A consideration of the possible withdrawal of the VAT zero rating on fuel in South Africa

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Mini-dissertation accepted in partial fulfilment of the requirements for the degree Master of Commerce in South African and International Taxation at the North-West University

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Graduation: May 2020

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SUMMARY/ABSTRACT

Title: A consideration of the possible withdrawal of the VAT zero rating on fuel in South Africa.

Key terms: Value Added Tax (VAT), VAT and government deficit, VAT and government revenue, VAT on fuel and Fuel levy

South Africa faces various economic and socio-economic challenges. One such challenge is the rising debt service costs and the fiscal budget deficit. The budget deficit arises as a result of government expenditure exceeding government revenue. The government spends on different items to meet the public's needs. Examples of such expenditure include health, education, social grants and the maintenance and upgrade of the infrastructure. Government collects revenue from different taxes: personal income tax, corporate tax, estate duty and Value Added Tax.

Currently South Africa's VAT is levied at 15%. This was increased by government as an avenue to collect more revenue. However, this did not solve all the government's problems of a budget deficit. This means the government needs more avenues to collect revenue.

One avenue which was proposed is the withdrawal of the zero rating on the VAT on fuel. Currently, fuel is levied at zero percent in South Africa. Fuel is also subject to fuel levies.

Other countries have repealed their VAT zero rating on fuel, with fuel being levied at either zero rate or exempted. Other countries have introduced VAT for the first time and subsequently introduced VAT on fuel. Previous research has indicated that South Africa learns from the experience of other countries and adapts similar approaches in different fields.

The purpose of this study was, therefore, to perform a comparative analysis from a policy perspective of the current and proposed VAT on fuel in South Africa with the

VAT on fuel in Kenya, the United Kingdom and Dubai. This study reviewed past research and literature concerning the different countries' policies on VAT on fuel.

The study found that in light of the prevailing fuel levy in South Africa, an additional VAT would put pressure on the average individual and the economy. This is derived from the conclusions performed on the countries where there was an increased burden on the taxpayer and economy as well as adverse effects on other factors such as administration of the tax and the effects on other taxes.

Recommendations were made on how the government could use the withdrawal of the VAT zero rating as avenue strategy to increase government revenue while taking into consideration different factors relevant in the implementation of VAT system.

The study therefore contributes to current knowledge by recommending how the government could approach the withdrawal of the VAT zero rating on fuel in South Africa.

Keywords:

South Africa, VAT, VAT on fuel, fuel levy, government deficit, government revenue

ACKNOWLEDGEMENTS

Firstly, I would like to thank God for His grace and provision throughout my studies. He granted me strength and ability to complete this mini dissertation, and for this I am eternally grateful.

To my parents, Nehemiah and Chipo Mavetera, no amount of words can ever express how grateful I am for the role you played in ensuring that I complete my studies. Thank you for your never-ending support, encouragement and motivation. Thank you for being the voice of reason when I felt like giving up. I am grateful for the opportunities you provided me and the way you paved through your own pursuit of excellence which enabled me to pursue my path too.

I would like to thank my supervisor, Professor Karina Coetzee for her guidance and valuable contributions towards this mini dissertation. I appreciate the patience you extended throughout the research process.

To my friends and family, thank you for the encouragement and all the acts of kindness you extended during this period. Thank you for being there for me in the good and bad times and never holding my absence against me.

Contents

Chapter 1: Overview of the Study

1.1 Introduction

Research shows that fuel costs affect the prices of almost all commodities/ goods and services within an economy (Kohler, 2006). Research has also shown that government tries to keep these prices as low as possible in order to regulate the prices (Heijden & Mbofholowo, 2008). However, the effect of VAT on any commodity results in an increase in price and thus a possible withdrawal of the VAT zero rating on fuel, followed by tax at standard rate, would increase the fuel price as VAT adds on to the price of fuel.

This study focused on the consideration of a possible withdrawal of the VAT zero rating on fuel in South Africa from a policy perspective. This chapter introduces the background to the study, the problem statement, research questions, and objectives. This chapter also highlights aspects of literature and methodology.

"Consideration" per the Cambridge dictionary (2009) means: "to think carefully about a fact when deciding or judging something." Merriam Webster (2009) defines this as "a matter weighed or taken into account when formulating an opinion or plan, facts to think about when making a decision." Consideration in the context of this study means to weigh different matters in order to formulate an opinion regarding the possible withdrawal of the VAT zero rating in South Africa. The consideration in this study was carried out through analysing literature. Analyse in the context of this study means the following: "to consider in detail and subject to an analysis in order to discover essential features or meaning (Merriam-webster, 2009)." The researcher will analyse available literature to arrive at a meaning.

1.2 Background to the research problem

Different revenue streams for the government include direct income tax, VAT, corporate income tax, estate duty, donations tax and personal income tax (National Treasury, 2019). With South African corporate tax already being among the highest in

the world, a further increase would severely impact the economy if the government decides on an increase in this sector (BusinessTech, 2016). Hence in the 2017 budget speech, a withdrawal of the zero rating on VAT on fuel followed by a VAT on fuel at the standard rate of 15% was mentioned as one of the considerations that government could adopt to curb the government deficit (National Treasury, 2017). It is estimated that this would bring in R18.2 billion in revenue per year (Schneider, 2017).

South Africa has one of the lowest VAT rates in the world. This low rate could be justified by the seemingly high personal income tax rates, the effective tax collection methods as well as the country's history (Rangongo, 2018). When compared to its African counterparts, levying fuel at zero rate of VAT is the norm, however when compared to most European countries that levy VAT on fuel at either the standard rate or a reduced rate (European Commission, 2019), South Africa's case may be deemed an anomaly.

The price of petrol in South Africa in July 2008 was at a moderate R6,92 but this has exponentially increased to R15,53 in July 2018 at the coast and R7,16 to R16,02 inland (Automobile Association, 2018). As at November 2019 the petrol price was R15,21 at the coast and R15,66 inland (Automobile Association, 2019). One major contributing cause for the increase is the general levy and Road Accident Fund Levy which is a component of the fuel price and which forms a significant average of 38% of the fuel price (Automobile Association, 2018). The two levies (hereafter referred to as the "fuel levy") have been criticised as they have been seen to be the "go to" taxes for increases by government (Njilo, 2019). A carbon tax on fuel was also introduced in the 2019 budget speech, resulting in another line of tax being added to the fuel price (National Treasury, 2019).

When VAT was introduced in South Africa, one of the considerations made in levying VAT on fuel at 0% was the fuel levy that was already in place (SAIPA, 2018). A VAT at standard rate would constitute "double tax" and would also cause administrative burdens (VATCOM, 1991).

With the ongoing need for government to increase its revenue, the repeal of the VAT zero rating is a lucrative option. However, with the price of fuel at what economists

refer to as “unnecessary high levels” due to fuel levies, the repeal of the zero rating on fuel followed by a standard rating on fuel has been criticised.

1.3 Problem statement

The government is constantly seeking to find revenue sources that would assist in increasing government revenue, whilst not increasing the burden on the taxpayer and other participants in the economy. The withdrawal of the VAT zero rating on fuel may contribute to an increase in government revenue, but it could affect the policy considerations involved in the initial policy relating to fuel levies. Though many countries have in the past successfully introduced and implemented a VAT on fuel, this avenue of increasing government revenue has been criticised in the South African context due to inherent factors applicable to South Africa. Furthermore, as concluded by the VATCOM in 1991 that VAT on fuel at the standard rate had attached to it many pitfalls led to the VATCOM opting to keep it at zero. It is worth exploring whether the current VAT on fuel concessions should be retained and also to ascertain whether the policy considerations which applied when VAT was introduced in 1991 are still relevant, or whether changed circumstances would justify the repeal of the VAT zero rating.

1.4 Research question

According to Hulley, et al.,(2007), questions arise out of a perceived knowledge deficit within a subject area or field of study. It is imperative to formulate a research question that is relevant and answerable, as failure to do this may compromise the quality of the study and subsequent results may be compromised (Hulley,et al., 2007).

1.4.1 Main research question

The main research question of this study is stated as follows: Is the withdrawal of the VAT zero rating in South Africa justifiable from a policy perspective?

1.5 Objectives of the study

To support the research process with the soundness of the research methods chosen, the research questions formulated are combined with research objectives. Hunter

(2003) elaborates a sound research study combines robust research methods with specific research objectives

1.5.1 Primary objective

The aim of this study was to analyze whether the withdrawal of the VAT zero rating on fuel is justifiable from a policy perspective.

1.5.2 Secondary objectives

In order to address the research problem, the primary objective is further broken down into minor objectives designed to:

- Review the literature on policies and concepts, relating to the history of the fuel levy, the current fuel levy and the possible withdrawal of the VAT zero rating on fuel, and its necessity in the design of a VAT system from a policy perspective and what that would mean for the existing policy- (Chapter 2).
- Compare different approaches on the repeal of the VAT zero rating from three different countries namely: Kenya, Dubai and the United Kingdom, and in turn logically attempt to make conclusions on what may happen to South Africa should the VAT zero rating on fuel be withdrawn. This includes exploring factors that should be considered in the development of the VAT process to determine where the countries that implemented this fell short and did well in this regard (Chapter 3).
- Recommend the possible solutions for South Africa after making conclusions based on the comparisons made (Chapter 4).

1.6 Research design and methodology

An in-depth literature review was performed with the aim to gain an understanding of the different elements contributing to the study. As part of the research methodology, this study considered the ontological and epistemological perspectives of the research. According to Killam (2013), ontology refers to what exists in other words the reality of the study. The main elements that exist in this study are: VAT, VAT on fuel, fuel levy, government deficit, and government revenue. The relationship between the

elements is outlined below. The nature of this research will be that of a qualitative approach.

The figure below depicts the relationship.

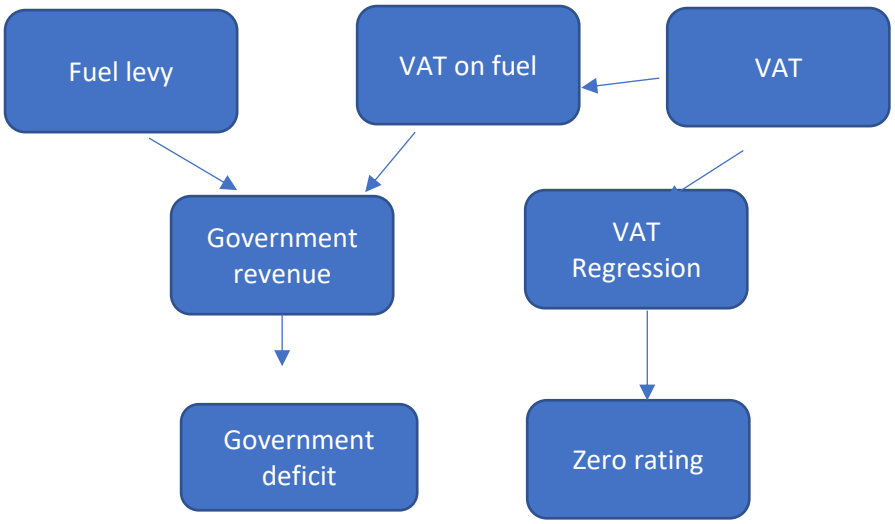

*Figure 1: The elements of the study- Source: Researchers own*1.6.1 Research Paradigm

Interpretivism involves researchers interpreting elements of the study, thus interpretivism integrates human interest into a study (Pham, 2018). Interpretivists adapt a relativist ontology in which a single phenomenon may have multiple interpretations rather than a truth that can be determined by a process of measurement (Pham, 2018). Virtually, with an interpretivism perspective, researchers tend to gain a deeper understanding of the phenomenon and its complexity in its unique context instead of trying to generalise the base of understanding for the whole population (Pham, 2018).

From the analysis of literature, the researcher in this study follows an interpretivist approach.

This study followed an emic approach to determine the projected realities of a possible increase of the rate on VAT on fuel. An emic approach refers to a subjective approach to reality where the truth is achieved by interacting with people or looking at similar

situations to get the truth. This then qualifies the research as interpretive in nature and therefore a qualitative approach was applied.

