4

Taxation

National revenue is expected to exceed the budget estimate by R4,8 billion this year. Over the years ahead:

- *Improved administration will continue to provide scope for tax relief*
- *The burden of tax on lower and middle income taxpayers will again be reduced*
- *A wage incentive will be introduced to encourage learnerships*
- *R3 billion is set aside in tax incentives for strategic investment projects*
- *Taxation of retirement funds will be reviewed.*

Introduction

Robust revenue performance has been one of the hallmarks of the turnaround in the public finances over the past five years.

The South African Revenue Service (SARS) has consistently out-performed its annual revenue targets, contributing both to the steady improvement in the fiscal position and to the scope afforded to the Minister of Finance to provide tax relief each year.

Strong revenue growth has been instrumental in improving the fiscal position and allowing for tax relief

Tax reform has had two broad thrusts – lower rates of tax on income and a broadening of tax bases to protect the integrity of the tax structure and provide scope for moderating tax rates. Tax policy contributes to the redistribution of incomes and opportunities and to making South Africa an attractive destination for investment and job creation.

The two most significant changes to the tax structure in recent years were the change to a residence-based income tax and the capital gains tax. The residence-based income tax recognises South Africa's rapid reintegration into the world economy and the opportunities this creates for South African companies to grow internationally. The capital gains tax remedies a fundamental deficiency in the income tax, thereby improving the overall equity and efficiency of South Africa's tax system.

The 2002 Budget will bring a period of consolidation to ensure a stable, certain and competitive tax environment

Tax stability, certainty and an internationally competitive and attractive rate structure are critical for promoting investment and economic activity. Against the background of the tax reforms undertaken in the past two years, the 2002 Budget will herald a period of consolidation. The personal income tax structure will again be adjusted to provide relief to lower and middle income taxpayers and with a view to narrowing the gap in due course between the maximum personal rate and the rate of tax on companies. Further amendments to the list of public benefit activities will extend the range of organisations qualifying for tax exempt status. During the course of next year, a thorough review of the tax treatment of retirement saving will be undertaken. But the broad parameters of the tax law are now in place, and taxpayers can arrange their affairs with confidence in both the structure of the tax code and the steadily improving capacity of the revenue authority to ensure its impartial and effective administration.

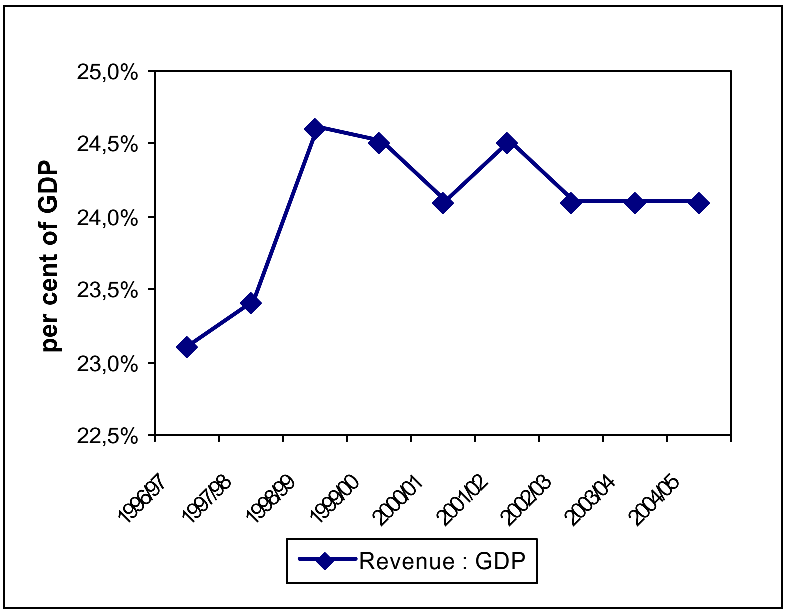
National budget revenue

Improvements in tax administration and base broadening efforts have ensured stable and buoyant tax revenue

Over the past five years, improvements in tax compliance and enforcement have complemented base broadening policy changes to ensure stability and buoyancy in tax revenue. SARS has consistently collected more revenue than forecast in the annual budget, which has contributed to reducing the fiscal deficit and borrowing costs for Government. Taxpayers have benefited through substantial cuts in individual and corporate tax rates.

