemented by over 200 countries to date and it is an efficient way of raising tax revenue. Most countries have one standard rate levied at final consumption, whilst other countries, particularly countries in the EU use standard rates and reduced rates (Tax Foundation, 2022a). There is a common need to use or reduce rates to stabilise income-based equity as lower income households tend to spend a large share of their income on basic goods and services (Kalyva *et al*., 2015). VAT has evolved since its introduction in the 19th century and the evolution can be described as the increase in standard VAT rates from 15.6 percent to 18,1 percent between the years 1975 and 2000, the stabilisation of the standard rate of VAT between the years 2000 and 2009, and finally the considerable increase of the standard rate between the years 2009 and 2014 (OECD, 2020). The considerable increase was a response to significant revenue constraints caused by the 2008 economic financial crisis and VAT being an effective revenue generation instrument for governments worldwide (OECD, 2020). The evolution of VAT, coupled with the increases throughout the years is expected to have placed a heavy burden on lower income earning households who have a low ability to pay for goods and services. The evaluation of the different countries will provide an in-depth analysis of how this burden was lessened; the evaluation follows in the next paragraph.

3.3 Background: New Zealand

New Zealand is an island country, southwest of the Pacific Ocean and has an estimated population of about five million citizens as of 2022. New Zealand is a young country in terms of its inhabitants. The first humans to arrive in New Zealand arrived between the 1200s and the 1300s and since the 1980s, a wide range of ethnic groups have inhabited the country and made it a multicultural country (Oliver *et al*., 2022). The country's economy changed over the past century. In the 1950s New

Zealand was an isolated economy which grew into a country with a broad-based economy (Conway & Orr, 2000). In the 20th century it was one of the most liberal English-speaking economies in the world and has managed to perform well on a selected range of economic growth indicators (Goldfinch, 2004). New Zealand's economy, although small, is different from South Africa's economy. South Africa's economy has struggled with growth whilst the New Zealand economy has steadily maintained economic growth in the past few decades (OECD, 2020). Currently, New Zealand boasts low levels of unemployment, coming in at 3,4 percent in the third quarter of 2021. It however struggles with an inflation rate that is above the Reserve Bank's target and the inflation expectations have increased significantly for households in the country with prices soaring relative to household income (OECD, 2022). When consideration is given to income inequality in the country, the average households net worth in New Zealand was estimated as 397,000 dollars in 2021 (Statistics NZ, 2022). Figure 3-1 below shows the distribution of household wealth in the country for the years 2015, 2018 and 2021. The top 10 percent of households hold over 50 percent of the total household wealth in the country, which is a huge disparity between households which contributes to the elevated levels of inequality. Even though the country has low levels of unemployment and stable economic growth, the number of people who are poor in New Zealand seems to have doubled since the 1980s (Dyer, 2015), making the country one of the most unequal countries in the world, with a deepening poverty crisis.

Figure 3- 1**: Distribution of household wealth in New Zealand for the years ended June 2015, 2018, and 2021**



Source: Statistics NZ (2022).

New Zealand's economy, although different from South Africa's economic landscape, struggles with issues of elevated levels of income inequality and poverty like South Africa's economy, therefore the negative distortion caused by VAT on income-based equity will and is experienced by both countries. It would be beneficial to understand how New Zealand tries to improve the distortion whilst alleviating poverty levels and income inequality.

3.4. New Zealand's Tax model

This section will provide an overview of New Zealand's current tax system, including the GST model in the country. Furthermore, an evaluation of the negative distortion caused GST and any relief provisions provided by the country to improve the negative distortion will be provided.

3.4.1. Background of taxes in New Zealand

New Zealand has the most coherent tax system in the world, the tax bases are wide, and the rates are considered moderate when compared to the rest of the world and its tax system currently ranks third in the OECD (Tax Foundation, 2022c). Taxes are collected on individual income, business income and the consumption of goods and services. Individual income is taxed with different tax rates for different income tax brackets, the highest rate being 39 percent as of 1 April 2021. Business income is taxed with companies' tax and is set at a rate of 28 percent and 33.3 percent for trusts. GST is the equivalent of VAT in South Africa and is set at a rate of 15 percent. The revenue collected by the government from taxes is depicted in Table 3-1 below and shows the major contributors of what is called "Crown revenue" for government revenue. As seen in Table 3-1 GST is the second biggest contributor of the government's crown revenue after individual taxes, this is in line with what has been seen for other countries around the world (The Treasury, 2022). With GST being a major contributor to the country's crown revenue and the levels of household income inequality, it would be expected that the government will bring forth provisions to lessen the burden of GST on households with lower income earning levels. These provisions are considered in the next few paragraphs.