The document analysis research strategy followed by a cross case analysis was applied, where documents with discussions of perspectives from different countries (Kenya, Dubai and the UK) are analysed to obtain the required information to satisfy the requirements of the study. The types of documents included relevant legislation governing VAT on fuel in these countries, past research performed in the form of academic books and journals, the South African budget speech and a review of articles written by experts.

1.7 Chapter division

1.7.1 Chapter 1 gives the overview of the study and includes the introduction and background, research objectives, research question and research method. The chapter generally introduces the nature of the study. This is where the concepts surrounding the research were put into perspective. It also states the research methods adopted. It also stated the research question that the study addresses.

1.7.2 Chapter 2 discusses literature on the introduction of VAT, current VAT on fuel policy, the possible withdrawal of the current policy. This chapter discusses the inception of VAT in South Africa. This research looked at the rate of VAT on fuel upon the introduction of VAT, the reasons behind the choice of rate then, as per the VAT committee and the policy that was adopted.

1.7.3 Chapter 3 discusses the approach adopted by Kenya, UK and Dubai upon withdrawing the VAT zero rating fuel.

1.7.4 This chapter analyses the results of the analysis performed in Chapter 3. It is in this chapter where document and cross case analysis is used to derive conclusions and formulate recommendations for South Africa regarding its consideration of the repeal of the VAT zero rating on fuel.

Chapter 2: VAT, fuel levy and VAT Concepts

2.1 Introduction

The objective of this chapter is to review the literature on policies and concepts relating the history of the fuel levy, the current fuel levy and the possible withdrawal of the VAT zero rating on fuel, and its necessity in the design of a VAT system from a policy perspective and what that would mean for the existing policy. This chapter establishes a tone for the study in line with the first secondary objective stated in paragraph 1.5.2. Since the VAT legislation used by the countries that are referred to in this study differs, it is necessary to discuss the basics of VAT in the South African context to form a foundation for the study before the detailed analysis in Chapter 3. The chapter begins with a definition of VAT and an explanation of the concept of government revenue and government deficit in relation to VAT. Thereafter, the chapter proceeds to discuss the current VAT on fuel policy (zero rated) and the reasons behind the current policy. Finally, the chapter examines the possible withdrawal of the current VAT on fuel policy.

2.2 Value Added Tax (VAT)

According to the Value Added Tax Act no. 89 of 1991:

Section 7(1) Subject to the exemptions, exceptions, deductions and adjustments provided for in this Act, there shall be levied and paid for the benefit of the National Revenue Fund a tax, to be known as the value-added tax

(*a*) on the supply by any vendor of goods or services supplied by him on or after the commencement date in the course or furtherance of any enterprise carried on by him;

(*b*) on the importation of any goods into the Republic by any person on or after the commencement date; and

(*c*) on the supply of any imported services by any person on or after the commencement date, calculated at the rate of 15 per cent on the value of the supply concerned or the importation, as the case may be (South Africa, 1991).

2.2.1 Description of VAT

Value Added Tax (VAT) is a consumption tax where the consumer ultimately bears the burden (Go, et al., 2005). In South Africa, VAT is levied on the supply and importation of goods and services, while exported goods and services are exempted (Kearney, 2003). VAT is charged at all stages of production, but firms can offset the input tax they have paid on their own purchases of goods and services against the output tax they charge on their sales of goods (VATCOM, 1991). The basic idea of a VAT system dates back to the 1920s, although the first practical evidence of such a system appeared in France in 1948 (Azaria and Robinson, 2015).

2.2.2 VAT in the South African Context

In South Africa VAT was implemented on 30 September 1991 at a rate of 10%, after replacing the local retail sales tax (known as the general sales tax or GST) (VATCOM, 1991). The rate increased to 14% in 1993 (following the inclusion of additional zero-rated foodstuffs (VATCOM, 1991). In the 2018 Budget Review it was announced that the VAT rate in South Africa would increase from 14% to 15% (National Treasury, 2017). The increase was welcomed as this new VAT rate was seen as one of the strategies in which the government's budget shortfall could be funded in the least damaging way to the economy (other measures considered included an increase in the VAT on fuel from 0% to 15%) (Van Der Zwan, 2018). VAT is important in the collection of government revenue (Le, 2003). During the period of 1993 to 2002, the budget deficit decreased from an average of 7 percent to an average of 0.86%. This was mainly due to prudent fiscal management, more efficient tax collection, and the broadening of the tax base (Kearney, 2003). The revenue base is made up mostly of taxes. The most important taxes are income tax, value added tax, import taxes, and estate duties (National Treasury, 2008). Currently the government faces a budget deficit and therefore requires an expansion of the revenue collection avenues to decrease and eventually eliminate the budget deficit (National Treasury, 2019). Investopedia (2019), defines a budget deficit as a state when the expenditure of the government exceeds its revenue.

2.2.3 Addressing the regressive nature of VAT

VAT regression

VAT is a central aspect of the revenue systems in over 125 countries, and its widespread use raises important questions of equity, along with efficiency and ease of administration (National Treasury, 2018). VAT raises the challenge of how to generate adequate public funding in a way that does not place an unfair and undue burden on the poor and marginalised (National Treasury, 2018). Since its inception, VAT has been restructured in order to make it more equitable (Go, 2005).

The discussion of how VAT is regressive contributes to this study as it assists in understanding why certain items are levied at zero percent, in particular the VAT on fuel.

2.2.4 The relationship between VAT regression and zero rating

A recent study shows that VAT in South Africa would be regressive (taking a proportionally greater amount from those living on lower incomes therefore causing a return to a less developed state) in the absence of the zero-rated food items (VATCOM, 1991). The same sentiments were echoed by Kearney and Van Heerden (2004), when they stated that VAT is in nature regressive unless specific steps, like zero rating essential foodstuffs, are taken. In order to curb the regressive nature of VAT, the South African Value-Added Tax Act No.89 of 1991 makes provision for exemptions, exceptions, deductions and adjustments that effectively lower the VAT liability (Kearney, 2003).

From an efficiency point of view having one uniform rate which applies to all consumption is optimal however, no country in the world has such a system (The Davis Tax Committee, 2014). Nearly all jurisdictions provide relief of one sort or another in relation to so-called basic foodstuffs in order to advance equity considerations, either by way of zero rating, exemption or by applying a reduced rate to certain foodstuffs (VATCOM, 1991).

Due to its regressive nature, it was concluded that different rates for different goods, as well as zero rating would combat the regression of the VAT system (Kearney, 2003). In South Africa, zero rating applies to a wide range of basic food items and petroleum products (paraffin, petrol and diesel) which means that VAT becomes less regressive and could even be more or less proportional (National Treasury, 2018). South Africa as a developing country, faces challenges of poverty, meaning that zero rating and exemption measures were necessary and had to be considered upon implementation (National Treasury, 2018). In a report published by Statistics South Africa, it is stated that 49 per cent of South Africans spend less than R250 per month (Kearney, Van Heerden, 2004). The number of people living below the 2015 poverty line of R441 per person per month, or in extreme poverty, increased to 13.8 million in 2015, compared to the 11 million reported in 2011 (Omarjee, 2018).

2.2.5 Regression and progression

The opposite of a regressive tax system is a progressive tax system. A tax is progressive if the relative tax burden increases as income increase, and thus falls mainly on the rich (Varela, 2016). VAT is regressive because it is a tax on consumption and, compared to the rich, the poor consume a larger proportion of their income (Kearney, 2003). Without any zero rating or exemptions, VAT is regressive if considered in isolation for the reasons outlined above (National Treasury, 2018). It must then be noted that the efforts to ensure that VAT remains progressive involve zero rating items like fuel for example (Kearney, 2003). This explains one of the reasons why VAT on fuel was levied at zero percent when VAT was introduced in South Africa.

2.2.6 History of VAT in South Africa

In South Africa, the standard rate of VAT was fixed at 14 per cent from 1993 to 2018 and the zero-rating of 19 food categories is provided for (VATCOM, 1991). The introduction of these zero-rated items was made on the grounds that they provide a

means by which the government could indirectly target the poor, for whom such expenses may take up a large amount of their budget (Gcabo, et al., 2019). In 2018, the standard rate of VAT was increased by 1 percentage point to 15 per cent in order to generate additional revenue (National Treasury, 2018a). This took place alongside other adjustments to the tax system, including the use of fiscal drag, an increase in ad-valorem excise duty on luxury goods to 9 per cent, the introduction of a higher estate duty and donations tax rate for estates greater than R30 million, increases to the fuel levy and the Road Accident Fund Levy and increases in excise duty for alcohol and tobacco (National Treasury, 2018a). It was argued that the increase in VAT was "unavoidable if we are to maintain the integrity of our public finances" however "vulnerable households will also be compensated through an above average increase in social grants" (National Treasury 2018a: 11–12). To combat the increase of VAT, social grants were increased in the usual way on 1 April 2018 and unusually for the second time on 1 October 2018 (Feketha, 2018).

Concerns about these measures and the VAT hike were raised through public hearings and submissions from various sectors, including a joint written statement from 42 civil society organizations (Civil Society, 2018). The Minister of Finance through the Davis Tax Committee appointed a panel of experts to review the list of zero-rated items (Gcabo, et al., 2019), and their report-back was published in August 2018 (National Treasury, 2018). The Independent Panel undertook extensive analysis and argued that the increase in VAT would raise the tax on the poorest 50 per cent of households by around R1.8 billion or an average of R216 per household per annum (Independent Panel, 2018). The panel observed that "it would be cheaper to return the cost of the VAT increase to the poorest households than to extend zero rating" (Independent Panel, 2018: 8), but nevertheless recommended that various additional items should be zero-rated alongside other measures, such as nutritional support, free provision of sanitary products, and cash transfer amount increases. History shows that the South African government understands the effects of increased VAT on the economy and the citizens and hence it undertook different measures to combat this.

2.3 VAT and Government deficit

A German economist Adolf Wagner introduced “Wagner’s Law” also known as the law of increasing state spending. The law simply states that "as the economy develops over time, the activities and functions of the government increase" (Akrani, 2011). South Africa is no exception to this law, as its expenditure has been constantly increasing (South African Cities Network, 2018). With unexpected expenditure attributed to drought, water infrastructure and maintenance and other factors, the gap between the revenue collected and expenditure is widening. In turn the government needs more revenue to cover these expenses (South African Cities Network, 2018).

South Africa recorded a government budget deficit of R17 903 million in November 2016 (National Treasury, 2019). The budget deficit is now projected at 4.3% of income for 2017-18 (Hogg, 2018). While the total shortfall for the year that ended on March 31, 2019 was 232.9 billion (Naidoo, 2019). A deficit arises as a result of expenditure exceeding revenue (Amadeo, 2019). There is a trend indicating that South Africa has been in a deficit position over the past few years. The October 2016 Medium Term Budget Policy Statement (MTBPS) noted that revenue collection would fall well below estimates. Reference can also be made to 2017 where tax revenue was expected to be R23bn lower than the budget estimate due to slower economic growth. In 2017 MTBPS projected a revenue shortfall of R22.8 billion, which was then revised to R30.4 billion. This was the largest tax revenue shortfall relative to budgeted estimates since 2009/10. The 2018 Budget estimated that government would receive total tax revenue of R1.345 billion during 2018/19 (National Treasury, 2017). The projected budget deficit for the 2018/2019 period is projected to be 3.6% of Gross Domestic Product (National Treasury, 2018).

Projections have fallen short for three of the four main tax instruments. Personal income tax, VAT and customs duties were down by an estimated R15.2 billion, R11.3 billion and R6.5 billion respectively relative to the 2016 Budget estimate (National Treasury, 2017). The decline in import VAT was partially offset by strong domestic VAT collection, but VAT refunds have been higher than anticipated, reducing net revenue (National Treasury, 2017).