Fig 4.1 illustrates the ratio of main budget revenue to GDP for National Government from 1996/97 to the end of the MTEF period. Between 1996/97 and 1999/00, the ratio rose due to improvements in the efficiency of tax collection and the buoyancy of South African tax bases, particularly the personal income tax.

Figure 4.1: Revenue:GDP, 1996/97 - 2004/05



Main budget revenue will ease from 24,5% of GDP in 2001/02 to 24,1% over the MTEF period

With the significant tax cuts introduced in 2000 and 2001, main budget revenue eased from 24,6 per cent of GDP in 1998/99 to 24,1 per cent in 2000/01. The projected increase in the ratio for this year is mainly due to expected higher tax revenue from the corporate sector. Over the MTEF period, Government proposes further moderation of income tax rates and anticipates an overall ratio of revenue to GDP of 24,1 per cent.

Initial results indicate that main budget revenue for 2000/01 was R2,6 billion more than the February revised estimate of R213,4 billion.

Revenue in 2000/01 exceeded the original budget estimate by 3,2%

In the 2000 Budget, national tax revenue of R213,7 billion was estimated for 2000/01, which was revised to R216,8 billion at the time of the 2001 Budget. Preliminary analysis of actual collections suggests that national tax revenue of R220,5 billion was collected. This is 3,2 per cent more than the original budget estimate.

Based on a preliminary classification of 2000/01 receipts, the main deviations from the budget estimates are:

Robust corporate tax receipts contributed to a sound revenue performance in 2000/01

- Individual income tax is R1,1 billion lower
- Company taxes are R3,1 billion higher
- The tax on retirement funds is R1 billion lower
- Value added tax is R402 million higher
- Levies on fuel are R405 million lower.

Table 4.1: National budget revenue, 2000/01 estimates and outcome

R million	Budget Estimate	Revised Estimate	Preliminary outcome
Taxes on income and profits	**122 703**	**124 225**	**125 418**
Persons and individuals	87 821	86 400	85 293
Companies	24 583	26 025	29 169
Secondary Tax on Companies	2 100	3 800	4 028
Other	8 200	8 000	6 928
Taxes on property	**3 338**	**4 004**	**3 979**
Domestic taxes on goods and services	**79 448**	**78 868**	**79 020**
Value-added tax/sales tax	52 858	54 000	54 402
Specific excise duties	9 570	9 031	9 127
Levies on fuel	15 970	14 900	14 495
Other	1 050	937	996
Taxes on international trade and transactions	**6 500**	**8 189**	**8 227**
Stamp duties and fees	**1 700**	**1 500**	**1 562**
Miscellaneous[1]			**2 290**
Total tax revenue	**213 689**	**216 786**	**220 495**
Non-tax revenue and repayments	5 107	4 995	3 864
Less: SACU payments	8 396	8 396	8 396
Main budget revenue	**210 400**	**213 386**	**215 963**

1 *Receipts not yet classified.*

The 2001 Budget revenue estimates have been updated to take account of the revenue performance in 2000/01, the revenue collection trends during the first part of 2001/02 and the revised macroeconomic forecast set out in Chapter 2. These figures are presented in Table 4.2.

Continued growth in company taxes and STC have raised estimates of main budget revenue in 2001/02 to R238,2 billion

The revised 2001/02 estimate for main budget revenue is R238,2 billion, which is R4,8 billion more than the original estimate. Estimates of total tax revenue are increased by 2,1 per cent to R241,8 billion. This can largely be ascribed to the following changes in estimated tax revenue:

- Company tax receipts have been adjusted to R36,3 billion from the original R30 billion, reflecting robust growth in corporate earnings, the effect of broadening the income tax base by including foreign dividends and enhanced collections from the long-term assurance and banking industries.
- The expected yield of the secondary tax on companies has been increased by R2,6 billion to R6,8 billion, reflecting strong growth in company dividend distributions.
- The value-added tax estimate has been reduced to R58,6 billion, taking account of anticipated slower growth in consumption expenditure.
- Fuel levy revenue has been reduced by R436 million.

