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Budget 2023: Inflation - the invisible taxman

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'Inflation' is the increase in prices over a specific period and which leads to a reduction in the purchase power of money.

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The correlation between inflation and purchasing power is important because sometimes we are fooled into thinking that just because an amount increased, like your salary, your purchasing power remains the same.

For example, in year one, you get R1,2m after tax. Assume 'goods' per measure unit costs R300,000 and you can therefore buy four units of goods (R1,2m divided by R300,000 is a multiple of four full units). If your income remains the same for five years, at an inflation rate of 5%, those goods per unit will cost R383,000 after five years. So, you will only be able to buy three full units of goods (a multiple of 3.13) even though your income has remained the same.

So, to compensate for inflation, employers usually increase salaries annually and businesses increase the price of the goods and services they sell to match the inflationary increases in their costs. If you are lucky enough to have your salary matched to inflation, you should still in theory be able to buy four goods after five years. Or can you?

In South Africa, we subscribe to a progressive income tax system i.e. the more you earn, the more tax you pay. As you can only buy goods with a taxed income, the impact of taxation has to be determined as well on your 'purchasing power'.

So, using the above example, if in 2017 you got a taxed salary of R1,2m (R1,875m before tax) you can buy four units of goods at R300,000 a ton.

Five years later, your inflation-matched and adjusted gross salary would be R2,393m, which seems a healthy increase from five years and therefore you should still be able to buy four units of goods, right? Wrong. Your taxed salary is only R1,488m and the goods would cost R383,000 per unit. So now you can only buy three full units of goods (3.8 multiple) even though your salary increased at the same pace as the cost of goods. Your 'purchasing power' has decreased by a 0.2 multiple (5% decrease).

In the tax world we refer to this as 'bracket creep'.

The progressive tax is calculated based on a formula, which relies on constant amounts. If those constant amounts are not all adjusted by inflation, then the tax calculated will proportionally increase. Therefore, when the minister announces Rx billion in tax relief, as shown in the example, it mostly means that only a portion of the inflationary impact on 'purchasing power' has been given to taxpayers with the fiscus keeping a portion for itself. 'Bracket keep' is in essence a tax increase hidden in the detail and tax calculation mechanisms. This principle applies to every tax that is subject to a threshold or rebate etc., for example, income tax, estate duty, capital gains tax and donations tax. In the above example, tax cost as a percentage of my spending power increased by 5% and did not decrease over a five-year period even though the minister provided 'tax relief' in each of those years.

So, does government treat everyone like this or only the 'rich'? Let’s see how progressive the tax system is for normal families. Per National Treasury data, the average public sector worker earns R457,000 a year.

So, with 2017 as the base year that is a net after tax salary of R356,000. Should you receive 5% increases over five years, your salary in 2022 would have been R444,435 (before tax salary of R583,000).

So, in 2017 at R3,000 you can buy 118 goods. In 2022 when goods cost R3,830, you can buy 116. So even for the 'average' public sector worker, tax has increased over the last five years and their purchasing power has decreased by 1.69%. Many people will also rightly note that in the last five years, inflation has been much more than 5% and that their salary increases a lot less than 5% per year, which compounds their dilemma. So maybe their tax adjustments were not as bad, but inflation was. Well, maybe not.

So, in 2017 a unit of goods cost you R3,000 and included VAT of R368. In 2022 a unit of goods would include R500 of VAT (R470 if the VAT rate increase is excluded). So, to buy the exact same amount of goods, you will now pay 28% more tax due to the inflationary impact on the sale price and consequently the nominal tax amount included in it. It is for this reason that the government excludes certain primary foodstuffs from VAT to reduce this cost impact on the poor; but for everything else, it becomes a tax increase.

Inflation and 'bracket creep' can therefore be used to increase taxes at nominal values even when it seems in the Budget Review that the minister is providing 'tax relief'. The man on the street should therefore be very cognisant of the 'invisible taxman' and its real impact on their 'real purchasing power' before making any spending or debt decisions.

ABOUT THE AUTHOR

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