In laymen's terms this means that there is a shortfall of government revenue and the government needs more money to sustain the country and the growing needs of the people of South Africa. One avenue to increase the revenue as mentioned in the 2017 budget proposals is in the form of a repeal of the VAT zero rating on fuel (National Treasury, 2017). This repeal would then constitute an increase in VAT on fuel from 0% to 15%. The imposition of VAT as a policy option to increase revenue has high revenue potential and is widespread in other developed nations (Bickley, 2003).

2.4 VAT and Government Revenue

Government revenue is money received by the government (Mkhwanazi, 2008). Government receives revenue from different sources by levying taxes on wealth and income accumulation of individuals and corporations, goods and services produced, imports and exports (International Monetary Fund, 2001). To enable a uniform approach that is consistent when levying these taxes, the National Treasury has different policies attributed to each type of tax in place to administer the collection of the tax. (South African Market Insights, 2017)

Government expenditure is divided into different categories. In the spirit of the 2018 budget speech, government would be spending its limited resources on basic education, health, social grants, peace and security, economic development and higher education and training (National Treasury, 2018). When the government expenditure exceeds government revenue, this is a signal that more revenue is required (Lojanica, 2015). The government must then look at increasing revenue from certain sources or alternatively introduce new revenue sources. The three major tax instruments which raise over 80 % of the South African government's revenue are personal and corporate income tax and VAT (National Treasury, 2018).

The additional sources constitute a fuel levy, estate duty, donations tax and customs duty (SARS, 2019). Each of these categories has a different policy the government has in place to administer the collection. (National Treasury, 2008:1). It is during the annual budget speech that the Minister of Finance announces how the government will alter its fiscal policies to ensure enough revenue is collected to cater for the needs

of the country. In 2018 one of the avenues proposed to achieve more revenue collection included an increase in the VAT rate from 14% to 15% (National Treasury, 2018).

According to Wagner's Law, South Africa needs more revenue and different avenues must be explored to enable this. This study focuses on one avenue mentioned in the budget speech of 2017 namely a possible increase in the VAT on fuel from 0% to 15%.

The Tax Reform Act of 1986 had a basic structure of broadening the tax base and lowering rates. Economic research and trend however make clear that the "broaden the base and lower rates" blueprint is flawed. The right mantra should be "broaden the base and raise top rates" (Fieldhouse, 2013). An increase in the VAT on fuel from 0% to 15% entails "broadening the base" as per above principles. VAT accounts for 25% of the overall budget revenue and is probably the most effective tax to use, through a higher overall rate or a new higher luxury good rate, to generate additional revenue to help reduce government debt (Businesstech, 2018).

2.5 VAT on fuel

When VAT was introduced the implementation, process was experienced as most painful (Kearney, 2003). As mentioned in section 2.1.1 as VAT was regressive in nature, certain measures had to be considered. Zero rating of basic foodstuffs such as brown bread, maize and mealie rice was one of the measures taken to combat the regressive impact of the tax (VATCOM, 1991). In addition to this, petroleum products were also zero rated. Administrative burdens of the already existing fuel levy were among the reasons quoted to justify the zero rating on fuel (VATCOM, 1991). There therefore was/is no VAT on fuel.

While the VATCOM understood the importance of having certain foodstuffs as zero rated, they also thought it would be ideal to have fuel at zero rate (National Treasury, 2007). The reason behind this was that a fuel levy was already in place, and that an additional VAT charge would result in double taxation on fuel. The VATCOM, implemented a zero rate on fuel because goods like diesel and fuel are subject to

excise duties (as is the case in South Africa) (VATCOM, 1991). It was then held that excise duties and import duties form an integral part of the basic price, in the case of excise duties to partly account for certain externalities and in the case of import duties as a means of protection for local industry – i.e. the so-called infant industry argument (VATCOM, 1991). Thus, in both instances the duties constitute part of the price (consideration) paid for the goods acquired by end consumers, and as such generally form part of the value upon which VAT is imposed (VATCOM, 1991).

Zero-ratings and VAT exemptions shrink the tax base and necessitate a higher standard rate in order to compensate for the revenue loss (Toder, et al., 2012). Thus, for example, in South Africa, R55 013 billion in revenue was forgone in the 2015/16 fiscal year as a result of zero rating certain supplies (R22 794 billion in relation to basic foodstuffs), while revenue was reduced by a further R1 332 billion as a result of the exemption of other supplies (VATCOM, 1991).

This shows that a repeal in the VAT zero rating would indeed influence the government's revenue, by way of an increase. In 2017, the Minister of Finance announced a number of considerations and that a repeal of the zero rating on fuel whilst applying the standard rate (14% then) on fuel was a trending consideration. Looking ahead to 2018, South Africa experienced its first VAT increase from 14% to 15% in 14 years, however fuel remained zero rated. Here the principle mentioned above can be observed that: zero ratings shrink the tax base and necessitate a higher standard rate in order to compensate for the revenue loss. This logically leads to the need to respond to the research question generated in this study: the repeal of a zero rating on fuel, and what this would entail, what then would happen to the current fuel levy that is in place?

The structure of the petrol price

One of the components of the petrol price is the fuel levy. Before exploring the fuel levy this study analyses the structure of the petrol price. The structure of petrol price has remained essentially the same since the 1950s consisting of:

2.5.3.1 The basic fuel price

The basic fuel price (BFP) is based on the import parity principle i.e. what would it cost a South African importer of petrol to buy the petrol from an international refinery, transport the product from that refinery, insure the product against losses at sea and land the product on South African shores (Sinthumule, 2010).

2.5.3.2 Tax component (various government levies)

The different levies inherent in the petrol price include:

- Petroleum products levy: to reimburse the pipeline users for the applicable NERSA tariff on transporting fuel through the pipeline - a levy set by the Ministers of Energy and of Finance in line with the expenditure budget of NERSA
- Illuminating Paraffin (IP) Tracer dye levy: to reimburse the oil industry for buying IP tracer dye and to inject it into IP to curtail the mixing of IP and diesel (loss to the Fiscus)
- Slate levy: to finance the cumulative under recovery of the industry. Only applicable when the cumulative slate balance exceeds R250 million (under recovery)
- Fuel levy: Tax levied by the Government (Minister of Finance)
- Custom and Exercise levy: a duty collected in terms of the Customs Union Agreement
- Road Accident Fund (RAF) levy: To compensate for people involved in vehicle accidents.
- Demand Side Management levy (DSML): Introduced in 2006 to curtail the use of ULP 95 in the inland market (Sinthumule, 2010).

2.5.3.3 A wholesale margin–

This is an oil company margin which is determined to yield a benchmark industry average of 15% rate of return (10%-20% range with a one-year lag) on the depreciated book value of assets for the year ended December.

2.5.3.4 A retail margin – dealer margin and other components that have varied over time (Mondliwa and Roberts, 2014). Historically a survey by Small Business Advisory Bureau (SBAB) annually held that the retail margin included:

- Annual operating costs (OPEX) – Average annual petrol sales
- Other costs adjusted by CPI
- Asset Base adjusted by PPI
- Total volumes
- Electricity (NERSA)
- Salaries for Forecourt workers (MIBCO)

2.6 Fuel Levy

2.6.1 Definition of fuel

The Cambridge dictionary (2019), defines fuel as “a substance that is used to provide heat or power, usually by being burned.” In this study fuel will refer to the petroleum products on which a fuel levy is charged. These include petrol, diesel, biodiesel, unmarked aliphatic hydrocarbon solvents and unmarked illuminating kerosene (unmarked paraffin) however. This study will, however, specifically focuses on petrol and diesel (National Treasury, 2019). The focus of this study being on the repeal of VAT on fuel at the pump, hence the focus has been confined to these two petroleum products.

2.6.2 Fuel levy

The fuel levy, also known as "General Fuel Levy, “is a tax payable by the licensed manufacturers of petroleum products within South Africa (Department of Logistics, 2017). This fuel levy is an annually adjusted tax that is largely intended to fund government’s general expenditure programmes (Department of Logistics, 2017). About a third of the money is also shared with metropolitan municipalities (van Wyk, 2014). Petroleum products include petrol, diesel, kerosene and biodiesel. There are two fuel levies in South Africa: The General Fuel Levy, and the Road Accident Fund (RAF) Levy. These two levies along with the basic fuel price and the wholesale and retail margins, and distribution and transport costs form part of the fuel price (Automobile Association, 2019). The General Fuel Levy is a tax charged on every litre

of petrol sold. As at February 2019, the general fuel levy was at R3.37 for petrol and R3.22 a litre for diesel (Businesstech, 2019) .

The fuel tax (consisting of several levies on fuel) has been the next biggest contributor to the pump price of fuel since 2000 (Amusa, Chitiga, Mabugu, 2009). The general fuel levy forms part of the national revenue fund and is a nationally administered tax, collected by the South African Revenue Service (SARS) and is treated as a general tax and not, as many people assume, for road-related expenses (SARS, 2016). The fuel levy in South Africa represents a tax paid at the pump on fuel, predominantly processed fossil fuels like petrol and diesel (Ncanywa & Mgwangqa, 2018). In 2011 this tax represented about 29.6% of the price of 93 octane petrol and 30.3% of the price of diesel (SARS, 2011). Five percent of the total fuel price paid at the pump in South Africa goes to the Road Accident Fund which is a state insurer that provides insurance cover to all drivers of motor vehicles in South Africa in respect of liability incurred or damage caused as a result of a traffic collision (Mondliwa and Roberts, 2014).

2.6.2.1 Uses of the fuel levy

South Africa's main source of income to fund the construction and maintenance of roads, as well as lend support to public transport, has been the fuel levy (National Treasury, 2014). Money collected through the RAF Levy portion of every litre of petrol sold is used to fund the Road Accident Fund, which uses the money to compensate victims of road accidents (Automobile association, 2018). During the 2012/2013 financial year the fuel levy (which was ring-fenced for the provision of road infrastructure from 1935 to 1988) contributed R40.4 billion to the National Revenue Fund administered by National Treasury (Van Rensburg, 2015).It is contended that the fuel levy was and remains an economically efficient way of collecting income from road users (Van Rensburg, 2015).

2.6.2.2 Commendation and Criticism of fuel levy

Proponents of the fuel levy state that there is an existing mechanism to administer this levy and no additional infrastructure elements, such as toll booths, retail billing systems or enforcement issues, need to be implemented (Van Rensburg, 2015). Administration costs are therefore low in proportion to the revenue collected, and fuel levy is readily accepted by the public (Department of Logistics, 2017). Policy changes that affect fuel prices would obviously affect households that consume fuels (Ncanywa & Mgwangqa, 2018). It is also stated that fuel levy is a tax hard to evade, hence it is the preferred revenue stream (Businesstech, 2018).

Notwithstanding the favourable characteristics of the fuel levy, opponents to the fuel levy state that this tax is not without problems. While the fuel levy is levied nationally, it is used to fund roads in specific regions, thus there is a spatial mismatch between those who pay (everyone) and those who benefit (the region) according to Van Rensburg, (2015).These sentiments were mirrored by the World Bank where it was stated that fuel levies contribute to fuel price distortions and fuel smuggling (Heggie & Vickers, 1998). If the fuel levy is not levied nationally, it is likely to give rise to increased arbitrage opportunities near periphery regions (Van Rensburg, 2015).

An increase in the fuel levy has a negative impact on socio-economically deprived population classes, as it is a regressive tax where everyone pays the same (Ncanywa & Mgwangqa, 2018). Lower-income car users will therefore be hit hardest by the fuel levy increase, as they do not have as much disposable income as higher-income car users (Mabugu , et al., 2009).

2.6.2.3 Review of the fuel levy

It was considered at the South African conference in July 2015 whether the fuel levy needs to be reviewed and supplemented by a long-term sustainable income source for the country's ageing transport road infrastructure (Businesstech, 2018). Professor Stephan Krygsman (2018), of Stellenbosch University said: "There is a need to move away from a general fuel tax that is dependent on fuel sales to a road user pricing system that reflects actual costs that road users and society incur."

