

State Capture and Kleptocracy in South Africa: The Case of the South African Revenue Service (SARS)¹

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Summary⁴

State capture occurs when a small number of influential actors in the public and private sectors collude to change rules, regulations, legislation and institutions to further their own narrow interests at the expense of the broader public interest.⁵ In South Africa, state capture became a prominent topic in the media in 2016 following widespread allegations that several state-owned enterprises and other agencies were infiltrated by persons close to President Jacob Zuma and that they radically altered the processes and functions of these entities to serve the interests of a few individuals and companies linked to Zuma. These institutions included South African Airways, Electricity Supply Commission of South Africa (ESKOM), the South African Broadcasting Corporation (SABC), Denel (arms manufacturer), the State Security Agency and the South African Revenue Service (SARS).

This briefing note summarises research that provides a detailed account of how one South African institution, SARS, was captured and the detrimental impact of this on the capacity of SARS to detect, investigate and prevent tax and financial crimes. Before this, SARS adopted a 'whole of government approach' that entailed closer cooperation among different branches of the state in the fight against tax and financial crime. There were three components to how state capture happened at SARS: (1) infiltration of the organisation by new employees who set out to weaken or manipulate the institution to serve the interests of captured politicians, (2) allegations in the media which cast doubt on the integrity of the institution and its leaders (especially if they were hostile to the interests of the capturers)⁶ and (3) organisational change and staff purges that further weakened the institution. The alleged misconduct of senior managers undermined their integrity and that of the

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5 Hellman, J. S., Jones, G.; Kaufmann, D. (2000). *Seize the State, Seize the Day: State Capture, Corruption, and Influence in Transition*. Policy Research Working Paper; No. 2444. World Bank, Washington, DC. © World Bank. <https://openknowledge.worldbank.org/handle/10986/19784> License: CC BY 3.0 IGO.

6 Groenink, E. (2020). *The Unlikely Mr Rogue: A Life with Ivan Pillay*. Jacana Media. Cape Town.

institution and provided a justification for a radical organisational restructuring and the appointment of new senior managers. The combination of institutional changes through restructuring or disbanding of key units involved in investigating tax and financial crime, plus the ensuing staff purges, left the institution with weak systems and skills gaps.⁷ SARS lost critical investigative and technical skills and its capacity to investigate tax and financial crime deteriorated.⁸ Moreover, SARS failed to meet its direct and indirect tax collection targets from 2014 to 2017.⁹

The literature on state capture focuses on close relations among these actors¹⁰ but does not provide detailed accounts of how institutions are captured or the impact on the capability and functioning of institutions. This study contributes to the literature by providing evidence of the detrimental impact of state capture on institutions and the public interest. It suggests that the lack of similar detailed case studies may lead to an underestimation of the negative impact of state capture on institutions in the public sphere. The integrity of SARS as the receiver of revenue has been tarnished; this may lead to taxpayer apathy and a further decrease in direct and indirect tax revenue. With less revenue the state may struggle to maintain the level of social protection and essential services that it provides for those living in poverty.

Background

The term 'state capture' arose in the late 1990s to describe close relations between political and new business elites in countries in Eastern Europe and Asia that transitioned from communism to free markets. State capture occurs when a small number of elites in the public and private sectors collude to modify rules, policies and legislation for their own benefit at the expense of the public interest.¹¹ In South Africa, state capture became a prominent topic in the media in 2016 following widespread allegations that several state-owned

enterprises and agencies were infiltrated by supporters of President Jacob Zuma and radically altered for the benefit of a narrow group of individuals and companies linked to him.^{12,13} The end result was kleptocracy and money laundering to move billions of Rands offshore.

One of these agencies was the South African Revenue Service (SARS). Under the leadership of its former Commissioner, Pravin Gordhan, SARS became widely recognised as a model government department and revenue service. SARS adopted a 'whole of government approach' with regard to its detection and investigation of tax and financial

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- 8 Commission of Inquiry into Tax Administration and Governance by SARS (Final Report). (2018, December 11). <http://www.thepresidency.gov.za/report-type/commission-inquiry-tax-administration-and-governance-sars>
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crime after the Oslo Dialogue in 2011, where the G20 advocated for closer cooperation among different branches of the state in the fight against tax and financial crime. SARS was primarily concerned about illicit economies, in particular the illicit cigarette trade, but it also worked with the other branches of state that were involved in investigating or prosecuting financial crimes. In fact, financial crime investigation capabilities were concentrated in SARS. Other departments such as the South African Police Service (SAPS), Directorate for Priority Crime Investigation (The Hawks) and the National Prosecuting Authority (NPA) regularly collaborated with SARS when they were working on cases related to financial crimes.

Our research provides a detailed account of the alleged capture of SARS and how the ability of SARS to detect, investigate and prevent tax and financial crime changed after 2014, under the Zuma presidency. Although two judicial commissions of enquiry (the Commission of Inquiry into Tax Administration and Governance by SARS, also referred to as the Nugent Commission of Inquiry,¹⁴ and the Judicial Commission of Inquiry into Allegations of State Capture, Corruption and Fraud in the Public Sector including Organs of State, also referred to as the Zondo Commission of Inquiry¹⁵) have generated extensive evidence on the impact of state capture on state institutions, they did not focus on the role of SARS in the fight against organised crime. Other secondary data sources include grey literature on revenue agencies and SARS, reports and books from whistle blowers and investigative journalists. These sources were used to build an understanding of the role of tax collection agencies, and SARS in particular, in combating tax and financial crime and how this changed. In-depth interviews were conducted among a range of stakeholders across the government agencies involved in the 'whole of government approach' to curbing tax and financial crime.

