THE CORPORATE INCOME TAX GAP IN SOUTH AFRICA: A TOP-DOWN APPROACH

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Introduction

- Priority of many governments is to improve tax revenue mobilization
- Consider improving tax compliance, but requires knowledge on tax gaps
  - Difference between what tax should be paid and what is actually paid.
  - Information about these gaps can help policy makers develop appropriate revenue mobilization strategies.
- In this study we applied the top-down approach to estimate the CIT gap for SA, using national accounts statistics and tax administrative data
  - Focus on non-financial corporate sector

Two approaches– Tax gap analysis

- The top-down approach entails a single estimation of the tax base, which is then used to determine the theoretical tax liability, i.e. the tax revenues that are to be collected if taxpayers fully comply with tax legislation.

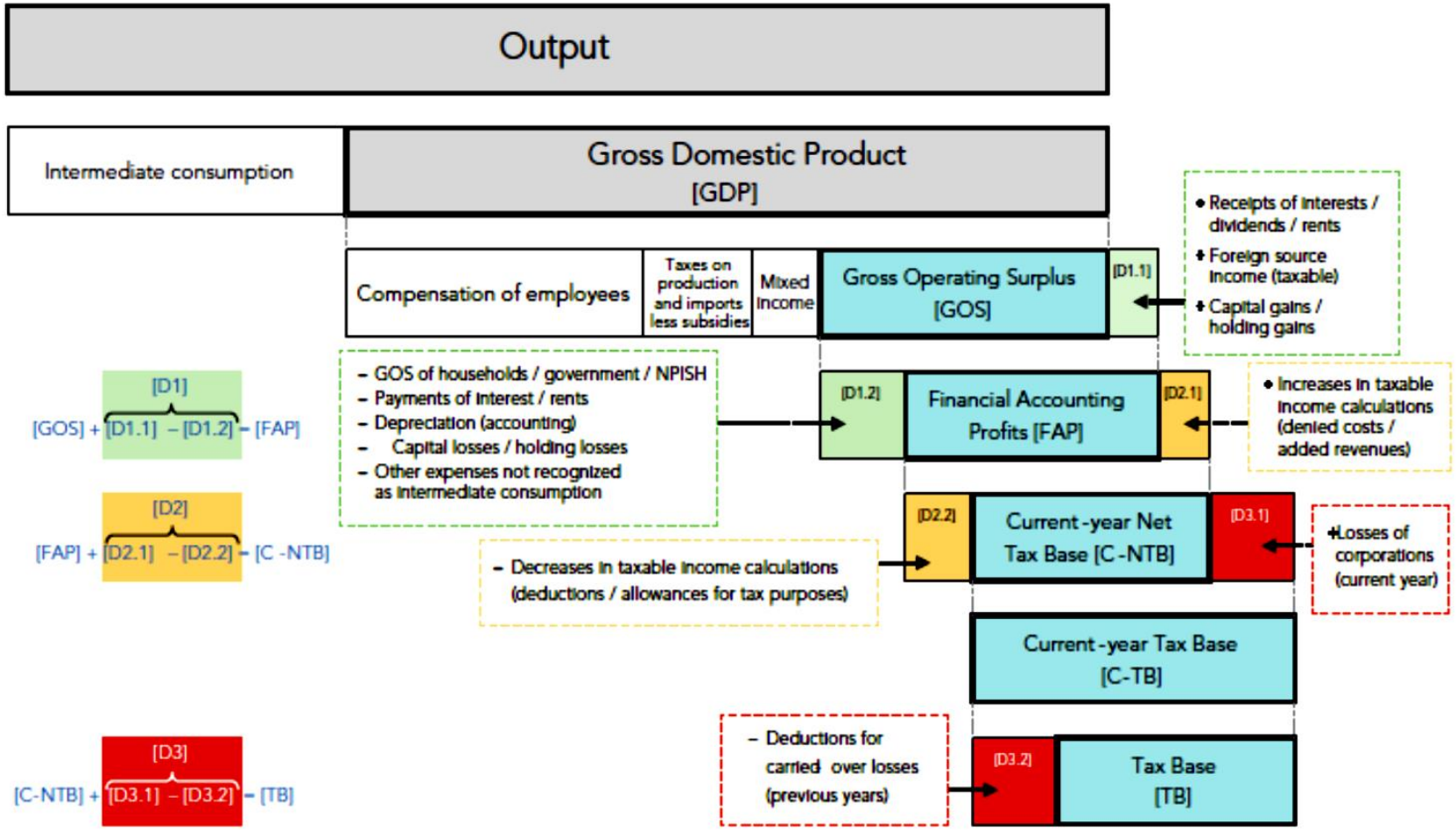
- The bottom-up approach calculates the tax gap by aggregating estimates of various components of the tax gap. This approach entails using several techniques such as data matching, tax information, risk registers and random enquiries.