Another factor to take into consideration when determining the sustainability of the current fuel levy is the rapid development in the technology that affects vehicle's usage of fuel (Department of Logistics, 2017). New advances in technology are making road vehicles more fuel efficient each year (Sustainable Energy Africa, 2017). Between 1970 and 2012 the average fuel efficiency of all vehicle types increased by 32% at an average rate of 0.9% per annum (Van Rensburg, 2015). Roughly translated this implies that a 2012 model vehicle can travel 32% further than a 1970 model vehicle, using the same fuel amount, and paying the same fuel levy. The result is an increasingly unproductive fuel levy (Van Rensburg, 2015).

Road users do not really consider the fuel levy when driving and the levy therefore does not really induce people to change their travel behaviour (Van Rensburg & Krygsman, 2018). The King Review commissioned by the UK Government concluded that 30% fuel consumption savings are achievable for the average new vehicle in the short (5–10 years) time frame (Australian Transport Council, 2008). Increasing the fuel levy will have a corresponding increase in transport costs, which will in turn have an impact on inflation (Van Rensburg, 2015).

A review of the current fuel levy is necessary, as increasing the fuel levy, which would be accompanied by a corresponding increase in inflation each year, is not sustainable (Businesstech, 2018). As cars become more fuel efficient, the long-term trend for the amount of fuel sold decreases, with the net result that revenue from fuel levies will also decrease (Department of Transport, 2017). If the fuel levy is said to be unsustainable, it is worth exploring if a repeal of the zero rating of VAT on fuel is justifiable so as to possibly replace it.

2.6.2.4 Link between fuel levy and economic growth

Researchers have examined the impact of fuel levies on economic growth in developed and developing countries, where the results have yielded similar outcomes (Rasche & Tatom, 1977). The impact of an introduced fuel levy on the South African economy, showed that there was a negative effect on production input costs of petroleum products (Reynolds & van Schoor, 2005). Increasing the fuel levy might

lead to decreasing expenditure by households, lower employment and decreasing returns to factors employed in production (Ncanywa & Mgwangqa, 2018). The price of fuel to consumers in South Africa includes a portion that is a fuel levy (Rasche & Tatom, 1977). The increments of fuel levies can therefore lead to an increase in the price of fuel (Ncanywa & Mgwangqa, 2018). Rangasamy (2017) found that petrol price increases have a direct impact on headline inflation by virtue of its share in the CPI basket.

2.7 VAT on fuel

Taking into consideration the above regarding the current fuel levy, it is clear that government expenditure remains under threat and therefore it can be anticipated that more revenue would be required to cater for the ever-increasing expenditure (United Nations, 2015). To increase government revenue (grow the tax base), it is then understandable why Pravin Gordhan (Minister of Finance in 2017) announced a possible increase in the VAT on fuel from 0% to the standard rate (now 15%) (National Treasury, 2017).

In terms of the 2017 budget considerations, the repeal of the VAT zero rating on fuel would come with an increase to the VAT on fuel to 15% (National Treasury, 2017). The budget review said that to mitigate the effect on transport costs, the government would consider combining this with either a freeze or a decrease in the fuel levy (National Treasury, 2018).

South Africa currently has a zero rate on fuel which means that there is no VAT on fuel (South Africa, 1991). It is stated that the already existent fuel levy mentioned above, would either have to be taken away and be replaced with VAT or an additional VAT amount added to the amount currently paid for petrol and diesel at the pump, (National Treasury, 2017)

2.8 Chapter Summary

This chapter reviewed the literature on policies and concepts, relating to the history of the fuel levy, the current fuel levy and the possible withdrawal of the VAT zero rating

on fuel, and its necessity in the design of a VAT system from a policy perspective and what that would mean for the existing policy. The study's first secondary objective (par 1.5.2) was met.

In the next chapter how, other governments approached a repeal of VAT zero rating on fuel will be examined.

Chapter 3: VAT Introduction in other countries

3.1 Introduction

In chapter two the definition of VAT, concepts such as fuel levy, government debt, VAT on fuel and the government policy were explored. The aim of this chapter is to analyse the various approaches adopted by different countries when they repealed a zero rating on fuel. In line with the second secondary objective stated in Chapter 1, this chapter compares different approaches on the repeal of the VAT zero rating from three countries namely: Kenya, Dubai and the United Kingdom. For the country that did not levy VAT (Dubai), the study explores the introduction of VAT.

VAT is a revenue generating instrument for most countries which has helped them earn more revenues than they would have had without the VAT in place (Alavuotunki, et al., 2019). As of 2018, 166 of the 193 countries with full UN membership employ a VAT, including all OECD members, except the United States, which uses a sales tax system instead (OECD, 2019). Today, VAT and GST continue to expand and evolve as new systems roll out and existing ones adapt to the implications of digital disruption and other forces (Chanel, 2019).

In order to have a successful VAT system in place, it is important that businesses and the government have a well-planned transition as the introduction of such a tax requires administrative capacity, training and technology on the part of both (EY, 2017). Due to differences in legislation, in parties implementing the changes some countries may experience more challenges than others (Le, 2003). “In the EU, making changes is particularly difficult because all the countries need to agree unanimously on the change,” says Heady (2019), Professor of Economics at the University of Kent in the UK and former head of the OECD”s Tax Policy and Statistics division (Chanel, 2019).

Amidst policy planning, many policies have made provision for their respective country’s circumstances at country level to curb poverty, inflation and many other factors (National Treasury, 2007). The use of exemptions, reduced rates and zero ratings are amongst the mechanisms adapted (Gendron, 2016). In South Africa

particularly, the VAT on fuel has been zero rated. It has been mentioned by the Department of Finance that the zero rating on fuel could be repealed in order to expand the VAT base and in turn increase government revenue (National Treasury, 2017).

This chapter follows the document analysis approach to evaluate the possible withdrawal of the VAT zero rating in South Africa by exploring how other countries have approached it. The following countries will be evaluated: Kenya, Dubai, and the UK. The reason why these countries were chosen is outlined in section: 3.2.2

3.2. Data analysis

3.2.1 Factors considered in the implementation of VAT

The following factors considered in the implementation of VAT are used to form the basis for conclusion in Chapter four.

- Burden on taxpayer

  One of the key considerations in evaluating taxes, is the distributional effect, whether the burden falls on the rich, or the poor, or both (Valodia & Francis, 2018). Tax burden refers to the amount of tax borne by an individual or a business (Mutua, 2012). Tax burdens vary depending on several factors including income level, jurisdiction and current tax rates (Mutua, 2012). It is worth noting that tax burden may not be the same as the tax actually paid because of the possibility of passing a tax on (Mutua, 2012). South Africa is known as one of the jurisdictions with the highest tax burden in the world hence it is essential that the addition of additional VAT be carefully considered (Siziba, 2019). The repeal of a zero rating on the VAT on fuel may lead to more pressure on individuals, especially the poor. Through taxes, tolls and other unavoidable levies, individual taxpayers are giving up to half of their monthly salaries to the taxman (Peacock, 2011). Whether or not it is sustainable to add on to the pressure by repealing the zero rating would need to be considered.

- Administrative burden

  When VAT was introduced the VATCOM insisted that there were administrative burdens associated with the levying of VAT on fuel at the standard rate hence

they sought to levy VAT at zero percent (VATCOM, 1991). It was argued that exemption is an elegant way of relieving certain businesses from the administrative burden of complying with the VAT system (e.g. public transport, taxis) (National Treasury, 2011). In this regard, the threshold below which certain businesses do not have to register for VAT is also an indirect form of exemption (The Davis Tax Committee, 2014). However, whilst VAT exemption might result in administrative relief for businesses that make only exempt supplies, it results in major administrative complexities for those businesses that make both exempt supplies and taxable supplies (standard- and /or zero rated) (National treasury, 2011). The repeal of the zero rate will bring into consideration the administrative effect on businesses that would then have to comply with the new rule.

- Effects on other taxes

  Currently there are other taxes charged on fuel known as the general fuel levy, Road Accident Fund (RAF) levy and customs and excise taxes (Automobile Association, 2019). Consumers currently pay R5.34 towards indirect taxes on every litre of petrol bought, and R5.19 on every litre of diesel (Businesstech, 2019). Whether the fuel levies will be repealed or reduced will have to be considered upon the repeal of the VAT zero rating as many are concerned the levying of both the fuel levy and VAT on fuel would constitute double taxation as well making the commodity expensive (National Treasury, 2017).

- Government revenue and the expansion of the VAT base

  The South African government has three main tax policy instruments – Personal Income Tax, VAT and company taxes, which respectively make up 37%, 25% and 18% of total tax revenues (OECD, 2018). A repeal in the VAT zero rating is said to increase government revenue by an estimated R18.2 billion a year, if Treasury's calculations were correct (Hogg, 2017). The repeal of VAT zero rating on fuel would lead to an expansion in the VAT base as well as an increased revenue.

- Environmental consequences

  The production and use of fuels can have adverse effects on the quality of air and climate change. The repeal of a zero rating of VAT on fuel in other countries (the UK for purposes of this study) was introduced to discourage the use of cars (which require fuels to operate) and therefore contribute to the wellbeing of the environment.

  Different factors contribute to the high fuel prices. More recently, climate change concerns have led to increases in fuel prices in several states (Fergusson, 2000). In formulating the EU policies on fuel, environmental considerations have played a part in the different price ranges (Fergusson, 2000). The high fuel prices in the UK are attributed to member states pursuing policies for environmental reasons in isolation of taxation decisions being made in other member states (Speck & Palear , 2016)

  The countries that used the above motivation to repeal a zero rating on VAT are discussed and their success factors explored.

- Government debt

  In South Africa, the planned fiscal deficit of 4.5% of GDP in 2019/20 will be greater than previously planned and the largest since 2012 (Krugel & Viljoen, 2019). In addition to this, debt service costs will remain the fastest growing spending item, while rating agencies will be unhappy with the widening of the fiscal deficit, higher peak in public debt, and increased exposure to the financial woes at State Owned Enterprises (SOE) (PWC, 2019).

  Some countries e.g. Kenya, who had similar challenges with regard to fiscal debt were advised by the IMF to introduce a VAT on fuel as a means to decrease the fiscal deficit. This will be explored further in the study.

- Public transport

  The taxi industry will be hard-hit once the proposed scrapping of the Value-Added Tax (VAT) zero rating on diesel and petrol is implemented (Visser,

2017). Government indicated that it could consider combining the zero-rate removal with a freeze or a decrease in the fuel levy to decrease the impact on transport costs (National Treasury, 2017). Petrol is a necessity for most South Africans as people either use their own transport or public transport [taxies and buses] to get to work and back (Sustainable Energy Africa, 2017). Since transport is part of the basket for measuring inflation, inflation will increase (Visser, 2017).

3.2.2. Motivation for choice of countries

In this section, the following countries are discussed: Kenya, the United Kingdom and Dubai. A comparative analysis was performed, based on the literature relating to the different countries.

A homogeneous purposive sample is one that is selected for having a shared characteristic or set of characteristics. Kenya was selected because it has some characteristics that are similar to South Africa. Like South Africa, Kenya is a developing economy in Africa. The socio-economic challenges that the two countries face are common. Kenya repealed its VAT zero rating on fuel in 2018, which is recent and would form the basis for comparison that is relevant. Kenya also had a widening budget deficit that could be solved by the increase in revenue from the repeal of a VAT zero rating.

The United Kingdom was chosen due to its efficient VAT on fuel system that has been in place for a long time. The approach that the UK took where it introduced fuel at a reduced rate is worth exploring too.

Lastly, Dubai was chosen as its situation is unique. Owing to not having had VAT/ tax at all prior to the current VAT on fuel, the approach adopted by the country was worth exploring. The developments in the tax system are also recent as the VAT on fuel was introduced in 2018. This makes comparison easier and assists with relevance. Dubai is a country that has one of the lowest petrol prices after the VAT on fuel is levied. This was relevant as the approach could also be explored from a South African perspective.

The three countries had a common objective when they made changes to their respective tax policy to which South Africa can relate. The motivation to increase the VAT rate on fuel was an increase in government revenue.