Table 4.2: National budget revenue - medium term estimates

R billion	2000/01 Preliminary outcome	2001/02 Budget Estimate	2001/02 Revised Estimate	2002/03	2003/04	2004/05
				Medium term estimates		
Taxes on income and profits	**125,4**	**134,4**	**142,1**	**151,5**	**164,8**	**178,1**
Persons and individuals	85,3	90,1	90,1	97,0	105,4	114,0
Companies	29,2	30,0	36,3	37,7	41,1	44,5
Secondary Tax on Companies	4,0	4,2	6,8	7,3	8,1	8,7
Other	6,9	10,1	8,9	9,5	10,2	10,9
Taxes on property	**4,0**	**4,7**	**4,2**	**4,6**	**5,0**	**5,2**
Domestic taxes on goods and services	**79,0**	**86,7**	**84,3**	**90,5**	**98,8**	**106,8**
Value-added tax/sales tax	54,4	60,4	58,6	63,2	69,6	75,9
Specific excise duties	9,1	9,8	9,6	10,2	10,8	11,4
Levies on fuel	14,5	15,3	14,9	15,9	17,0	18,0
Other	1,0	1,2	1,2	1,3	1,4	1,6
Taxes on international trade and transactions	**8,2**	**9,4**	**9,3**	**10,5**	**12,0**	**13,3**
Stamp duties and fees	**1,6**	**1,6**	**1,8**	**2,0**	**2,2**	**2,4**
Miscellaneous	**2,3**	**0,0**	**0,0**	**0,0**	**0,0**	**0,0**
Total tax revenue	**220,5**	**236,8**	**241,8**	**259,0**	**282,7**	**305,9**
Non-tax revenue and repayments	3,9	4,8	4,6	4,8	5,2	5,5
Less: SACU payments	8,4	8,2	8,2	9,1	11,2	12,0
Main budget revenue	**216,0**	**233,4**	**238,2**	**254,7**	**276,8**	**299,3**
per cent of GDP	***24,1%***	***23,6%***	***24,5%***	***24,1%***	***24,1%***	***24,1%***
Changes from 2001 Budget						
Total tax revenue			**5,0**	**2,1**	**3,6**	
Main Budget Revenue			**4,8**	**1,9**	**3,7**	

Implementation of 2001 Budget proposals

Significant tax relief was announced in the 2001 Budget, including:

Tax relief announced in the 2001 Budget included personal income tax cuts, a wage subsidy and a number of investment allowances

- R8,3 billion in personal income tax cuts
- A wage incentive to encourage formal sector employment
- A strategic investment incentive, focussing primarily on manufacturing
- Accelerated depreciation allowances for capital purchases by small business corporations
- Extending depreciation allowances for airport infrastructure
- Extending the VAT zero-rate to illuminating paraffin
- Further diesel fuel concessions for the primary production sector
- The delay of the implementation of capital gains tax until 1 October 2001 to allow for proper development of management information systems, particularly in the financial services industry.

During the course of 2001, these policies were refined and set out in the Revenue Laws Amendment Bills.

Capital gains tax

The residence-based income tax system and capital gains tax were introduced to correct fundamental weaknesses in the South African tax structure

In the 2000 Budget, Government announced that it was introducing a residence-based income tax and a capital gains tax. These far-reaching tax reform efforts were essential to address structural weaknesses in the South African income tax system. The residence-based income tax regime came into operation on 1 January 2001 and the capital gains tax on 1 October 2001.

The general principles of the capital gains tax were set out in the 2001 Budget Review and given effect in legislation passed by Parliament in June 2001. At the time of introducing the legislation, Government committed to refining critical policy areas, especially the impact of capital gains tax on company formations and re-organisations.

CGT rules have been introduced to allow for company reorganisations aimed at ensuring the efficient allocation of capital in the corporate sector

Around the world, capital gains tax regimes contain special provisions to facilitate the reallocation of capital resources in the corporate sector with a view to obtaining more efficient corporate operations. In general, capital gains taxes are deferred when an asset is "disposed of" in the formation of a new company and the original owner retains an effective individual interest in the asset disposed of to the company; or where assets are transferred between companies and there is a continuation of the original business activity.