Table 3- 1: Total tax revenue for the year ended June 2022

2021/22 Tax Revenue
Year to June

	2021/22 Actual ($million)	2021/22 Forecast[1] ($million)	Difference ($ million)	Difference (%)	2020/21 Actual ($million)	Annual Growth ($ million)	Annual Growth (%)
DIRECT TAX							
Individual							
PAYE	41,346	40,786	560	1.4%	37,184	4,162	11.2%
Other persons tax	11,120	10,045	1,075	10.7%	8,773	2,346	26.7%
Refunds to individuals	-1,739	-1,766	27	-1.5%	-1,716	-23	1.4%
Fringe benefit tax	684	641	43	6.8%	608	76	12.6%
Subtotal	51,411	49,706	1,705	3.4%	44,849	6,562	14.6%
Corporate							
Gross company tax	20,493	18,219	2,274	12.5%	18,277	2,216	12.1%
Company tax refunds	-630	-649	19	-2.9%	-344	-287	83.4%
Foreign dividend withholding payments	0	0	0	n/a	0	0	n/a
Non-resident withholding tax	516	508	8	1.5%	472	43	9.2%
Subtotal	20,378	18,078	2,300	12.7%	18,405	1,973	10.7%
Other withholding taxes							
Residents' interest	842	717	125	17.5%	1,000	-158	-15.8%
Residents' dividends	1,108	969	139	14.3%	1,519	-412	-27.1%
ESCT	1,800	1,697	103	6.1%	1,554	245	15.8%
Subtotal	3,750	3,383	367	10.8%	4,074	-324	-8.0%
TOTAL DIRECT TAX	75,539	71,167	4,372	6.1%	67,329	8,210	12.2%
INDIRECT TAX							
GST							
GST (Customs)	12,403	12,194	209	1.7%	9,612	2,792	29.0%
Gross GST (IRD)	41,611	41,883	-272	-0.6%	40,268	1,343	3.3%
Refunds GST (IRD)	-16,920	-16,655	-265	1.6%	-14,252	-2,668	18.7%
Net GST (IRD)	24,691	25,228	-537	-2.1%	26,016	-1,326	-5.1%
Subtotal	37,094	37,422	-328	-0.9%	35,628	1,466	4.1%
Other indirect taxes							
Excise duties	1,542	1,618	-77	-4.7%	1,909	-367	-19.2%
Customs duty	3,493	3,226	267	8.3%	3,292	201	6.1%
Approved issuer levy	97	91	6	6.2%	88	9	10.0%
Cheque duty	0	0	0	n/a	0	0	n/a
Motor vehicle fees	234	238	-3	-1.5%	231	3	1.2%
Road user charges	1,840	1,853	-14	-0.7%	1,930	-91	-4.7%
Energy resources levy	26	26	1	2.6%	23	3	11.6%
Gaming duty	273	258	15	5.6%	322	-49	-15.3%
Other	1	7	-6	-87.9%	1	-1	-40.9%
Subtotal	7,505	7,317	188	2.6%	7,797	-292	-3.7%
TOTAL INDIRECT TAX	44,598	44,739	-141	-0.3%	43,425	1,174	2.7%
TOTAL TAX	**120,137**	**115,906**	**4,231**	**3.7%**	**110,753**	**9,384**	**8.5%**

Source: The Treasury (2022).

3.4.2. New Zealand's GST model

New Zealand implemented GST on 1 October 1986 at a rate of 10 percent and since then has increased it to 12,5 percent with the last increase being an increase to 15 percent in September 2010 (OECD, 2020). The implementation of GST was smooth, had no key issues and was regarded as an efficient tax in the country (Sawyer & Maples, 2017). New Zealand levied GST on the supply of goods and services in the country on or after 1 October 1986 except for exempt supplies as defined *(Goods and Services Tax Act, 1985*). New Zealand's GST model has been compared to the old European VAT model with major improvements made in the implementation, making the New Zealand GST model an effective and preferred model around the world. The model has been a starting point for many countries who have implemented or considered implementing VAT (Dickson & White, 2008). The New Zealand GST model is a modern one that has few exemptions and has a single rate of tax that is applied across all goods and services except for exempt goods and services. The exempt services provided by GST are financial services, donations, leaseholds, etc. Goods and services taxed at a rate of zero are exports, this is as per the country's Goods and Services Tax Act 141 of 1985 ("GST Act"). Unlike South Africa, New Zealand does not have a list of zero-rated food items included in its model or items such as primary education and transportation as exempt supplies. Zero-rating and exempt supplies in New Zealand are focused on targeting economic growth, i.e., exports and to increase GDP growth, they are not focused on consumers and their

consumption. The lack of these provisions can be attributed to the welfare subsidies currently offered by the government (Percy, 2019).

3.5. Relief provided to lower income earning households in New Zealand

This section explores the distortion caused by GST on income-based equity in New Zealand and the relief provided by the government to assist in the improvement of the distortion. The provisions evaluated in this section are reliefs provided by the government through social initiatives.

3.5.1. Distortion caused by GST on income-based equity

Egan (2018) highlighted how New Zealand's tax system is weak at reducing inequality. The paper focused on the prevalent and previously mentioned income inequality in the country and how the effective rate on the lowest income households' averages 26 percent compared to 31 percent for the highest income households. The effective tax rate difference is a cause of concern as 10 percent of households in the country hold over 50 percent of the total households' income, however the tax rate between these households is almost similar. The researcher has evaluated and highlighted the regressivity of GST in this study and when GST is considered with reference to the inequality of households and income tax rates as outlined above, all households ought to pay the same amount of GST in proportion to their expenditure levels and not in proportion to their income levels. The absence of exclusions on household goods in the GST Act and the inequality of households reiterates the fact that the GST paid is not equitable between the different households. These disparities in the taxes paid by households indicate a distortion on income-based equity particularly with regards to GST between the different households (Egan, 2018).