The countries are compared to South Africa. South Africa is a relatively "younger" nation which gained its independence in 1994 when it held its first non-racial democratic elections (SA History, 2017). South Africa has an extremely high unemployment rate, which rose to 27.5% in the third quarter of 2018 (Business report, 2019), South Africa has a conventional transport system catering both to the rich and poor. Currently, there are no alternatives to ameliorate the increasing fuel cost, there are no alternatives to the low standard, inefficient and ineffective public transport system (Department of Economic Development and Tourism, 2005). A large portion of the monthly earnings of poor people is used for home-based work trips by public transportation (Pillay, 2001).

The need in most developing countries is to increase government revenue in order to cater for the ever-growing public expenditure. (Gupta, 2007). The countries used for comparison are analysed in the subsequent segment of this study.

3.3 Kenya

3.3.1 Introduction

An African country which has recently introduced a VAT on fuel is Kenya. Before analysing the most important aspects surrounding the VAT policy in Kenya and its role as a comparison to South Africa, it is important to highlight some key facts about Kenya as a country. There are a few similarities it shares with South Africa.

Along with the coffee industry, tourism is a significant generator of income for Kenya (Condliffe, et al., 2008). People visit the country to explore nature and go on safaris. There is no government-run public transportation system in this country (Nation Facts, 2019). Kenya's economy remains energy starved with restricted access to electricity (Blimpo & Cosgrove-Davies, 2019). The population is 51 711 721 and according to the Labour Force Basic Report (2016) the unemployment rate at the time of the report was

7.04%. Like SA, it is a developing country because it has a less developed industrial base and generally a lower human development index. It is however the biggest and most advanced economy in east and central Africa (Expogroup, 2019), as South Africa is the largest economy in Southern Africa (African Development Bank, 2018).

3.3.2 VAT in Kenya

The introduction of VAT in Kenya can be traced back to 1990 (1 January 1990) when it replaced the Sales Tax which had been in operation since 1973 (PWC, 2014). Sales tax was a reliable source of revenue but as the economy continued to grow and became more sophisticated the limitations of the system became more pronounced, hence the country moved from sales tax to VAT (Wawire, 2017). Of the total revenue collected in the last decade, VAT constitutes 28% of total revenue, making it the Kenyan government's second largest source of government revenue (Mutie, 2016)

Upon its introduction Kenya experienced a revenue shortfall in the initial introduction period, but VAT performance has subsequently contributed to improved revenue collection at lower administrative and compliance cost (Mutua, 2012). Administration of VAT relies heavily on proper recording of transactions as the product moves toward final market (Le, 2003). The pillar for ensuring proper recording is done is transparency. After two decades, the VAT structure was deemed to have become complex, inefficient and unproductive (Mutua, 2012). According to Mutua (2012), the factors contributing to the challenges include:

- High procedural and administrative costs regarding managing high frequency tax filing, processing refund claims.
- Distortions of the VAT system and tax leakages caused by exemptions and zero rating of certain goods and services.
- Huge backlog of refund claims which has not only been difficult to administer but also affects cash flow for businesses;

For the above reasons the Minister undertook, through a constituted task force, to review the VAT Act with a view to "making it simpler and easy to administer" (Mutua, 2012). When it comes to the administration of the VAT on fuel, it was stated that the businesses with a turnover of five million Kenyan Shillings (KES) for a period of twelve

months were expected to register (Deloitte, 2019). When translated at an average rate (period ranging from 23 May 2019 to 17 November 2019) of R1= 7.0009 KES[1] (Exchange Rates UK, 2019), the 5 million amounts to R714 276 . Businesses within this range can register voluntarily. This meant that there were persons who had not yet put in place the necessary systems to start charging VAT (TaxKenya, 2018).

Six petroleum products had been exempted from VAT since 1 September 2013 (when the Value Added Tax Act, 2013 (the VATA) became effective) for a transition period of three years, which was due to end on 1 September 2016 (Anjarwalla & Khanna, 2018). Since the introduction (1990) of VAT, petroleum products had been exempted from VAT (Wanjala, 2017). According to Anjarwalla and Khanna (2018), the petroleum products that had been exempt from VAT during the transition period are set out below:

a. Petroleum oils;
b. Motor spirit – regular and premium;
c. Aviation spirit and spirit type jet fuel;
d. Special boiling point spirit and white spirit;
e. Light spirits and preparations;
f. Partly refined crude;
g. Kerosene – jet fuel and illuminating kerosene;
h. Medium petroleum oils and preparations;
i. Gas oil – automotive, light, amber – for high speed engines; and
j. All-natural gas in a gaseous state

On 2 September 2013, following recommendations from the IMF, the cabinet secretary announced a commencement date of the new VAT Act 2013, which would result in the re-classification of most zero rated and exempted goods and services to standard rated (at 16%) (Anjarwalla & Khanna, 2018). VAT on petroleum products such as petrol, diesel, kerosene and natural gas did not survive the re-classification. They were re-classified from exempt to standard rate ("vatable") (Nyabira, 2019).

[1] The exchange rate will be used consistently in this study for conversion of Kenyan Shillings to South African Rands.

3.3.3 VAT on fuel in Kenya

The idea of re-classification of VAT from zero rate to standard rate on fuel in Kenya, came about in 2013 after it was encouraged by the International Monetary Fund (IMF) (Mutie, 2016). The IMF even set this as a condition for Kenya when they applied for a standby credit facility that would allow emergency borrowing in the event of economic shocks of general economic nature (IMF, 2015). The IMF regards the taxation of petroleum oils as critical for Kenya to maintain and deal with the level of public debt (Ngumy, 2018).

This section of the study analyses how Kenya approached the introduction of reclassification of VAT on fuel. The reclassification was effective from September 2018 and it affected all petroleum products as they were now subject to VAT at the standard rate of 16% of their taxable value (Ngumy, 2018).

The Kenyan Treasury Department expected to raise 71 billion shillings (R10 141 553 229) from the VAT on fuel (Business daily, 2018). Njiraini (2019) states that in order to control the 2018 budget deficit which was estimated to be around Sh559 billion (R79 846 876 830), Treasury had to broaden its tax base and cut spending. Alternatively, the government considered increasing the VAT rate to 18% from 16% to raise the extra required revenue. This option would have spared reclassification of VAT on fuel to standard rate and helped realise an extra Sh49 billion (R6 999 100 115) in revenue. However, it could not raise the required revenue on its own. It was projected to raise Sh22 billion (R3 142 453 113) less than reclassifying petroleum products from exempt to standard rate (Njiraini, 2019).

On 9 June 2016, the National Assembly, through the Finance Act, 2016, approved a two-year extension (Business Report, 2018). This meant that the sale of petroleum products had not been a taxable supply for purposes of the VAT (either at a rate of 0 percent or 16 percent (standard rated)) and hence players in the value chain had not been required to charge VAT (Anjarwalla & Khanna, 2018).

The approach taken by the authorities seems to be a harsh one as they mentioned that VAT would be imposed on the taxable value of fuel. Without VAT on fuel,

petroleum products were already subject to excise duty, the road maintenance levy, the petroleum development levy, the petroleum regulation levy, import declaration fees and Kipevu Oil Storage Facility charges (Anjarwalla & Khanna, 2018). According to the VAT Act of 2013, this meant that the VAT would be charged on an amount inclusive of all the above-mentioned components of the fuel price. As of August 2018, the taxes (excluding VAT) paid per litre of petrol and diesel were 39.37 shillings (R5.62) and 29.78 shillings (R4.25) respectively. When including VAT, the total taxes paid amounted to 57.57 shillings (R8.22) and 119.18 shillings (R17.02) per litre of super petrol and diesel respectively (Business Daily, 2018).

There had been uncertainty regarding what constitutes the “taxable value”, which was cleared up when the VAT Act stated that it is the aggregate of the consideration paid for the petroleum product and all taxes, levies and charges paid or payable on the supply (Owino, 2018). This “tax on tax” may therefore carries an additional inflationary burden across the value chain above the absolute value of 16 percent (Anjarwalla & Khanna, 2018).

A few challenges faced by the Kenyan government upon the implementation of the 16% VAT on all petroleum products which entered into force on September 1 2018, include a dealers’ strike, anger among commuters and a lawsuit after transport and fuel prices jumped when the 16 percent value-added tax was introduced (Miriri & Melander, 2018). The public transport industry was negatively impacted as petrol went up by 12%, with taxi drivers highlighting the need to increase the fare charged to customers for transportation (SABC, 2018).

After levying the VAT on fuel at 16% (standard rate), there was a public outcry against the introduction of VAT on fuel products due to the expected resultant increase in the cost of living (IKM-Advocates, 2018). To respond to the public outcry, the government reduced the VAT rate on fuel to 8% and also reduced the taxable value of fuel by excluding excise duty, fees, and other charges (Deloitte, 2019). The reduced rate was effective from the 21st of September 2018 (IKM-Advocates, 2018).

Another factor to consider, that other countries use as motivation, is the effect a repeal of a VAT zero rating would have on the environment. Fiscal instruments are an important item in the policy maker"s toolkit for promoting efficient energy use and protecting environmental quality (Mutua, 2013). The question in this case would then be, did the repeal of a VAT zero rating contribute to the betterment of the quality of the environment? While the effects on the environment were not stated as motivation when the zero rating was repealed, there have been studies dealing with the use of fuel taxes to meet certain environmental objectives (Mirrlees, 2011). Taxes have been used as environmental/economic instruments to help achieve equity and environmental sustainability (Panayotou, 1994). Fiscal instruments in the energy sector in Kenya vary from taxes and duties, and levies that have been implemented to meet certain objectives in revenue maximisation, environmental protection and transport management among other desired policy targets (Mutua, 2013). A common argument against transport fuel taxes is that fuel demand is inelastic; therefore, the environmental benefit of the fuel taxes is small. It is assumed that due to motorists not being sensitive to changes in fuel prices a tax increase would not reduce consumption, therefore it would also not decrease the associated emissions (Brons, et al., 2006).

3.3.4 Kenya"s cost structure in comparison to South Africa

The cost structure of the fuel price in South Africa is like the Kenya structure described above. This means that, upon the repeal of a zero rate VAT on fuel, South Africa too, could charge VAT at standard rate on the current fuel retail price. The cost structure of the current retail price is comprised of four main elements. These are:

:

- The General Fuel Levy,
- The Road Accident Fuel Levy,
- The Basic Fuel Price (freight and insurance costs, cargo dues, storage and financing),
- Wholesale and retail margins, and distribution and transport costs (Automobile association, 2018).

3.3.5 Effects of reclassification of VAT on fuel in Kenya

Success story or not*:*

Whether or not the introduction of a VAT on fuel has been successful remains unclear as it is still too early to tell. However, it has been reported that on the 14th of September 2018, the president Honourable Uhuru Kenyatta said the Finance Bill 2018/19 that contained the 16% rate of VAT on fuel fell short of fulfilling its constitutional duty to ensure that legislative instruments presented for his signature conformed to the national aspirations the country had (Kamau, 2018). He said that the Bill "protected the status quo and sacrificed the bigger vision" (Agutu, 2019). He then went on to say the legislation requiring his signature for a go ahead in a 16% VAT on fuel was good politics but bad leadership (Kamau, 2018).

After addressing a few developments that Kenya made in the past few years, the President tackled the issue of VAT on petroleum products. He repeated that the purpose of the tax was simple. The government needed to pay for the new constitutional order and the public services on which Kenyans depend (Agutu, 2019). Honourable Kenyatta continued with his address stating that a delay in implementation of the tax would compromise government's ability to deliver basic services to Kenyans and to maintain the trajectory of Kenya's development (Kamau, 2018).

The Kenyan Parliament agreed to the president's request, which resulted in an increase of 8% (instead of the initial 16%) (Journal du Cameroun, 2019). The President then signed into law a Bill that would result in VAT on petroleum products being slashed by 50 % (Journal du Cameroun, 2019).