Subject to certain conditions, the following activities will not attract capital gains tax, and are also relieved from income tax, marketable securities tax, uncertified securities tax and stamp duty.

- The transfer of assets into a new company
- Combinations of companies in 'share for share' transactions
- Asset liquidations and transfers of assets within groups of companies
- Unbundling transactions.

These tax concessions only apply to transactions occurring within South Africa.

The liberalisation of exchange controls has allowed South African taxpayers to geographically diversify their investment portfolios and South African businesses to expand their operations globally. This means that South Africans are operating in a variety of different currencies and the income tax regime must be adapted to take account of currency movements.

Rules have been introduced for the taxation of currency transactions that is fair, practical and internationally consistent

The introduction of capital gains tax necessitated a careful evaluation of the taxation of currency transactions to ensure a tax system that is fair, practical and internationally consistent. The legislation and regulations also align the capital gains tax provisions with the residence-based income tax rules in respect of currency transactions.

SARS devoted considerable resources to ensuring that the revenue authority and taxpayers were prepared for the introduction of capital gains tax on 1 October. Changes have been made to the New Income Tax System (NITS) to include capital gains that will be reported by taxpayers in their income tax returns from 2002 onward.

SARS has also conducted internal training sessions and sent over 2 000 employees to training courses offered by the Rand Afrikaans University. One-day seminars to the public were offered around the country as part of SARS ongoing drive for taxpayer education. In addition, SARS has made available further information material, including brochures and answers to taxpayer questions on its website.

SARS invested considerable resources to prepare itself and taxpayers for the introduction of CGT on 1 October

Strategic investment incentive

Government has allocated R3 billion over the next four years for an investment tax incentive to encourage strategic investment projects, primarily in the manufacturing sector. This intensifies efforts to ensure that South Africa begins to realise the benefits of its sound macroeconomic and fiscal policy position through higher rates of investment, growth and employment.

R3 billion over 4 years has been allocated to the strategic investment incentive to promote faster investment and job creation

To qualify as a strategic investment, a project must satisfy a number of basic criteria. Specifically, the project:

- Must entail a minimum investment of R50 million
- May not displace more than a minimum level of existing jobs and production in its industrial sector
- Must be commercially viable
- May not benefit from certain other investment incentives or be an Industrial Participation Project.

Investment projects satisfying the minimum criteria are evaluated against an objective points system to determine the potential economic benefits of the project and the possible tax allowance

An investment project that meets these minimum criteria can qualify for either a 50 per cent or 100 per cent additional tax allowance, depending on the total score the project achieves when measured against the factors set out in Table 4.3. A project that obtains 4 points will receive an additional tax allowance equal to 50 per cent of the value of its qualifying investment and a project that obtains 6 points will receive a 100 per cent additional tax allowance.

The SIP programme is underpinned by extensive reporting requirements to ensure transparency and accountability in the awarding of the incentive

An inter-departmental Adjudication Committee has been established to evaluate projects through awarding points in line with the criteria. The Minister of Trade and Industry may then approve a project if he is satisfied that the criteria have been met. This awarding of the incentive is underpinned by extensive disclosure rules to ensure the fiscal resources are allocated in a transparent and

Table 4.3: Point-scoring system for strategic investment incentives

Factor		Points
A. Upgrading industry		
i. New product or process		1 point
ii. Key component of a cluster		1 point
iii. Value-added process		1 point
B. Business linkages		
i. SMME purchases	10% of total purchases	= 1 point
ii. Infrastructure (5% of cost of the investment)	20% of total purchases	= 2 points
C. Direct and indirect employment creation		
i. Job creation	3 full-time jobs per R1 million of qualifying assets	= 1 point
	4 full-time jobs per R1 million of qualifying assets	= 2 points
	5 full-time jobs per R1 million of qualifying assets	= 3 points
	6 full-time jobs per R1 million of qualifying assets	= 4 points

accountable manner. Hence, Parliament and other stakeholders can carefully assess the success of the programme.