On 1 October 1986, when the New Zealand government introduced GST, the top income tax personal rate was decreased to 48 percent from 66.6 percent. This top rate only applied to income brackets over 60,000 dollars. This decreased the income tax burden on the top earning households and not necessarily lower income earning households. This rate of tax was further decreased to 39 percent on 1 April 2022 (Wilkinson & Jeram, 2016). The distribution of income tax liabilities during the years 1986 to 2010 has been extremely unequal and the study performed by Wilkinson and Jeram (2016) shows that government expected to receive more than half of individual income tax from just 12 percent of the 3.6 million registered taxpayers, which makes the income tax burden more unequal than the distribution of income. The distribution of the net tax burden can however be justified by the amount government spends on lower income earning households, as government spends more on lower income earning households than what it receives in taxes from lower income earning households (Wilkinson & Jeram, 2016). The taxes paid by the different households, particularly GST, are unequal, which is expected, however government focuses on welfare spending as a form of providing relief to lower income earning households rather than providing tax exclusions

that alleviate or decrease the amount of tax paid by lower income earning households.. This aspect is discussed in the next few paragraphs.

3.5.2. Social welfare initiatives provided by the government

The New Zealand government introduced a welfare system to ensure that people who cannot afford basic food necessities can still acquire them. The welfare system functions through the Work and Income New Zealand ("WINZ"), which deals with benefits and provides financial assistance in New Zealand (Ministry of Social Development, 2022).

The current main benefits provided by government are as follows:

- Jobseekers support;
- Sole parent support;
- Youth payment support;
- Young parent payment;
- Disability allowance;
- State housing; and
- NZ Super (financial benefit for citizens over the age of 65).

There are other benefits provided by the government, i.e., benefit advances, hardship assistance, special needs grants, etc. The financial assistance is designed to provide assistance should a person be unable to provide for themselves in certain circumstances. A report published by the Ministry of Social Development in 2022 provided a snapshot of benefits provided by the government for the year ended June 2022. The number of working age persons registered to receive a benefit was 344,622, which is over 10 percent of the population and of the 344,622 over 181,896 benefits were advanced to citizens in 2022. Given the low levels of unemployment in the country, aiding over 10 percent of the population can significantly improve living conditions and affordability of the benefit receivers (Ministry of Social Development, 2022). Benefits will never be a pathway out of poverty or a substitute for having a job (Upston, 2021), however, benefits are a way in which government can redistribute income and improve income-based equity in a country, whilst trying to formulate long term strategies of individual economic growth and stability. The New Zealand government spent 113 billion dollars on crown expenses, which comprise financial assistance benefits, COVID 19 relief programmes, health and education in the year ended May 2022 (The Treasury, 2022). Tax revenue is not the only source of funding for crown expenses nor is it adequate to cover all crown expenses in any given year, indicating that the amount of income redistributed for the benefit of lower income earning households is greater than what is actually paid by households (The Treasury, 2022). As seen above the New Zealand government might not offer relief in the form of reduced GST rates i.e., the zero-rating of basic necessities however, they have a comprehensive social welfare programme

that provides financial assistance to most households who are unable to provide for themselves. The absence of zero-rating has increased the amount collected from GST, which is in turn distributed to lower income earning households, contributing towards the improvement of the distortion on income-based equity and lessening the burden on lower income earning households.

3.6. Background: France

France, officially known as the French Republic is a European country in Northwest Europe. The country has a population of around 65 million people as at 2022 and is amongst the world's oldest nations. France has influenced the development of art, science, society, and democratic ideals, i.e., the French revolution, in and around the world. The country is a leading member of the EU (an international organisation that comprises 27 European countries and governs common economic, social and security policies) (Oliver *et al*., 2022). France is one of the leading economies in the world and is counted within the ranks of the United States, Germany, Italy, and Japan (Focus Economics, 2022). France is different to South Africa and New Zealand, it is a country with a thriving economy that has low levels of unemployment, poverty, and inequality. An issue published in a French journal indicated that the levels of inequality in France are low when compared to other European countries (Rousselon & Viennot, 2020). An analysis of France's taxation system will be given in the next few paragraphs to obtain an understanding of how the system contributes to the low levels of inequality.