Questions were raised on what would happen to the remaining 50% that government was supposed to raise (Agutu, 2019). The President went further to say that the government would be going through some major cuts on expenditure (Kamau, 2018).This measure to promote equity remains questionable as there is evidence that reduced rates are not an effective tool to achieve redistribution or to pursue other non-distributional goals (OECD, 2018)

3.4 United Kingdom

3.4.1 Introduction

The United Kingdom (referred to as “the UK”) consists of four constituent countries namely England, Ireland, Scotland and Wales (Johnson, 2019). Within the U.K, Parliament is sovereign, but each country has autonomy to some extent. The UK is part of the European Union, which it joined on 1 January 1973 (History Extra, 2019). The UK subsequently voted to exit the EU in a process commonly referred to as Brexit on 23 June 2016 (BBC,2019).

Following its exit, the UK”s approach to taxation may change as the government may have additional freedom of choice (Dodwell, et al., 2016). Some indirect taxes are EU taxes: principally VAT and customs duty legislation (Deloitte, 2016). The UK would have to introduce its own customs duty law however, because VAT is already part of UK law, the changes it may make in this regard would include (among others) reduction of VAT rates or/ and exemption and zero rating of supplies that were not allowed under the EU laws (Dodwell, et al., 2016). Basically, they would not be constrained by EU laws.

3.4.2 VAT in the UK

Despite the many reasons put forward for the introduction of VAT in the UK the main ones (James, 2000) consisted of desire for a tax:

- that was broadly based;
- on consumption (indirect tax);
- that promoted tax harmonisation in Europe;
- that contributed to the balance of payments policy and; and
- that was self-enforcing

When VAT was first introduced in 1973 in the United Kingdom, supplies of fuel and power was charged the zero rate (James, 2000).

3.4.3 VAT on fuel in the UK

On 2 July 1997 in his Budget Speech the Chancellor, Gordon Brown, announced that a new 5% value added tax (VAT) rate on domestic supplies of fuel and power would come into effect on 1 September 1997 (Seely & Twigger, 1997). Initially the Conservative government's intentions would have it that fuel and power be levied at the standard rate, which was 17.5% at that time (James, 2000). This was, however, voted against during a budget resolution. Amending legislation was then introduced so that these supplies continued to be charged VAT at 8% (Seely, 2018). The 8% was then decreased to 5%. The rate then increased to the standard rate of 20% from 4 January 2011 and has remained the same since (Seely, 2019). As of February 2018, when VAT is included, tax represents 64% of the final petrol price and 63% of the final pump price for diesel (Seely, 2018).

3.4.4 Reasons for the repeal of VAT zero rating

The Conservative Government gave two reasons for abolishing the zero rate, in addition to the need to raise additional revenue in the medium term: first, to encourage energy conservation and contribute to the reduction of carbon emissions; and second, to widen the VAT base (Seely & Twigger, 1997). The UK had a commitment under the United Nations Framework Convention on Climate Change, signed at the Rio summit in 1992, to reduce greenhouse gas emissions by the year 2000 to their level in 1990, and the repeal of a VAT was meant to assist in meeting this commitment (Leicester, 2006).

3.4.5 How the UK approached it

VAT is charged on the entire cost or value of any taxable supplies - that is, the consideration in money which the business receives in return for this supply. Consequently, standing charges for domestic supplies of fuel and power have been charged VAT at the same 8% rate (Seely & Twigger, 1997). The utility companies do not have any discretion in charging VAT on standing charges, though some customers have mistakenly believed otherwise (HM Revenue & Customs, 2014).

According to the Office for National Statistics, the price of fuel can be divided into three sections:

- the cost of the fuel itself (which is made up of the wholesale price,

- the cost of distributing the fuel and fuel companies" profit margins);
- fuel duty (which is charged at a fixed rate of 57.95 pence per litre); and VAT which is charged at 20% of the wholesale price plus the duty, which equates to 16.7% of the final price (Office for National Statistics, 2016).

Making an exception in the case of fuel and power and zero-rating standing charges was ruled out by the conservative government when it first announced the abolition of the zero rate as part of the March 1993 Budget (Mirrlees, 2011). The then Chancellor, Norman Lamont, confirmed during Treasury questions on 1 April 1993 that to encourage administration efficiency, standing charges would be treated in the normal fashion (Seely & Twigger, 1997). It was stated that an exclusion of the standing charges from VAT would mean a substantial reduction in the revenue and that alternative means to seek that revenue would then have to be explored (Seely, 2018).

As mentioned above fuel, taxes in the UK serve two purposes namely, to change behaviour and reduce fuel consumption in order to protect the environment, and the other is to raise revenue (Smith, 2000). Research found that an attempt to reduce the reliance on cars, and onto public transport by increasing the cost of fuels (though taxes like VAT) would not have been successful (Brons, et al., 2006). Another predicament would be that the government would lose out on a valuable source of revenue, if people resorted to public transport (Mirrlees, 2011). So attempting to reduce the social costs associated with road transport by imposing an additional tax on road fuel consumption is difficult because of the lack of response to changes in the price of petrol and because fuel cost is not always very closely related to the social cost involved (Brons, et al., 2006).

The effects of the repeal of VAT on fuel would have the result that fuel duty was frozen since 2011. The freeze meant no escalation in the fuel duty was applied. The freeze led to fuel at the pump being 13% lower than it would have been (Begg & Haigh, 2018). While the freeze would have pros and cons, the most noticeable one is the decrease in public transport by between 1.3% and 3.9% causing up to 60 million fewer rail journeys and up to 200 million fewer bus journeys, loss of revenue and worsening pollution (Begg & Haigh, 2018).

In addition to the VAT on fuel the high oil price and the near record pump price of petrol and diesel were also imposing a significant burden on motorists (The Guardian, 2018). Therefore, the fuel duty was retained.

When it comes to the administration burden associated with the repeal of the VAT on fuel, the principle is like other tax policies that have been observed. The more there are exemptions and multiple rates, the harder and more complex it becomes to administer the tax (Mirrlees, 2011). VAT on fuel having been levied at a reduced rate contributed to the challenges in administration (Mirrlees, 2011).

To curb this anomaly and assist the poor, the certain measures were taken by the government:
A few measures were taken to deal with the regression of VAT:

- Compensation for pensioners

When the abolition of zero-rating was first announced, the Conservative Government intended to compensate poorer pensioners and relevant disabled persons by income-related benefits. In his November 1993 Budget the then Chancellor, Kenneth Clarke, announced that this extra compensation would be given to all pensioners, in two staged increases in the weekly retirement pension: one from April 1994; the second from April 1995.

- Increases made to benefits

This compensation was in addition to the increases made to benefits under the normal increasing rules, which keep benefits in line with inflation.
Initially it was estimated that the total additional help given to compensate for the imposition of VAT on fuel and power would have cost £1.3 billion by 1996-97 (Seely & Twigger, 1997). This approach enabled the government to raise revenue by increasing the rate on VAT on fuel while also compensating the losses of particular groups (Crossley, et al., 2009).

3.4.6 Effects of reclassification of VAT on fuel in the UK

Success story or not:

The imposition of VAT at 8% on domestic supplies of fuel and power raised £850 million in 1994-95, and £1,100 million in 1995-96 (Poole, et al., 1997). In 1994, the Treasury forecast VAT revenues for 1995-96 would be £49 billion, yet the actual revenues for this year proved to be just £43.1 billion. The 6 billion shortfall was attributed to two significant factors namely successful legal challenges to Customs" interpretation of VAT law, and better tax planning and increasing tax avoidance by companies (Seely & Twigger, 1997). One obvious way of limiting the scope of this tax avoidance is to widen the tax base (Bowler, 2009).

Environmental concerns due to the reclassification of VAT on fuel in the UK

Britain wants to be a world leader in the fight against climate change. It has committed to reduce greenhouse gas emissions to almost zero by 2050. The use of VAT on domestic fuel and power as an environmental measure depends on the responsiveness of demand to changes in the price of energy (Brons, et al., 2006). The less sensitive demand is to changes in price, the less effective an environmental policy instrument VAT would be (Seely, 2018). Nonetheless the UK remains on course to meet its Rio commitments due to several other developments in this sector (Seely & Twigger, 1997).

The goal of raising revenue and expanding the tax base was achieved, however using VAT as a tool for reducing emissions may not have been as effective due to the inelasticity of demand to price changes. This is mirrored by the UK having introduced a climate change levy which is a tax on energy

3.5 Dubai

3.5.1 Introduction

Dubai is one of the seven emirates of the United Arab Emirates (UAE) and is the most populated city of the UAE (Howari & Nazzal, 2017). It is a global city and the business hub of the Middle East (Mukasa & Nilsson, 2015). About 30 per cent of the country's

gross domestic product is directly based on oil and gas output (Mazrouei, 2019). It has the world's 7th largest proven crude oil reserve and since the discovery of oil in the UAE, the country has become a modern state with a high standard of living (Mazrouei, 2019). Dubai's oil production peaked in 1991 at 410,000 barrels per day and has been steadily declining ever since (Gulf-News-archives, 2010). Dubai's oil reserves have reduced over the past decade and are now expected to be exhausted within 20 years (Howari & Nazzal, 2017).

It must be noted that before the introduction of VAT, there was no tax applicable in the UAE and no capital gains tax for companies and businesses (PwC, 2015). There was also no VAT applicable (PwC, 2015). The Gulf Cooperation Council (GCC) states, in general, have always been known to be tax-free havens for businesses and for expatriates who represent 88.4% of the UAE Population (Bannaga, 2017). The cost structure of fuel in the UAE was as follows:

- the Ministry of Energy's Retail Pricing Committee refers to benchmarks compiled by Platts at the end of each month,
- the pricing committee adds a margin for transportation and operating costs
- prices are implemented by fuel retailers at the beginning of each month (Sanmarti, 2017).

Upon the introduction of VAT on the 1st of January 2018, VAT on fuel was levied at the standard rate of 5% (Rodl & Partner, 2017). As noted, the UAE is introducing a VAT rate which is considered relatively lower than what is implemented in other jurisdictions (Bannaga, 2017). Lower rates of the VAT ranging between 3% to 5% are applied mostly in Asia in countries like Japan, Taiwan, and Singapore, while higher rates of the VAT of 20% to 25% are more prevalent in Western Europe (IMF 2015). But the imposition of VAT still leaves petrol prices as some of the lowest in the world (Khaleej Times, 2018).

3.5.2 The introduction of VAT

To boost revenues and cut spending as a persistent slump in world prices has led to ballooning budget deficits and to revive their oil-dependent economies, Saudi Arabia and the United Arab Emirates introduced value-added tax with effective 1 January

2018 (Saderuddina & Barghathi, 2018). Another reason VAT was introduced was to diversify revenue and income due to the falling oil prices in recent years (Bannaga, 2017). The introduction of the VAT is expected to promote and secure economic growth in the region through the diversification of revenue sources other than oil products (University of Oxford, 2019).

The decision to introduce VAT was discussed with reasons at the Gulf Cooperation Council (GCC) (which Dubai falls under) annual meeting of ministers of finance and central bank governors, which took place in Doha, Qatar in November 2015 (International Monetary Fund, 2015). The annual meeting focused on the necessity of implementing modern systems of tax in the GCC region. During the meeting, it was resolved and largely concluded that the "Existing tax systems in the GCC countries are limited and do not meet rising financing needs in the context of a potentially prolonged period of low oil prices" (Bannaga, 2017), and that oil is exhaustible at some point, and a country cannot rely on oil indefinitely (Bannaga, 2017).

The introduction of VAT came about as a result of the International Monetary Fund's taxation advice to the Gulf Cooperation Council (GCC), which included implementing VAT as a first step towards generating higher and more reliable revenue streams. The IMF recommended VAT to minimise the dependence on the fluctuating global price (IMF, 2016).

The five percent sales tax applies to most goods and services and analysts project that the two governments could raise as much as $21 billion (R251-billion) in 2018, equivalent to two percent of GDP (Teegardin, 2018). According to the UAE Finance Ministry the VAT returns will be used for infrastructure development, to upgrade public services and boost the UAE economy's competitiveness (Teegardin, 2018).