Top-down approach – IMF method

- The IMF RA-GAP framework adopts two measures for CIT compliance:
  - ***CIT base gap*** *(difference between potential C-TB and declared C-TB)*
  - ***CIT gap*** *(difference between potential CIT liabilities and declared CIT liabilities)*

IMF top-down approach: CIT

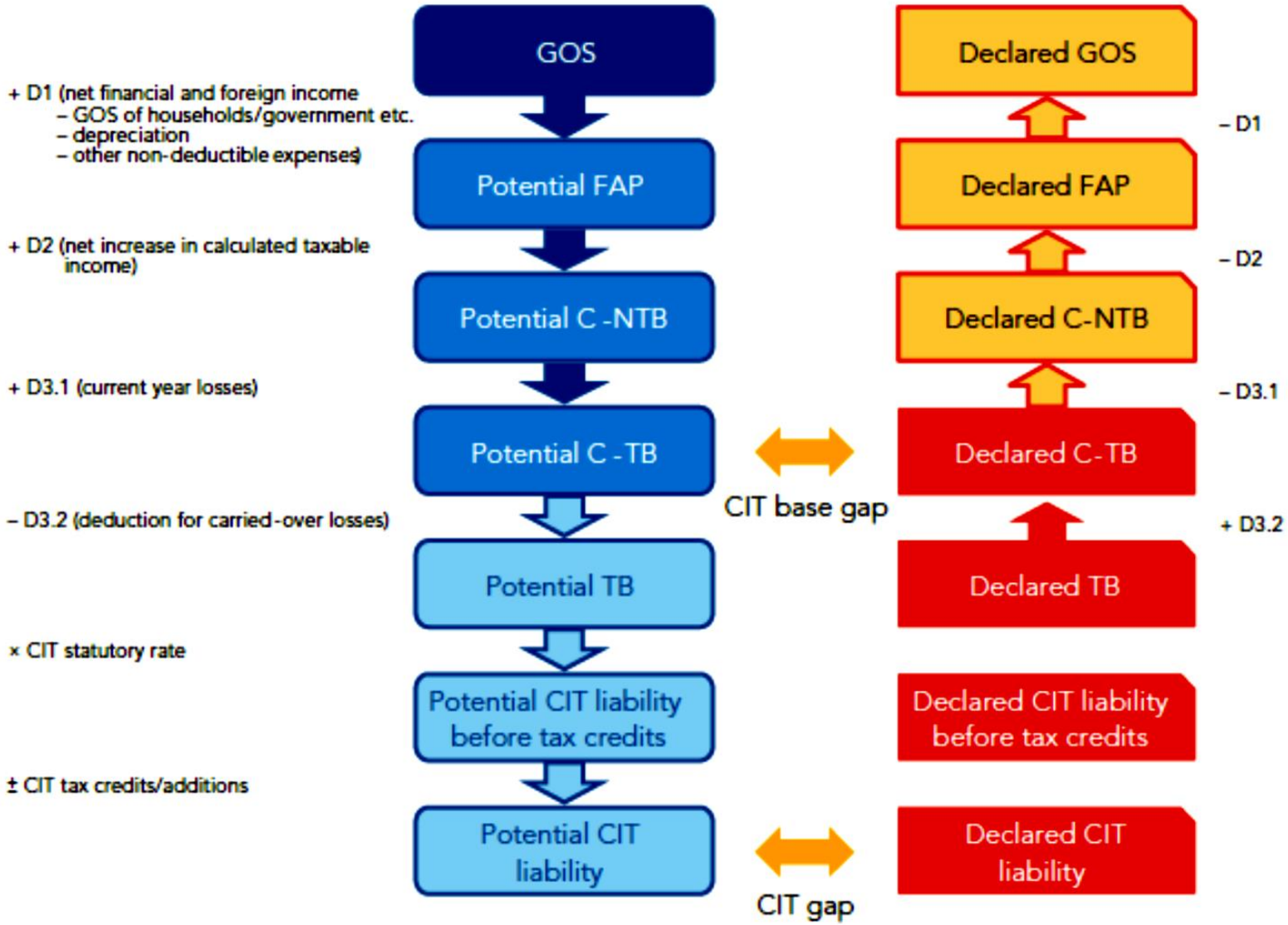
FIGURE 1. Theoretical Relationship between GDP and CIT Base



Source: Ueda, 2018: 9

CIT Gap

FIGURE 2. Concept of CIT Gap



Source: Ueda, 2018: 10

Data

- We use firm-level tax administrative data extracted, cleaned by the SARS data specialists.
- The data set incorporates income tax return data of companies who submitted their ITR14 tax returns.
- Certain variables (taxable income, assessed loss brought forward from previous year, net amount payable under this assessment, the assessment result and tax payable variables) from the corporate income tax ITA34C assessed data were extracted and used to supplement the ITR14 tax return data.