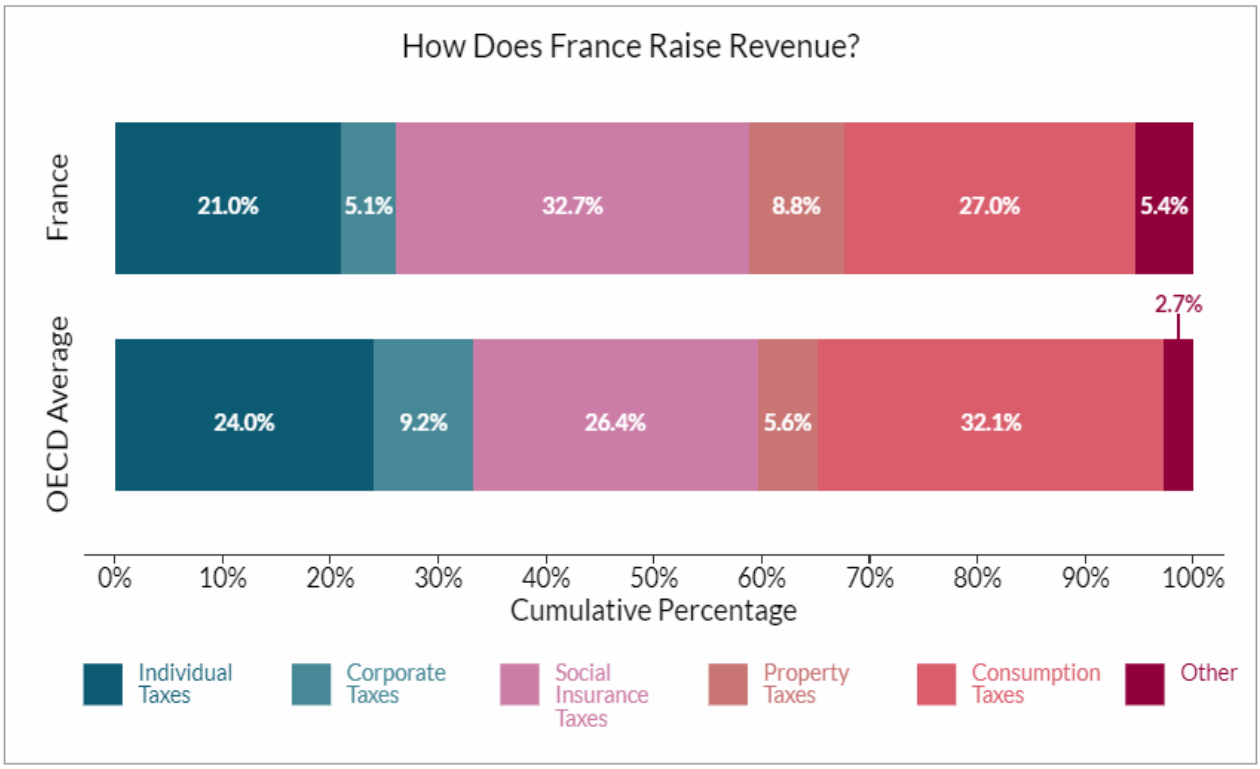
3.7. France's Tax model

This section will provide an overview of France's current tax system, including the VAT model in the country. Furthermore, an evaluation of the negative distortion caused VAT and any relief provisions provided by the country to improve the negative distortion will be provided.

3.7.1 Background of taxes: France

In the OECD's measurement on how well a tax system encourages competitiveness and lowers tax burdens through a well-structured tax code. The French tax system ranks 35th out of 36 countries in that code. France's overall score was below 50 percent in 2021 for overall taxes, and 70 percent for consumption taxes. This indicates that the country's tax system is not efficient in ensuring the proper administration of taxes. The mix of taxes in a tax system can dictate how distortionary or neutral a tax system is. Figure 3-2 below illustrates the current mix of major taxes for government revenue generation in the French tax system in 2021 (Tax Foundation, 2022b).

Figure 3- 2: Source of the 2021 government revenue in France



Source: Tax Foundation (2022b).

The figure above demonstrates the composition of tax revenue in France and the several types of taxes currently administered by the country. The figure also shows a comparison to the OECD's tax revenue average (this is an average of taxes administered by countries that form part of the OECD). The taxes shown in the figure are like the type of taxes administered by New Zealand and South Africa, except for social insurance taxes. Social insurance taxes are taxes paid by most employees, employers, and self-employed workers to fund the government social security programme (Tax Foundation, 2022b). Consumption taxes, comprising VAT is the second biggest contributor to government revenue and is an expected trend with the past two countries evaluated in this study. It is however slightly less than the OECD average as it contributes to 27 percent of the country's overall taxes and the OECD average shows a 32.1 percent contribution. The remainder of the chapter will focus on one consumption tax, namely VAT.

3.7.2 France's VAT model

France introduced VAT in 1968 at a standard rate of 19 percent. The standard rate was increased twice, and currently sits at 20 percent (Kalyva *et al.,* 2015). The standard VAT rate in France is currently higher than the average VAT rate of 19 percent observed by the OECD, and it can be argued that this contributes to France's tax score being 50 percent for overall taxes and the current rank they hold in the OECD's tax code (OECD, 2022). The French VAT model is a complex model that applies four different rates of VAT, the current VAT rates are as follows:

- 2.10 percent applies to sales of pharmaceuticals if it is reimbursed by the social security, and the sales of newspapers and certain magazines;
- 5.5 percent applies to food, beverages without alcohol, books, services to old people and handicapped persons, supply of works of art by their authors;
- 10 percent applies to home services (cleaning, childcare, home courses), sales for immediate consumption (restaurants, beverages without alcohol), works and repairs on residential buildings built more than two years ago, sights, passengers transport, pharmaceuticals which are not reimbursed by the social security, bio-fertilisers, etc.; and
- 20 percent applies to all other items where reduced rates are not applied.