Wage incentive

In the 2001 Budget, Government announced its intention to introduce a wage incentive from 1 October 2001 with the following objectives:

- Encourage job creation by reducing the cost of hiring new workers and of offering learnerships.

- Encourage the formalisation of employment that is currently in the informal sector. This will have positive effects on other government programmes - for example, the Unemployment Insurance Fund - and ensure their benefits are more widely available.

Tax allowances to encourage learnerships will contribute to expanding the skills base in South Africa and easing unemployment

Following the Budget, an inter-departmental task team was established to consider various possible wage incentives that would be appropriate in South Africa's current circumstances. It is proposed that the wage incentive take the following format:

- Employers will be allowed an additional tax allowance when a learnership agreement is signed with a learner.

- A further tax allowance is granted when the learner successfully completes the learnership covered by the agreement.

SARS, National Treasury and the Department of Labour will release draft legislation regarding the wage incentive before the end of the year for broad consultation with stakeholders.

Banking sector

Government's tax reform efforts are premised on broadening tax bases and reducing statutory tax rates. As noted in the 2001 Budget Review, it is unacceptable and inequitable that any one sector of the economy pays less than its fair share of tax. Accordingly, the low effective tax rate in the banking sector was raised as an issue of concern to Government.

Government has worked closely with the banks to identify legislative and administrative measures to combat the low effective tax rate in the sector

The National Treasury and SARS have engaged with the banking sector through the Banking Council in order to identify the mechanisms by which banks are able to reduce their tax liabilities. The industry information gathered through this co-operative approach has highlighted several areas of the income tax legislation that require attention. SARS has also continued to challenge individual banks' tax avoidance transactions. Satisfactory settlements have been reached in a number of cases while others will be resolved in the courts.

Reform of ad valorem duties

In the 2001 Budget, Government proposed to reform the ad valorem duties, which are levied on imported and domestically produced "up-market" goods. It was proposed

The ad valorem system has been simplified, yielding administrative and compliance savings, without compromising tax equity to abolish the value determination method of determining the dutiable value of domestically produced goods, except for motor vehicles. It was also proposed that the maximum ad valorem duty rate be reduced from 10 per cent to 7 per cent. In addition, based on household expenditure survey evidence, the rate on cosmetic products was reduced from 10 per cent to 5 per cent. This reform would realise significant administrative and compliance cost savings for SARS and taxpayers, respectively, while maintaining the effective tax rates for most products.

Following this announcement, Government and Parliament's Portfolio Committee on Finance received representations from affected industries regarding possible unintended consequences arising from the proposals. Further investigation revealed that the invoice method is not appropriate for certain industries at this stage. Consequently, a simplified value-determination procedure is retained for a very limited list of products for one year (ending 30 June 2002) to allow for further analysis of an appropriate taxation method for these products.

Provincial taxation

The Provincial Tax Regulation Process Bill provides the framework for provinces to introduce taxes, allowing for provinces to generate more of their own revenue

The Provincial Tax Regulation Process Bill was tabled in Parliament in August 2001, fulfilling the Constitutional obligation that provincial taxing powers must be regulated by national legislation. Provinces may impose taxes that are consistent with the requirements of Section 228 of the Constitution. Any province proposing a tax must make a submission to the Minister of Finance that:

- Explains the reasons for the tax
- Sets out the tax base, the desired tax rate and any special tax relief measures or exemptions being considered
- Identifies the preferred tax collection agency
- Estimates of the revenue to be collected and the potential impact on economic activity inside and outside the province.

Provincial tax proposals must be consistent with Government's broad economic and fiscal policy objectives and take cognisance of the potential impact on other provinces

The Minister of Finance must ensure that the proposal is consistent with the Constitutional imperatives and consider the impact of the tax on the fiscal position of General Government and the overall tax burden within the country. Provincial tax proposals will therefore be considered in detail within the consultative forum of the Budget Council in order to promote the spirit of co-operative governance, and fully assess the potential economic, distributional and revenue impacts of provincial taxes across that sphere of Government.