3.5.3 VAT on fuel in Dubai

Unlike the UK, when Dubai introduced VAT, it went further to introduce the tax on fuel at standard rate (Saderuddina & Barghathi, 2018). It did not zero rate fuel or levy it as an exempt item. Dubai, however announced several reforms and measures to

stimulate growth in the emirate and ease some pressure on households despite the VAT introduction (Haque, 2018).

These measures are geared towards reducing the cost of doing business and lowering taxes, rather than increasing budget spending. They include reducing the municipal tax for businesses, writing off administrative fines owed by businesses, and scrapping 19 fees related to aviation (Haque, 2018). The aim is to boost government revenues and help diversify previously hydrocarbons-dependent regional economies at a time of lower oil prices (Townsend, 2019). Dubai has also frozen school fees for the next academic year, providing some relief for households facing higher fuel costs (up more than 22% year on year in 2018) and VAT (Haque, 2018).

The IMF provided advice on the technicalities of introducing VAT, stating that an argument in favour of the introduction of VAT is the fiscal stability that comes about as a result of diversifying government revenues (Augustine, 2007). The robust level of compliance in the first year is a “positive reinforcement of the UAE’s high institutional strength”, Moody’s said (Townsend, 2019) . The agency rates the UAE government "Aa2 stable" (Townsend, 2019).The good compliance figures do not take away the tedious nature of a hasty registration process as well as administration costs inherent in the implementation of VAT (Hanafin, 2018). Research indicates that plans to introduce blockchain and automate the system are underway to ease the administration burden (Arman, 2019).

The introduction of VAT will consequently have effects on the cost of public transportation. To tackle this, Dubai is backed by a treaty which states that it can choose whether to exempt or zero rate local transportation (Junkin, et al., 2017). According to research, transportation of goods and passenger from one member state to another or from the GCC territory to outside GCC will be zero rated along with the other transport related services (EY, 2017).

The biggest beneficiary of the introduction of VAT in 2018 in terms of allocation was Dubai, which received around 60 per cent of the share of revenues attributed to the Emirates in 2018 (Townsend, 2019). Dubai benefits from the highest level of tourism

spending of all emirates and a higher daytime population as workers commute in from other emirates (Moody's, 2018). However, the addition of a new revenue source from VAT collections is also important for the federal government. Its share of VAT revenues equates to only under half of the direct budget grants it receives from Abu Dhabi and Dubai 69.79 billion Dirham (AED) (R279 669 467 000) – “making VAT an important driver of own-source revenue and in turn less reliant on grant transfers from the emirates”, Moody”s said (Townsend, 2019).The exchange rate used was 1AED= 4.0073 Rands[2] which is the average rate from 23 May 2019 to 17 November 2019 (Exchange rates UK, 2019).

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VAT revenues are likely to be the second-largest source of non-grant revenues for the federal budget in 2019, after combined royalties and dividends from the federal government’s holdings in the telecommunications sector (Moody's, 2018). There was only a nominal and short-lived impact on inflation from the introduction of VAT last year, as subdued demand “migrated” the inflationary impact leading many retailers to partially absorb the effect on their margins, Moody’s added (Townsend, 2019). PwC stated that the overall consumer price index (CPI) jump was 2.7% month on month in UAE, however due to the absence of secondary inflation, prices declined towards the end of the year (PwC, 2019).

Another consideration with the VAT on fuel is the possible effect this change may have had on the environment. Whilst the introduction of VAT on fuel was motivated by the UAE”s goal to decrease reliance on oil revenue, it should be further investigated what the effect on the environment was (Hanafin, 2018). Whilst it was reported that Dubai decreased its carbon emissions by 19 percent in 2019 (Ali & Dayekh, 2019), there is no mention of the decrease associated with the introduction of VAT on fuel. Among others, a decline in the per-capita annual consumption of electricity and water in Dubai were the reasons contributing to the improvement in carbon emissions (UAE, 2019). The effect of the VAT on fuel on the environment or carbon emissions is still to be explored.

[2] The exchange rate will be used consistently in this study for conversion of United Arab Dirhams to South African Rands.

`3.5.4 Effects of reclassification of VAT on fuel Dubai

Success story

The rating agency, Moody said that the revenues from the UAEs (which Dubai forms part) value added tax, which came into effect in January 2018, exceeded government expectations in 2018, boosting state coffers and proving credit positive for the country (Townsend, 2019). The agency confirmed that the strong performance relating to VAT was due to the higher than expected compliance with the new law (Moody's, 2018). According to Townsend (2019), the government's 2018 and 2019 VAT revenue forecasts had included conservative assumptions regarding the level of compliance in the initial years of implementation. VAT collections were far higher than forecast in the first year of implementation, reaching 27 billion Dirham (R108 197 100) compared to the government's original projection of 12 billion Dirham (R48 087 600 000) (Townsend, 2019). The figure was even more than government's 2019 projection of 20 billion Dirhams (R80 146 000 000) (Moody's, 2018). It would seem that the VAT introduction was a success from a revenue raising point of view.

3.6 Chapter Summary

As stated within the introduction, the purpose of this chapter was to explore how other countries, namely Dubai, Kenya and the UK approached the withdrawal of a VAT zero rating in order to form a basis for South Africa and possibly propose solutions by observing their approach.

The study examined Kenya, which was motivated by their goal to decrease the government deficit. It was then found that the repeal of the VAT zero rate by introducing the standard rate on fuel was a heavy burden for the Kenyans hence the government responded by reducing the rate to a half of the standard rate. It was then concluded that since this policy has been newly implemented it is too soon to observe the success or failure of the implementation yet.

The study then focused on the UK which has a rich history of the VAT policy. It was found that the VAT policies in the UK were not only legislated by the UK, however, the EU also had an input as the UK is part of the EU. It was learnt that upon the repeal of

the zero rate, fuel was levied at a reduced rate too. This proved to be successful on the revenue collection side but there have been doubts as to whether levying VAT on fuel at the reduced rate decreases the negative effects on the environment and climate change, The answer to this is probably not as the UK has had to introduce the new climate change policies apart from the VAT on fuel to ensure their emissions and environmentally friendly goals are met.

Lastly, the study examined the UAE where tax has not been levied in the past. Prior to the implementation in 2018, Dubai did not levy a VAT however, it proved to exceed its forecast revenue collections due to the high compliance rates.

In chapter four, the study examines all the facts observed in this study and applies them to the South African context with the aim of answering the research question.

Chapter 4: Results and Discussions

4.1 Introduction

This chapter presents the findings of the document analysis spanning the three countries (Kenya, Dubai and the United Kingdom) introduced in Chapter 3. The findings are presented in such a way that each country's results are first discussed individually. Thereafter document analysis results and discussions are also presented. After reporting on the documents, cross-case analysis is done in order to generate common conclusions among the three countries (the cases) that would allow the formulation of a coherent recommendation regarding a possible withdrawal of the VAT zero rating.

The study analyses whether the withdrawal of the VAT zero rating on fuel in South Africa is justifiable from a policy perspective. A qualitative analysis method was used for analysis of recent and relevant literature. Below, the map provides an overview of how the discussions in this chapter are presented.

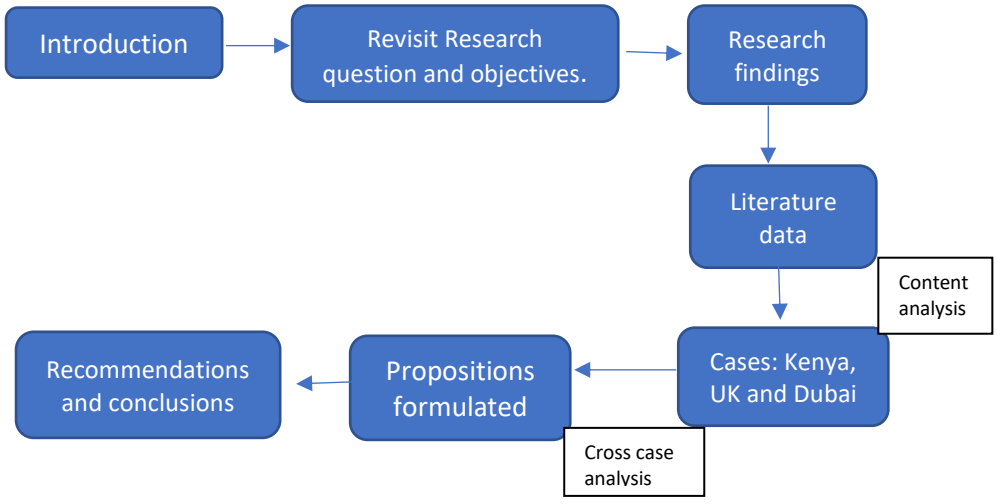

Figure 4.1: Overview of Chapter 4, *Source: Researcher's own*

4.2 Research Question and Objectives

The question and objectives of this research as well as the research questions that were derived from this objective are highlighted once again to give an insight into the findings of this study. The research question was to answer whether the withdrawal of

the VAT zero rating in South Africa is justifiable from a policy perspective. The objectives of the study were broken down as follows:

1. To review literature on policies of VAT zero rating on fuel. Chapter 2 looked at the review of literature based on history of VAT, history of the fuel levy and also the current fuel levy, the possible withdrawal of the VAT zero rating on fuel and its necessity in the design of a VAT system from a policy perspective and what that would mean for the existing policy.
2. The study researched different approaches on the repeal of the VAT zero rating from three countries namely: Kenya, Dubai and the United Kingdom. Conclusions were formulated based on the factors considered in the implementation of VAT and the cross-case analysis was performed in order to arrive at conclusions on the consideration of the repeal of a VAT zero rating in South Africa.
3. To recommend the possible way forward for South Africa to approach the repeal of a VAT zero rating after forming conclusions based on the comparisons made above. To detail recommendations for future research within this area of study.

Roode (1993) elaborates that most researches have what investigators refer to as main and minor research questions. The main research question if comprehensively answered, would holistically meet the requirements of carrying out an investigation (Saunders, Lewis and Thornhill 2007). The Main research question was posed as*:* Is the withdrawal of the VAT zero rating in South Africa justifiable from a policy perspective? The motivation behind this research questions was derived from the studies of the budget speech by the National Treasury (2017), where the Minister of Finance mentioned the increase of VAT on fuel as a possible revenue increase mechanism.

4.3 Summary of Research Findings

4.3.1 Documents

The data collection method used in this research is document analysis.

In light of the objectives discussed above, this section presents the summarized results of the study in the form of conclusions based on the work performed on Kenya,

Dubai and the United Kingdom in chapter three. Cambridge (2019), defines a conclusion as a statement or assertion that expresses a judgement or opinion.

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4.3.1.1 Conclusions for Kenya

In this section conclusions on the repeal of VAT zero rating in Kenya are formulated. The conclusions are formulated from the analysis of documents discussed by various authors who wrote on these concepts. These conclusions are formulated as a way of generating theory about levying VAT on fuel at a rate higher than zero percent and how they affect policy considerations.

4.3.1.1.1 Conclusion 1: Burden on taxpayer

There is general belief that citizens in Kenya face challenges which are caused by factors inherent in a developing economy. The repeal of a VAT zero rating intensifies the burden they face in terms of the capacity their income to meet their day to day demands.

4.3.1.1.2 Conclusion 2: Administration burden

The government had to reduce the rate at which VAT on fuel was levied at. A reduced rate was subsequently levied to try and ease the burden of the taxpayers.

The difficulties being faced in having the necessary systems in place to start charging VAT confirms that there are administrative challenges involved in the repeal of the VAT zero rating on fuel**.**

4.3.1.1.3 Conclusion 3: Effects on other taxes

The VAT on fuel was levied in addition to all the other taxes that were already chard on fuel. The repeal of VAT on fuel did not lead to a decrease or cancellation of other fuels.

4.3.1.1.4 Conclusion 4: Government revenue and the expansion of the VAT base

The repeal of a VAT zero rating on fuel increased government revenue and expanded the tax base.

4.3.1.1.5 Conclusion 5: Environment consequences

The repeal of VAT zero rating on fuel did not contribute to any environment goals that may have been set nor was the quality of the environment improved as a result of higher prices on fuel.