The four different rates can increase the administrative tax burden of VAT and contribute towards the negative distortion caused by the tax. The application of various reduced rates by the French tax system is justified to encourage consumption that will result in increased employment to achieve a certain level of social equity, i.e., ease the burden on lower income earning households (Kalyva *et al.,* 2015). The targeting of food, services to the disabled, childcare and the elderly is one of the ways in which the burden ought to be lessened (Kalyva *et al*., 2015). However, even though reduced rates can reduce the price on products consumed by lower income earning households, consequently alleviating the burden placed on lower income earning households as highlighted by Kalyva *et al*. (2015), do not necessarily have a significant impact on the improvement of a negative income-based equity because they are not targeted rates and tend to benefit both low and high income earning households resulting in significant revenue loss from VAT that could have been collected from higher income earning households. For this reason, such significantly reduced rates are not instrumental in the improvement of the negative distortion on income-based equity. Other target-based benefit schemes work better at improving the distortion, which are considered in more detail below.

3.8. Relief provided to lower income earning households in France

This section will focus on the distortion caused by VAT on income-based equity in the country and evaluate the relief provisions provided by the government to improve the negative distortion caused by VAT. The relief provisions are provisions targeted at lower income earning households, i.e., social welfare initiatives.

3.8.1. Distortion caused by VAT on income-based equity

The amount of VAT paid by different households as a proportion of their income is the same across all income earning groups, which emphasises the regressivity of VAT and the distortion caused by VAT on households with different income earning levels. This is emphasised by Figure 3-3 below, that illustrates the share of VAT to total consumption expenditure of households in several European countries.

Figure 3- 3: Share of VAT in the total consumption expenditure of households (%) by income quintile for 2015

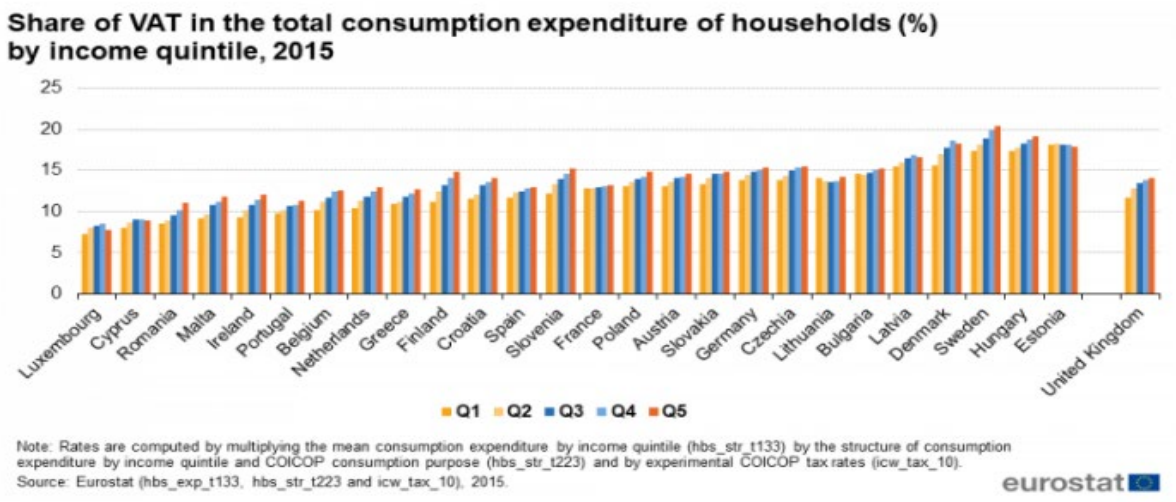


Figure 2: Share of VAT in the overall consumption expenditure of households by level of income, 2015

Source: Eurostat (2020).

The above figure not only shows how distorted VAT is in France but highlights the distortion across various countries. It emphasises the fact that VAT in its nature is regressive and places an emphasis on how distortion cannot be corrected by the same tax that caused it. France has low levels of inequality, and this is due to the county's income redistribution programmes, i.e., social benefit programmes. Redistribution through taxes in the country is not progressive and becomes very regressive when looking at the top income hierarchy, the top 0.1 percent get taxed at extremely low rates (Sterdynaik, 2013). Taxes do not improve a negative distortion on income-based equity in all the countries evaluated in this study, however, targeted income redistribution programmes are an important alternative to reduced taxes. The social security programmes implemented for this purpose in France, is therefore considered in more detail below.

3.8.2. Social Security programmes offered by the government in France

The French have an extensive social security programme that is target based in nature. It targets lower income earning households more than any other social security programme in the EU (Rousselon & Viennot, 2020). The social security programme can be divided into two categories, the social insurance system, and the social assistance system. The social insurance system is funded through premiums paid in the form of tax (social security tax) and the social assistance programme is a system set up by government to provide relief to lower income earning households. The following benefits are provided as part of the government's social assistance system (Rousselon & Viennot, 2020):

- Elderly pension;
- Minimum livelihood assistance;
- Unemployment allowance;
- Family assistance; and
- Child welfare assistance.