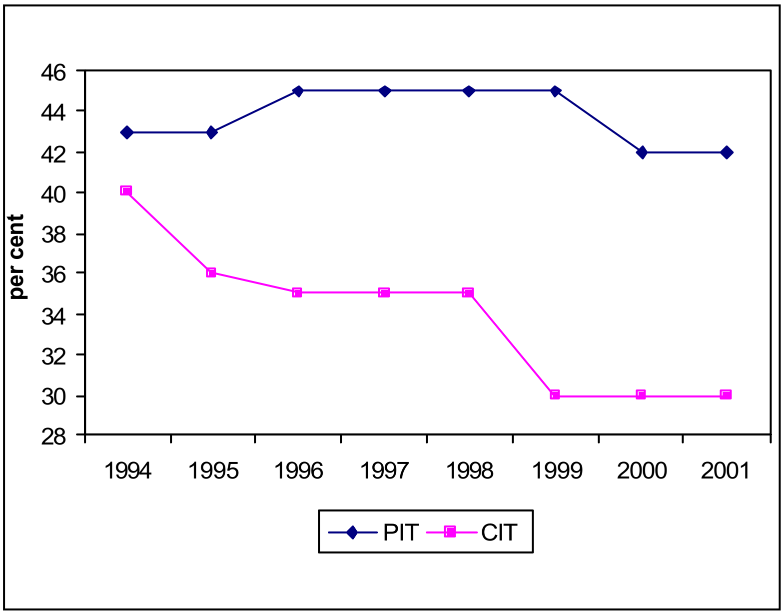
Tax policy for Budget 2002

Lower rates of income tax on companies and individuals have been implemented since 1994

Since 1994, Government has brought the company tax rate down from 40 per cent to 30 per cent. The personal tax rate structure has also been revised each year, bringing substantial relief to all taxpayers and particularly to lower and middle-income taxpayers. More targeted adjustments have sought to encourage investment, promote small business development and encourage regional industrial development and job creation.

The 2002 Budget will again bring income tax relief to individuals in the lower and middle-income brackets and narrow the gap in due course between the top marginal income tax rate and the company tax rate. The strategic investment incentive will provide support to targeted industrial development projects and measures supportive of job creation will continue to be sought.

Fig 4.2: Evolution of maximum corporate and individual income tax rates since 1994.



Review of tax on retirement saving

The taxation of retirement saving will be reviewed in 2002, informed by the work of earlier committees that have considered these issues

In 1996, Government introduced the Tax on Retirement Funds, after taking account of the recommendations of the Katz Commission regarding the taxation of retirement saving. This tax is levied on the gross interest, net rental and foreign dividend income of retirement funds attributable to contributing members.

The tax regime for retirement savings must be guided by the need to promote saving and post-retirement income security in an efficient and equitable way

Over the course of 2002, Government will undertake a holistic review of the taxation of retirement saving, as committed to Parliament's Portfolio Committee on Finance during the deliberations on the 2001 Budget. This investigation will be informed by work of, among others, the Katz Commission, the Smith Committee and the Comprehensive Social Security Committee, which is scheduled to table a draft report before the end of 2001.

In developing a tax regime for retirement saving, Government must be guided by a number of principles, including:

- Encouraging saving
- Facilitating post-retirement income security
- Equity in the overall distribution of government resources allocated for retirement provision, including the old age grant and tax expenditures for retirement savings
- Efficiency and neutrality in the allocation of the nation's savings
- Controling tax arbitrage opportunities
- Revenue stability and accountability for the provision of tax expenditures.

The National Treasury will release a discussion document for wide consultation during 2002. Comments from stakeholders will then be taken into account in the development of possible policy reform proposals to be considered for the 2003 Budget.

Taxation of public benefit organisations

Recognising the important role of PBO's, Government introduced significant reform to the tax environment for this sector to make it easier for them to raise money and provide vital social services

Public benefit organisations play a critical role in promoting democracy, relieving the burden of poverty and delivering vital social services to the people of South Africa. In the 2000 Budget, Government announced new measures to regulate the tax environment for these entities in a more coherent and systematic way. These changes were necessary to provide certainty for the organisations and taxpayers funding them, and to ensure that the tax incentives reflect the challenges currently facing South Africa and equitably addressing the funding crisis of the public benefit sector.