4.3.1.1.6 Conclusion 6: Government debt

The IMF advised Kenya to repeal the VAT zero rating in order to deal with the level of public debt however the increase in VAT on fuel was followed by a spike in the standard of living and led to Kenya needing more financial injections from the IMF, which then resulted in a two-year facility being extended to Kenya to deal with external shocks that distort the balance of payment.

4.3.1.1.7 Conclusion 7: Public transport

The repeal of the VAT zero rating on fuel placed pressure on the public transport industry.

4.3.1.2 Conclusions for the United Kingdom

In this section conclusions about the repeal of the VAT zero rating in the United Kingdom are formulated. The conclusions are formulated from literature from the various authors who wrote on these concepts. These conclusions are formulated as a way of generating theory about the VAT on fuel policy discussed in chapter 3.

4.3.1.2.1 Conclusion 1: Burden on taxpayer

The repeal of VAT on fuel placed burden on taxpayers as they had to spend more of their money of fuel taxes.

4.3.1.2.2 Conclusion 2: Administration burden

The repeal of VAT zero rating was introduced at a reduced rate. This intensified the administration burden on individuals and companies.

4.3.1.2.3 Conclusion 3: Effects on other taxes

Like Kenya, VAT on fuel was levied in addition to the other fuel taxes already in place.

4.3.1.2.4 Conclusion 4: Government revenue and the expansion of the VAT base
Though the government might not have met its desired budget, government revenue increased, and VAT base was expanded.

4.3.1.2.5 Conclusion 5: Environment consequences
The increase of the price of fuel due to a repeal in the VAT zero rating did not contribute materially to discouraging the use of cars and in turn benefiting the environment.

4.3.1.2.6 Conclusion 6: Government debt
Whilst this was not a key motivator the increase in revenue would directly impact the decrease of government debt.

4.3.1.2.7 Conclusion 7: Public transport
The repeal of a zero rate of VAT on fuel encourages the use of other modes of transport such as railway, walking and cycling.

4.3.1.3 Conclusions for Dubai
In this section conclusions on the repeal of VAT zero rating in Dubai are formulated. The conclusions are formulated from the analysis of documents discussed from various researchers who wrote on these concepts. These conclusions are formulated as a way of generating theory about levying VAT on fuel at a rate higher than zero percent and how they affect policy considerations.

4.3.1.3.1 Conclusion 1: Burden on taxpayer
A year after implementing VAT, it was found that there was a consumer price index increase of 2.7% therefore intensifying the burden on the taxpayer.

4.3.1.3.2 Conclusion 2: Administration burden

There was increased administration burden that came with high compliance and implementation costs, upon the introduction of VAT on fuel. The introduction of a VAT on fuel added significant administrative work to an otherwise simple tax system.

4.3.1.3.3 Conclusion 3: Effects on other taxes

The repeal of VAT on fuel had no effect on other taxes, because there were no taxes applicable to fuel prior to the introduction of VAT on fuel.

4.3.1.3.4 Conclusion 4: Government revenue and the expansion of the VAT base

Research conducted in Chapter 3, indicated that the repeal of a VAT zero rating on fuel increased government revenue and created the tax base.

4.3.1.3.5 Conclusion 5: Environmental consequences

The effects of the introduction of VAT on fuel on the environment are still to be determined.

4.3.1.3.6 Conclusion 6: Government debt

There is concern that top management involvement in the change endeavours is not very clear, there are a lot of bosses and a lot of unplanned requests for change.

4.3.1.3.7 Conclusion 7: Public transport

The introduction had no effect on the public transport sector as the treaty applicable provided an option to either zero rate or exempt public transport services from VAT.

4.4 Cross case analysis: Kenya, UK and Dubai

In this section combined conclusions are formulated to come up with similar patterns among the factors considered in the implementation of VAT. The results from the cases are combined to generate a possible theory on the policy of a repeal in the VAT zero rating in South Africa.

The repeal of VAT zero rating on fuel as a policy consideration:

From the discussions in this study, the repeal of a VAT zero rating comes with challenges as well as its rewards. When considering tax policy proposals, there are three main areas of concern, known as the “Three Es” of tax policy: equity, efficiency and ease of administration (National Treasury, 2018).

In 2018, through the Davis Committee, a committee was constituted, consisting of a panel of independent experts to consider and review the list of zero-rated food items. Though this was extensively focused on food items, the considerations followed would have been similar when VAT on fuel was levied at zero rate.
The Panel assessed its proposals in terms of their projected effects on five main outcomes.

1. The overall tax system must remain as progressive as possible.
2. The extent to which VAT could become more progressive.
3. Zero rating should incentivise merit goods and address special needs for women, older people, those living with disabilities and children if possible.
4. The cost of zero rating to the fiscus should not be excessively high.
5. The benefits of zero rating should not be absorbed by producers or retailers (National Treasury, 2018).

4.4.1 Conclusion 1: Burden on taxpayer

From observing the different mechanisms introduced by the different governments, there is no doubt that the repeal of the VAT zero rate on fuel to either a standard rate, or a reduced rate places a heavy burden on the taxpayer. The increase in fuel prices, has a ripple effect on prices for goods and services which in turn affects the ordinary taxpayer whose income needs to accommodate all their needs and wants.

4.4.2 Conclusion 2: Administration burden

It is difficult to compare administrative costs of VAT among nations because of differences in tax complexity, quality of administration, standard rate of taxation, tax compliance and data availability (Bickley, 2003). From an ease of administration perspective, VAT is a transparent tax – consumers can work out how much VAT they are paying on any item. From an administrative efficiency perspective, there are two

considerations – how much money does the state collect for a small change in the rate of tax, and how much of what the state should collect does it actually collect (National Treasury, 2018)

4.4.3 Conclusion 3: Effects on other taxes

Other taxes constitute other taxes levied on fuel which are not VAT e.g. excise duty, road maintenance levy, petroleum development levy etc. In Kenya VAT on fuel was levied on top of the other fuels which then raised concerns about inflation, as this was a “tax on tax”. It was later taken into account by reducing the VAT on fuel rate to 16% from the standard rate of 18%. While there was mention of a regulated transportation and an operating margin added to the price of fuel set by the energy ministry to compensate fuel retailers no other taxes levied on fuel before VAT. The UK also levied other taxes like Kenya. Although the UK had fewer taxes than prior to VAT, they also added the VAT on the full value of the fuel. This was followed by a reduced VAT rate.

From the observation of the countries discussed in Chapter 3. The effect of the repeal of VAT on other fuels was that the other fuels continued to be levied. To curb the possibility of inflation challenges as well as regression, VAT was levied at a reduced rate.

4.4.4 Conclusion 4: Government revenue and the expansion of the VAT base

From the analysis across the three countries used as the subject of this study, it has been established that the repeal of a VAT zero rating would expand the VAT base of a country, and in turn increase government revenue. The recorded incomes indicated that a repeal of VAT zero rating yielded more income than other avenues explored by different countries.

4.4.5 Conclusion 5: Environmental consequences

This factor was a strong motivator for the UK that believed the more expensive fuel would be (through a repeal of a zero rating on VAT on fuel), the closer they would reach their carbon emission targets. While this may discourage domestic users, studies have shown that non-domestic users would not be discouraged hence this measure was not enough to assist in meeting the environment goals. This resulted in

the introduction of a climate change levy delivered on non-domestic users in the UK. It could then be concluded that a repeal of VAT on fuel alone would not be enough to satisfy the environment goals of a country.

4.4.6 Conclusion 6: Government debt

Government debt is a growing trend among different countries with the public's needs growing as well as other factors. There is concern that a repeal of VAT zero rating on fuel, though may increase revenue, its effects are not sustainable enough to decrease the budget deficit.

4.4.7 Conclusion 7: Public transport

Public transport is bound to be more costly following a repeal of VAT zero rating, leading to higher costs for household where they rely heavily on public transport. This will also affect profit margins of businesses in the public transport industry.

4.5 Recommendations for South Africa

This section presents the recommendations available to South Africa in the event of a repeal of the VAT zero rating. There have not been many suggestions relating to this decision, but economists have hinted at the fuel levy being frozen or reduced. It must be noted that while in theory recommendations may seem easy, the practical implementation is difficult aspect and requires all parties involved to be actively involved in the decision-making process which would contribute to the ease of implementation. Recommendations have been made in consideration of the factors relating to the implementation of VAT namely:

1) Burden on the taxpayer
2) Administration burden
3) Effects on other taxes
4) Government revenue and the expansion of the VAT base
5) Environment consequences
6) Government debt
7) Public transport

Fuel in South Africa is already seen to be expensive. The more expensive fuel is the higher inflation is likely to be. For purposes of this study, the most suitable country to

make reference to is Kenya. This is owing to it being a developing country South Africa is. While it may be inevitable to have the VAT on fuel repealed in the near future, the following are the recommendations that should be considered in conjunction with the repeal of the VAT zero rating.

Firstly, the current fuel levy should be repealed in total. It has already been stated that the two charges being levied on fuel at the same time constitute double tax and is counterproductive. It also needs to be noted that the coexistence of the both a fuel levy and a repeal of VAT on fuel, indicated two different taxes that are meant to address the same goods. It has also been stated that in the South African context, the fuel levy is not sustainable. If the fuel levy is repealed, the VAT on fuel can be levied and the price of fuel will not be as high as the case with Kenya. A similar trend was observed in Dubai's case where VAT on fuel was introduced. This not only assisted in the increase in revenue in Dubai, but Dubai managed to maintain a relatively low overall fuel price despite the VAT on fuel being levied at a standard rate.

The next recommendation would be that the government invests in proper infrastructure to ensure the results of the repeal of a VAT zero rating are as beneficial as it was in Dubai. Improved technology and systems that ease compliance such as those that Dubai invested in will ensure that the administration burden, though expensive in the short run, will be reduced for businesses and individuals.

For the repeal of the VAT zero rating on fuel to be as progressive as possible, government need to implement subsidies and provide compensation for the poor. This can be carried out via direct or indirect measures. For example, an increase in the grants that the less fortunate receive (direct) or the subsidization of the transport industry. Dubai illustrates this, as it froze school fees for the following academic year, and provided some relief for households facing higher fuel costs. Dubai is also backed by a treaty which states that it can choose whether to exempt or zero rate local transportation.

Whilst the demand of fuel has been shown to be inelastic in relation to the increase in price, the imposition of VAT on fuel at a standard rate must not be used as an

environmental measure. Instead it is recommended that a separate tax aimed at specifically at reducing the CO2 emissions must be introduced.

Due to the main reason for repeal of the VAT zero rating, it is recommended that the government addresses the wastage in expenditure that its respective departments are found guilty of every year. More serious probes into corruption with accompanying repercussions for officials must be carried out. The government must also learn to live within its means.

To obtain acceptance from the average person and avoid strikes and rebellion as with the case of Kenya, it is recommended that the government includes the private sector and the ordinary individual in the implementation of this policy. Task teams consisting of individuals from different backgrounds must be formed and involved in the decision making surrounding the repeal of a VAT zero rating.

Finally, before the repeal of the VAT zero rating, it is recommended that the government seek consultation from specialists from countries like Kenya and the UK. While the experiences may not be the same due to differences in economies and other aspects, the principles and potential flaws will be similar. It is recommended that advice is sought from Kenya as Kenya is the closest match in terms of common characteristics, both economies are developing and African based therefore share similar socio-economic challenges.

With the above-mentioned recommendations based on the countries analyzed, it can be concluded that the repeal of a VAT zero rating is justified in South Africa. The approach is however key in the success of the process.

4.6 Limitations and future research

Despite the objectives of this studying having been met, this study had limitations which could serve as research opportunities in the future. The following are suggestions for future studies:

- an in-depth analysis of the success of the fuel levy in South Africa;

- the effects of vat on fuel on the different participants of the economy in south Africa;
- the success of the repeal of a vat zero rating on fuel in Kenya;
- the breakdown of the fuel price along with tax policy analysis in south Africa; and
- alternative sources of revenue to fuel levy.

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