According to Rousselon and Viennot (2020) the effectiveness of these programmes has been evaluated based on its ability to reduce inequality levels and alleviate poverty. Poverty is a shame experienced by every nation, regardless of how developed a nation is, and for that we also need to understand that inequality will never be fully eradicated. Social assistance programmes offered by the government do not reach all lower income earning households, some will always be excluded. However, France's social security programme has managed to lower the levels of inequality in the past few decades. Social security programmes reduce inequality in France by almost 19 percent and one Euro of social benefits lowers the inequality scale six times more than direct taxes, implying that social benefits have a stronger outweigh on the reduction of inequality than direct taxes (Rousselon & Viennot, 2020).

This enforces the findings from a study performed by Kalyva *et al*. (2015), that indicates that other alternatives are more efficient in improving social and economic equities than the reduction of taxes and the introduction of reduced rates. France employs the use of taxes and social initiatives to target inequality and improve the distortion on income-based equity caused by VAT and the lower levels of inequality.

As mentioned in paragraph 3.3.1 the two methods have played a pivotal role in alleviating the burden of lower income earning households and lowering inequality levels. Although the reduced rates can result in an administrative burden for government, they are a contributing factor to poverty alleviation and the social initiatives are doing more to ensure that the negative distortion caused by VAT is improved by significantly improving inequality, as per Rousselon and Viennot's (2020) evaluation.

3.9. Conclusion

This chapter has addressed the secondary objective of this study, which was to evaluate France and New Zealand's VAT models and evaluate how relief is provided to lower income earning households to improve the negative distortion of VAT on income-based equity. It had provided an evaluation of the two countries with different economic landscapes, tax systems and social welfare or security programmes. Both countries have attempted to improve the negative distortion of VAT on income-based equity by offering additional government assistance to lower the burden on lower income earning households and improve the negative distortion on income-based equity. The two very distinct tax models have highlighted an important aspect in relation to the negative distortion of VAT

or any other tax on income-based equity. A reduction of taxes on its own is not sufficient to improve the distortion on income-based equity. The levels of reduced rates, zero-rating or the lack thereof could result in an unfavourable impact on government's ability to raise enough revenue to fund social benefit programmes. The improvement of the negative distortion caused by tax should therefore also focus on redistributive programmes rather than solely on a reduction in taxes to receive a more beneficial outcome. Furthermore, this chapter has identified similarities and differences in the VAT models and relief provisions provided by France, New Zealand, and South Africa, which was evaluated in Chapter 2. Similarities were identified between New Zealand and South Africa; however, France has shown a few differences when compared to the other two countries. A summary of similarities and differences is tabled in Table 3-2 below.

Table 3- 2: Summary of comparison between South Africa, New Zealand, and France

	South Africa	**New Zealand**	**France**
Nature of VAT	VAT paid by end consumer	GST paid by end consumer	VAT paid by end consumer
Standard VAT rate	15% and 0%	15% and 0%	20%, 2.1%, 5.5% and 10%
Provisions applied to household goods and services	Zero-rating on selected items, the supply of goods consumed for agricultural or farming purposes, illuminating kerosene used for illuminating or heating, the carrying out of welfare activities as defined. Furthermore, South Africa also provides a VAT exemption on the following supplies (educational services, Childcare services,)	No zero rating on household consumer products.	A rate of 2% applied to (Some pharmaceutical products; some newspapers and periodicals; public television licence fees; admission to certain cultural events; some livestock intended for use as foodstuff), a rate of 5.5% on (Some foodstuffs; some non-alcoholic beverages; school canteens; water supplies, medical equipment for disabled persons; books (excluding those with pornographic or violent content); some e-books; admission to certain cultural events; some social housing; some renovation and repair of private

			dwellings; admission to sports events; some domestic care services; cut flowers and plants for food production; sanitary protection for women and 10% on (Some foodstuffs; certain non-alcoholic beverages; some pharmaceutical products; domestic passenger transport; intra-community and international road (some exceptions) and inland waterways transport; admission to some cultural services ;admission to amusement parks (with cultural aspect); pay/cable TV; some renovation and repairs of private dwellings; some cleaning in private households; some agricultural supplies; hotel accommodation; restaurants (excluding alcoholic beverages); some domestic waste collection; certain domestic care services; firewood; take away food; bars, cafes and nightclubs (except supply of alcoholic beverages); cut flowers and plants for decorative use; writers and composers etc.; some social housing; some works of art, collectors' items and antiques).

Government income redistribution programmes	Social grants catering for children, the disabled and the elderly	Social welfare programmes available to single parents, young parents, the unemployed youth, low income earning individuals, job seekers and the elderly	Social security programmes available to individuals earning minimum wage, children, the elderly, and families in need of assistance
Economic climate	Developing country	Developed country	Developed country
Political climate	Moderately stable	Stable	Stable

The next chapter will provide a summary of the three countries evaluated in this study and provide recommendations to assist South Africa in improving the negative distortion on income-based equity.