- National accounts survey data

Calculation of key variables from SARS dataset (determine assessed losses to calculate taxable income) (1)

- Constructed six scenarios at the individual corporate income taxpayer level, using SARS tax administrative data
  - *Information on the company's profit/loss position and whether there is a calculated profit or loss (after net computation adjustments).*
  - *From these scenarios the applicable net computation adjustments, aggregate current-year losses, prior cumulative losses utilized in the current year, taxable income, and taxes paid are calculated.*

Six scenarios:

- From **accounting profit to calculated taxable profit** after net adjustments.
  - *Tax payable (if positive taxable income net of carried-over losses)*
  - *Calculate cumulative loss for specific year*
  - *No calculated current-year losses*
- From **accounting profit to calculated taxable loss** after net adjustments.
  - *No (positive) taxable income to deduct any cumulative (carried-over) losses*
  - *Taxable income and tax payable are both zero.*
  - *Current-year losses added to cumulative losses brought forward from previous years*

Calculation of key variables from SARS dataset (determine assessed losses to calculate taxable income) (2)

Six scenarios:

- From **accounting loss to calculated taxable profit** after net adjustments
  - *Difference between calculated taxable profit and calculated taxable income at applicable average tax rate is utilized cumulative losses for specific year*
  - *Positive calculated taxable income, and tax payable*
- From **accounting loss to calculated loss** after net adjustments
  - *Current year's taxable losses added to cumulative losses brought forward from previous years*
  - *Zero utilization in the current year of previous year's tax losses, no (positive) taxable income, no taxes payable*
- From **zero accounting profit to calculated** taxable profit after net adjustments
  - *Difference between calculated taxable profits and calculated taxable income at applicable average tax rate is utilized cumulative losses for specific year*
  - *Positive taxable income, taxes payable*
- From **zero accounting profit to calculated loss** after net adjustments
  - *Current year's taxable losses added to the cumulative losses brought forward from previous years*
  - *Zero utilization in the specific year of previous year's tax losses*
  - *No (positive) taxable income, no taxes payable*

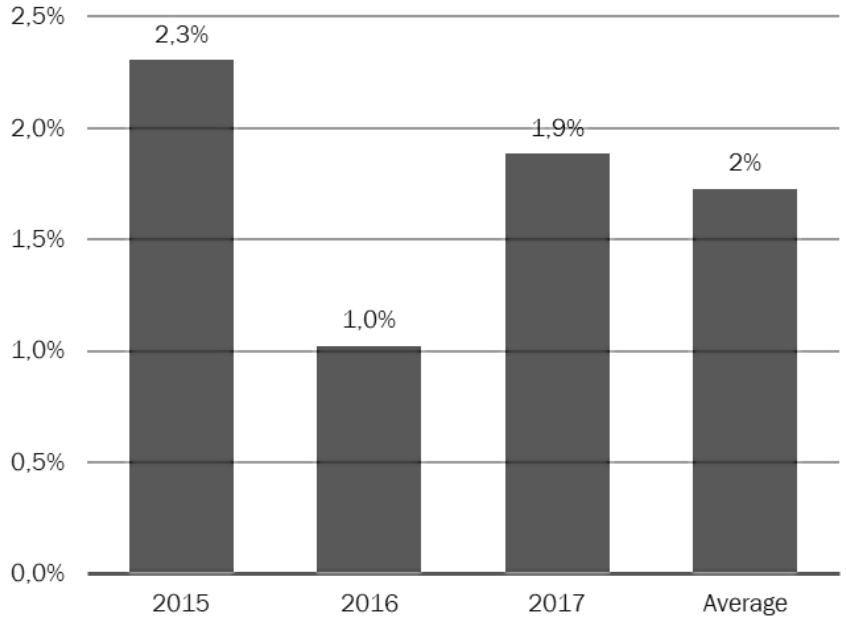
Results

CIT base gap and CIT gap

Note: amounts in Rand million.

Year	2015	2016	2017
Declared Current Year Tax Base (C-TB)	455,540	452,860	463,180
CIT base gap	351,373	156,62	320,079
CIT base gap / Potential C-TB	43.5%	25.7%	40.9%
Potential CIT liability	205,079	155,502	202,969
Declared CIT liability	111,946	110,995	115,152
CIT gap	93,133	44,507	87,817
CIT gap / Potential TB	12.3%	8.0%	12.1%
CIT gap / Potential tax liability	**45.4%**	**28.6%**	**43.0%**

CIT gap as percentage of GDP



Concluding remarks

- Research team faced numerous data challenges to determine the CIT tax base and CIT liability, mainly due to the non-linkage of tax assessed data and the ITR14 tax return data.
- We developed calculation methodologies to ensure that potential and actual CIT bases were estimated in a consistent manner that could be explained and replicated.
- This first attempt at estimating SA's CIT gap shows it varies between 8-12% of the potential tax base for 2015 to 2017. As a percentage of potential CIT liability, it is estimated at 39% (on average) over this period or close to 2% of GDP.
- These estimates could be further refined to contribute to evidenced based policy information supporting strategies for improved revenue mobilization.

- The CIT gap was only calculated for the non-financial sector.
  - *Further work: refine estimates plus determine the tax gap for the financial sector, for a total CIT gap for SA based on the top-down approach.*
  - *Supplement the top-down approach with a bottom-up approach*