There were two important aspects to the tax changes. Firstly, the range of institutions to which taxpayers can make tax-deductible donations was widened and the level of allowable deductions increased for individual taxpayers. Secondly, Government released a list of public benefit activities that an organisation must engage in, to qualify for tax exempt status.

These lists were published in the Government Gazette in July 2001, after extensive consultation and consideration of issues raised by all stakeholders. Government continues to engage with stakeholders in the Public Benefit Organisations sector with a view to expanding the range of activities that qualify for tax-exempt status.

Government continues to engage stakeholders to identify additional public benefit activities that should benefit from the tax privileges

Review of effective tax rates in the corporate sector

Following the review of the long term assurance sector in 1999 and the banking sector in 2001, the National Treasury and SARS will continue the periodic review of effective tax rates of corporate sectors in order to identify inappropriate tax dispensations that impair the efficiency and equity of the tax system. SARS will also continue to initiate audits on a sector basis in view of the success it has achieved in the electronics sector. Both legislative and administrative changes may be expected to flow from these processes.

The review of effective corporate tax rates will continue to identify base broadening reforms that improve the efficiency and equity of the income tax system and provide room for tax rate reductions

Administrative review

As part of the process of consolidation in 2002, SARS will be reviewing aspects of tax legislation to streamline the tax administration system for both taxpayers and SARS. This review will be aimed at reducing paperwork and aligning the tax administration system with modern business practices.

Regional Co-operation

The SADC Tax Subcommittee, which is chaired by South Africa, was formed in July 1999 to strengthen regional co-operation in tax matters. The Subcommittee has formed four Working Groups to concentrate on:

- Indirect taxation
- Tax incentives
- Tax treaties
- Capacity building

The SADC tax subcommittee continues to advance its efforts to enhance tax co-operation in the region with the development of a draft Memorandum of Understanding

After an extensive process of negotiation in the Subcommittee, a draft non-legally-binding Memorandum of Understanding was presented to the SADC Minister's meeting on 31 July 2001. Member States are tabling this document in their respective Cabinets for approval with the aim of ratifying it before the end of 2001.

Capacity building workshops, the development of a SADC tax database and efforts to develop a common approach to the use of tax incentives in the region are the primary initiatives of the Subcommittee

Two capacity building workshops have been conducted during the course of 2001, focusing on tax incentives and foreign direct investment; and revenue estimation and quantitative analysis of tax policy. Further workshops are planned on value-added taxation; the taxation of the mining sector; and double taxation agreements. These workshops, which have been facilitated by multilateral institutions and experts in the region, have been an integral part of the Subcommittee's efforts to enhance the tax policy making capabilities of regional governments.

The Subcommittee has initiated a project to compile and maintain a database of regional countries' tax systems. The database will include information on direct and indirect taxes and will provide an important reference source for investors, researchers and policymakers.

The Subcommittee seeks to develop a common approach to the use of tax incentives accross the region

The SADC Tax Subcommittee is also spearheading efforts to analyse the economic impact of various tax incentives being employed in Member States. This process will seek to develop a common policy approach toward the use of special tax incentives across the region, taking cognisance of efforts by multilateral institutions to minimise the use of "harmful tax incentives" and the costs of incentives on the regional economy. This will hopefully avoid an unsustainable "race to the bottom" as SADC member states seek to attract foreign direct investment.

Conclusion

The South African income tax system has undergone significant structural changes over the past few years to broaden tax bases, strengthen the overall revenue system and entrench more firmly the principle of equity in order to boost taxpayer morale. These changes have complemented administrative reforms to ensure that tax revenue has been both stable and buoyant, providing scope for significant tax relief to both individual and corporate taxpayers.

Over the medium term, tax policy will be characterised by a phase of consolidation of the reforms that have recently been introduced, considering reforms to the retirement taxation and continuing the trend of providing real income tax relief, as fiscal resources permit.