Chapter 4: Conclusion

This chapter provides a conclusion on the study and how the problem statement along with the study's objectives were addressed in a summary of key findings. It also addresses the third secondary objective of the study by tabling recommendations or suggestions that could be applied in the South African context. Finally, it highlights the study's main contributions to research, limitations and weaknesses relating to the study, and provides recommendations for further research in this area of study.

4.1. Introduction

In Chapter 1 paragraph 1.1.2 zero-rating in South Africa is widely seen by the public as a relief method that alleviates the burden VAT places on the poorest of households. The 2018 VAT rate increase resulted in a wide dismay from the public, which prompted the addition of a few zero-rated products to the zero-rated food items list. However, an extensive review performed by the independent panel appointed by the Minister of Finance revealed a few contrasting views into zero-rating, which prompted this study. This study strives to provide an understanding of the effects of VAT on income-based equity, what makes the tax regressive and how the regressivity of the tax can be improved. A summary of how the objectives of this study were addressed follows below.

4.2. Achievement of objectives

The following are the main research findings based on the study's objectives.

4.2.1. Main objective

The main objective of the study was to determine how South Africa's VAT model compares to New Zealand and France in terms of relief provided to low income earning households considering improving VAT's distortional effect on income-based equity. The main objective was addressed with secondary objectives that broke down the main objective into smaller objectives.

4.2.2. Secondary objectives

4.2.2.1. First objective

The first secondary research objective was to analyse South Africa's VAT model and determine how relief is currently provided to lower income earning households to improve its negative impact on income-based equity. The analysis of South Africa's VAT model identified zero-rating as a method used to provide relief to lower income earning households. A zero rate of VAT is applied to a list of products to remove the tax burden that will be incurred by households. This in effect is supposed to lower the price of products and make them more affordable as they are basic products that lower

income earning households spend a sizeable portion of their income on. However, this method has its own limitations and challenges.

It is difficult to determine the effects of zero-rating on consumer products, especially in informal markets, which is where most lower income earning households purchase basic food items from. therefore, it is difficult to evaluate or quantify how the zero-rating provisions have provided relief. A study performed by Statistics South Africa and reviewed in paragraph 2.3.2.1 has shown that the price of brown bread as a zero-rated product is not in line with what would be expected, when compared to white bread, a standard rated item. This demonstrates that in certain circumstances zero-rating on basic food products might not be functioning as intended by providing the intended relief. Furthermore, because zero-rating is applied to items consumed by all households and is not target based, it does not improve the distortion on income-based equity, except for any other limitations it provides relief to consumers of basic household products, which includes higher income earning households.

Additionally, to analyse the relief provided by government to lower income earning households, the study provided an evaluation of social development programmes, government grants. South Africa spends a sizeable portion of government revenue towards government grants and these grants target individuals who are vulnerable to zero or lower income, i.e., the elderly, children and the disabled. The grants however, although contributing to poverty relief and as an instrument of income redistribution can exclude other individuals who are not eligible for grants, the unemployed youth, people with low income and others. Therefore, not improving the distortion on income-based equity for all taxpayers who are affected by the negative distortion of VAT. The utilisation of zero-rating attempts to provide relief in the form of prices paid on household goods, but it cannot improve income-based equity. The one method that can be given focus to improve income-based equity is grants. Social grants are a redistribution of income, in other words a person who pays a certain amount of VAT on goods and services gets a portion of the VAT paid back through government grants. This is an effective method to improve the distortion on income-based equity. However as mentioned, South Africa's grant model is not a model that is inclusive of all lower income earning households, therefore limiting how well it can improve the distortion on income-based equity.

4.2.2.2. Second objective

The second secondary research objective was to analyse the current VAT models in place for New Zealand and France, and how these models provide relief to low income earning households and improve its negative impact on income-based equity.

New Zealand, like South Africa, has elevated levels of household inequality and the regressivity of GST is an issue faced by the country. The GST model on its own does not provide any relief in the

form of zero-rating or exclusions for households, making the GST model distinct from South Africa's VAT model in that aspect. The country however has a welfare system that caters for lower income earning households and the welfare system is targeted at individuals with low income or without the ability to earn an income. The welfare system caters for children, unemployed youth, individuals with low income, single youth parents and the elderly. This is the most important instrument used by New Zealand and it manages to almost cater for all lower income earning households. Although households do not receive any relief from tax, the benefits received from taxes improves the negative impact on income-based equity placed by GST. This is prevalent as; New Zealand uses over 100 percent of tax revenue collected on the crown expenses as detailed in par (3.5.2). Therefore, it can be argued that a major part of all the GST paid by households is in turn redistributed back to the lower income households, improving the income-based equity scale.

France on the other hand provides relief to lower income earning households to alleviate poverty and lessen the burden on lower income earning households. The tax rate on food and other basic household services, including pharmaceuticals is extremely low when compared to the 20 percent standard rate that is applied on all other goods and services. However, even though the reduced rates provide some sort of relief, it is not instrumental in the improvement of the negative distortion caused by VAT. As echoed in paragraph 4.2.2.1, reduced rates and zero-rating are not target based, all households enjoy the same benefits in proportion to their consumption, resulting in the same tax being paid by households.