Key findings

The SARS case study reveals three components of state capture. (1) Infiltration of the organisation by new employees aligned to politicians associated with state capture. These included Tom Moyane, appointed by Zuma as the new Commissioner of SARS in 2014. (2) Allegations in the media about an alleged 'rogue unit' in SARS which was accused of exceeding its legislative authority to investigate tax and financial crimes. (3) Restructuring of SARS based on a diagnostic evaluation by the consulting firm Bain International which had no prior experience with revenue services.

Firstly, the 'rogue unit' allegations (that were later retracted by newspapers) cast doubt on the integrity of SARS. They provided a justification for the restructuring of the organisation and the suspension, investigation and prosecution of former senior managers. Secondly, key units that were responsible for detecting and investigating financial crimes pertaining to the illicit economy were disbanded. There were staff purges and an organisational climate of intimidation, which contributed to widespread resignations.

Finally, the combination of institutional changes through restructuring or disbanding and the ensuing staff purges left the institution with weak systems and skills gaps, where SARS lost critical investigative and technical skills.^{16,17} Investigations that were under way became stalled and there was little if any cooperation with the Financial Intelligence Centre or the National Prosecuting Authority. The findings of the Nugent Commission of Inquiry confirmed that SARS underperformed against its own targets for revenue collection from 2014 to 2017, with potentially serious consequences for South Africa's

14 Commission of Inquiry into Tax Administration and Governance by SARS (Final Report). (2018, December 11). <http://www.thepresidency.gov.za/report-type/commission-inquiry-tax-administration-and-governance-sars>

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16 Judicial Commission of Inquiry into Allegations of State Capture, Corruption and Fraud in the Public Sector including Organs of State. (2018, February 9). *Government Gazette*. Vol. 632. https://www.sastatecapture.org.za/uploads/GOVERNMENT_GAZETTE_Vol_632.pdf

17 Commission of Inquiry into Tax Administration and Governance by SARS (Final Report). (2018, December 11). <http://www.thepresidency.gov.za/report-type/commission-inquiry-tax-administration-and-governance-sars>

economic development.¹⁸ It will take many years to rebuild SARS so that it can play a significant role in the 'whole of government approach' to preventing tax and financial crime; until (or unless) that happens, illicit economic activity and financial crime will continue to thrive.

The recovery of SARS under the leadership of Edward Kieswetter¹⁹ – appointed in 2019 by Zuma's successor, Cyril Ramaphosa – was hampered by the COVID-19 pandemic, but the organisation is gradually recovering. It is establishing new business units and is introducing technology²⁰ to make up for some of the shortfalls in critical human resource skills. Our research suggests that SARS needs to invest in training and skills transfer to gradually rebuild its capacity to detect and investigate tax and financial crimes, including those related to the illicit economies, even if it may take several years for SARS to regain the capacity that was lost.

Implications

Policy changes are necessary to shield SARS and other government agencies from political interference. These include competitive and transparent processes for the appointment of SARS commissioners and the appointment of an Inspector General who can oversee the functioning of SARS. However, it is difficult to insulate state institutions such as SARS from political interference when this is supported by the executive and in a country where the ruling party has a majority in parliament.

Ultimately, the prosecution of the individuals implicated by the Nugent and Zondo commissions of inquiry will send the strongest signal that there is political commitment to restoring the credibility of SARS. It is anticipated that prosecutions or

other efforts to promote accountability and justice may revitalise the staff still working at SARS and boost tax compliance among personal and corporate taxpayers in South Africa.

This detailed case study of state capture at SARS contributes to the knowledge base on state capture by identifying the processes and mechanisms that enable state institutions to become captured by narrow interest groups. It also provides evidence on the wider impact of state capture for governance and policymaking. The integrity of SARS as the receiver of revenue has been tarnished and this is expected to lead to taxpayer apathy and a further decline in direct and indirect tax revenue. This expectation does not bode well for national development which is critical function of the South African state. The study suggests that state capture can undermine social protection and service delivery in South Africa. These findings suggest there may be an underestimation of the negative impact of state capture for institutions in the public sphere because of a lack of similar detailed case studies.

The research also highlights the need to distinguish between state capture and neopatrimonialism;²¹ the latter tends to be the overarching concept under which most accounts of corruption and kleptocracy involving senior government officials in Africa are situated. Neopatrimonialism tends overwhelmingly to take place in countries where there are weak institutions and where the rules are easily bypassed through informal relations among state and non-state actors. In contrast, prior to Zuma's presidency, South Africa had relatively robust public institutions within its financial and criminal justice clusters. It was therefore necessary to capture and weaken these institutions in order for kleptocracy and grand corruption to occur with impunity. This

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20 Mzekandaba, S. (2021). *SARS pins hopes on key tech as modernisation plans advance*. IT web. <https://www.itweb.co.za/content/VgZey7JoZGjMdjX9>

21 Neopatrimonialism occurs when corrupt politicians misappropriate state resources and distribute them to their clients in return for political support (Erdmann & Engel, 2007).

is an important lesson from the research, with relevance not just for South Africa but also for other countries where relatively strong institutions currently providing a brake on powerful corrupt and criminal elites may show signs of being under threat.

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The Serious Organised Crime & Anti-Corruption Evidence (SOC ACE) research programme aims to help 'unlock the black box of political will' for tackling serious organised crime, illicit finance and transnational corruption through research that informs politically feasible, technically sound interventions and strategies. Funded by the UK's Foreign, Commonwealth & Development Office (FCDO), SOC ACE is a new component in the Anti-Corruption Evidence (ACE) research programme, alongside Global Integrity ACE and SOAS ACE. SOC ACE is managed by the University of Birmingham, working in collaboration with a number of leading research organisations and through consultation and engagement with key stakeholders.

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