France's security programme is like New Zealand's welfare system in that, the individuals targeted for the social security programme includes and is not limited to the unemployed, children, the elderly and low-income earning individuals, thus improving the income earning level of these individuals who form part of the low income earning households. The use of social security programmes has managed to contribute to the improvement of inequality and the negative distortion on income-based equity caused by VAT. It was determined in one of the literatures reviewed in this study that 1 Euro of social security programmes has managed to improve inequality six times more than any tax reductions or exclusions. This renders social security programmes as an important method used by France to provide relief and improve the negative distortion on income-based equity.

4.2.2.3. Third objective

The third secondary research objective was to identify areas of improvement or suggestions when evaluating the relief provided by New Zealand and France that could be implemented in the South African VAT model to improve the current model in place and enhance income-based equity. When we consider evaluations performed for New Zealand and France, there are some differences identified when compared to South Africa's model. There are differences in the relief provisions offered by the different countries. It is important to consider South Africa's economic landscape when

providing recommendations that will assist in the improvement of the negative distortion on income-based equity. France and New Zealand are developed countries, whilst South Africa is a developing country with a different political climate, any recommendations should take that into account. The recommendations are tabled in the following sections.

4.2.2.3.1. Recommendation A

Zero-rating has been a topic of contention in South Africa, however the impact that zero-rating provisions have on poverty alleviation and providing relief on lower income earning households is a topic of debate. South Africa would be in a better position to remove zero-rating and collect more revenue on these items. The additional revenue could assist in increasing the scope of government grants and provide additional grants to individuals who are excluded from the current grant system. Furthermore, grants are not the only way to provide relief, this study only focused on government social welfare, however further investment into other government initiatives that encourage job creation, entrepreneurship and skills development amongst others can possibly improve the effects of VAT on lower income earning households. New Zealand is one country that does not have zero-rating on household consumer goods or any other exclusions in their VAT model and it has managed to use all its tax revenue towards crown expenses , targeting a wide scope of individuals who are prone to low income. This recommendation would result in a big shift in the political climate of the country and would be ideal for implementation in a country that has a government that is committed to doing what it promises. The South African government would need to regain the trust of its citizens to ensure the successful implementation of this recommendation.

4.2.2.3.2. Recommendation B

The removal of zero-rating is one way to increase government revenue. However, another alternative that is seen in France is to include a higher standard rate for other items that are considered items purchased by higher income earning households, particularly luxury products. These items need to be carefully selected as items that are purchased by higher income earning households and the increase in VAT will not result in any dismay towards purchase. Luxury products are generally high value products and an increase of even 1 percent can have a noticeable increase in government’s tax revenue. VAT in its nature is regressive and the impact of the regression cannot be fully eradicated. However, as seen from the evaluation performed in this study, there are additional methods, specifically government’s social security programmes that make the impact of the regression endurable. Countries are different and influenced by different factors in their tax legislations and government policies, each country needs to take that into consideration when raising taxes or making amendments to current taxes.

4.3. Study's main contributions

The study provides an understanding of VAT as a form of tax by highlighting the history of VAT and its importance in government revenue. It also contextualises the regressivity of VAT by bringing in concepts such as vertical and horizontal equity, and income-based equity. It also contributes to an in-depth understanding of zero-rating in South Africa, including the limitations and benefits of zero-rating. It is widely assumed that zero-rating is a definite method for equalising the tax paid and provides relief in the form of reduced prices on zero-rated products. This study has provided contrasting views on how zero-rating is not the most effective tool to address the regressivity of tax and alleviate the burden tax places on lower income earning households.

4.4. Limitations or weaknesses

This study was a qualitative study that did not perform or provide an in-depth quantification of zero-rating benefits or any other government initiatives and could only rely on a literature review to provide an analysis of the impact mentioned. The study did not attempt to provide new theories on the relief provided to lower income earning households, but however built on the current existing theory. Furthermore, this was a limited study that covered three countries and did not provide extensive research on the study's research objectives. It could only provide a limited evaluation on the various aspects.

4.5. Direction for further research

As mentioned in the introductory chapter, this study was qualitative in nature. However, with the recommendations provided in this study, it would be beneficial to provide a quantitative analysis to better understand the benefits of zero-rating, government initiatives, not limited to social grants and how they improve the negative distortion on income-based equity. This can provide a more conclusive response to the recommendations tabled in this study and enhance awareness on the subject.

4.6. Conclusion

VAT is regressive and that fact cannot be changed, even with provisions like reduced rates and zero-rating, it will always be regressive as it is consumption based and not income based. This study has evaluated three different countries with different economic and political climates and the study revealed that a negative distortion on income-based equity is an issue that is experienced by all countries, due to the nature of VAT. The distortion can be improved using various methods aimed at income redistribution. Annexure A concludes the study by highlighting the similarities and differences identified between the three countries reviewed in this study.

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