4

Taxation

Sound tax policy and effective administration are essential underpinnings of an efficient state and a rules-based market economy. Policy reform and enhanced administration have increased the resources available to the state to achieve a sustained rollout of social services while promoting economic growth. Improvements to tax administration have contributed, alongside robust economic growth, to substantial upward adjustments to expected revenue.

Tax policy reforms this year included measures to ensure greater equity between both individuals and companies, and to limit the potential for abuse.

The tax reform agenda for 2006/07 will include adjustments to various monetary thresholds, relief for the effects of inflation, and reforms with respect to pension funds and retirement fund taxes. Government will continue to focus tax reform on efforts to reduce the tax burden and streamline tax administration for small businesses as part of continued efforts to promote economic growth and employment.

Introduction

Reforms broaden tax base and contribute to buoyant growth

A series of tax reforms and improved administration over the past five years have significantly broadened the tax base, improved the efficiency of tax collection and helped to increase revenue.

Government will continue to adjust the policy framework to ensure that tax policy contributes to sustainable economic growth and equity. Tax policy aims to increase the efficiency of tax collection and administration for both small business and the private sector as a whole, while ensuring that the tax burden on individuals is fair.

This chapter discusses the revised revenue estimates, including the medium term estimates and implementation of the 2005 Budget tax proposals, and some tax policy considerations for the 2006 Budget.

National budget revenue 2004/05

Audited main budget revenue was R20,9 billion higher than estimated

The audited main budget revenue outcome of R347,9 billion for the 2004/05 fiscal year was R20,9 billion higher than the original budget estimate of R327 billion, and R9,9 billion higher than the revised estimate of R338 billion published in the 2005 Budget Review. The main divergences in revenue were:

- Higher than expected profits in the financing, insurance, real estate and business services sectors resulted in corporate income tax collections R5,3 billion higher than projected
- VAT collections were R2,7 billion higher than the revised estimate, mainly due to the early flow of payments in March following changes in the deferment rules
- Largely as a result of higher import volumes, international trade tax receipts were R1,6 billion higher than estimated
- Interest, dividends and other non-tax receipts exceeded the revised projections by R175 million.

Table 4.1 National budget revenue, 2004/05 estimates and audited outcome

R billion	Budget estimate	Revised estimate	Audited outcome
Taxes on income and profits	**193,5**	**194,5**	**199,7**
Persons and individuals	105,9	111,0	111,0
Companies	68,8	65,5	70,8
Secondary tax on companies	6,8	7,6	7,5
Other	12,0	10,5	10,4
Taxes on property	**6,9**	**8,9**	**9,0**
Domestic taxes on goods and services	**121,5**	**129,0**	**131,9**
Value-added tax	89,5	95,5	98,2
Specific excise duties	13,1	13,0	13,1
Levies on fuel	17,4	18,8	19,2
Other	1,5	1,8	1,4
Taxes on international trade and transactions	**10,5**	**11,7**	**13,3**
Stamp duties and fees	**1,3**	**1,1**	**1,2**
Total tax revenue	**333,7**	**345,3**	**355,0**
Non-tax revenue and repayments	6,6	6,0	6,2
Less: SACU payments	-13,3	-13,3	-13,3
Main budget revenue	**327,0**	**338,0**	**347,9**

National budget revenue: medium term estimates

Based on revised macroeconomic projections set out in Chapter 2 and the revenue trends for the first six months of this fiscal year, main budget revenue for 2005/06 is revised upwards by R30,2 billion to R400,1 billion.

Higher estimate reflects strong demand for goods and services

The higher 2005/06 estimate partly reflects the momentum of revenue flows arising from economic growth in 2004, but also signals a boost in demand for domestic goods and services and imported goods, and improved corporate earnings. As a result, expected corporate income tax receipts for 2005/06 are revised upwards by R10,4 billion and secondary tax on companies by R1,5 billion. It is estimated that VAT will be R9 billion higher than originally forecast. Higher employment and remuneration increase the estimate of personal income tax by R8,3 billion.

Southern African Customs Union payments to the BLNS countries (Botswana, Lesotho, Namibia and Swaziland) – largely a function of customs revenue – are to increase by R2 billion to R14,1 billion after the calculation of adjustment payments based on the revenue-sharing formula.

Revised revenue projections for 2005/06 are presented in table 4.2, together with projections for the MTEF period.

Table 4.2 National budget revenue, 2004/05 – 2008/09

R billion	2004/05 Audited outcome	2005/06 Budget estimate	2005/06 Revised estimate	2006/07 Medium term estimates	2007/08	2008/09
Taxes on income and profits	**199,7**	**205,8**	**225,4**	**250,7**	**272,5**	**297,6**
Persons and individuals	111,0	116,9	125,2	138,6	152,0	166,5
Companies	70,8	68,7	79,1	87,0	94,0	102,6
Secondary tax on companies	7,5	8,7	10,2	13,0	13,5	14,2
Other	10,4	11,5	10,9	12,1	13,1	14,3
Taxes on property	**9,0**	**9,8**	**11,0**	**12,4**	**13,6**	**15,1**
Domestic taxes on goods and	**131,9**	**143,1**	**152,4**	**166,8**	**182,1**	**199,9**
Value-added tax	98,2	106,0	115,0	127,0	139,5	154,0
Specific excise duties	13,1	14,5	14,7	15,9	17,1	18,5
Levies on fuel	19,2	20,7	20,6	21,7	23,0	24,7
Other	1,4	2,0	2,1	2,3	2,5	2,7
Taxes on international trade and transactions	**13,3**	**13,2**	**16,3**	**18,4**	**19,8**	**22,1**
Stamp duties and fees	**1,2**	**0,9**	**1,0**	**1,0**	**1,1**	**1,1**
Total tax revenue[1]	**355,0**	**372,8**	**405,9**	**449,3**	**489,0**	**535,8**
Non-tax revenue and repayments[2]	6,2	9,1	8,3	8,8	8,8	11,9
Less: SACU payments	-13,3	-12,1	-14,1	-21,1	-18,8	-20,5
Main budget revenue	**347,9**	**369,9**	**400,1**	**437,0**	**479,0**	**527,2**
Percentage of GDP	*24,7%*	*24,2%*	*25,9%*	*25,8%*	*25,8%*	*25,9%*
Changes from 2005 Budget						
Total tax revenue			33,2	35,1	35,3	
Main budget revenue			30,2	31,6	34,4	

1. Includes provision for RSC levies of R7 billion in 2006/07, R8 billion in 2007/08 and R9 billion in 2008/09.

2. 2005/06 budget estimate includes R2,4 billion proceeds from the foreign exchange amnesty.

Foreign exchange amnesty

Amnesty proceeds earmarked for community infrastructure investment

Government has received approximately 43 102 amnesty applications since the implementation of the foreign exchange amnesty announced by the Minister of Finance on 26 February 2003. As at 30 September 2005, 39 442 (92 per cent) of these had been finalised, with resulting proceeds of about R2,4 billion. As stated in the 2005 Budget Speech, these funds will be used for investment in community infrastructure. The proceeds will be classified separately as extraordinary receipts.

A primary goal of the amnesty was to broaden the country's tax base through the disclosure of foreign assets. In this regard, a total of R64 billion worth of foreign assets has been disclosed. About 70 per cent of these disclosed assets were unauthorised, while 30 per cent were authorised through the Exchange Control Circular No. D. 405.

Implementation of the 2005 tax proposals

2005 tax proposals included relief for individuals and companies

The 2005 tax proposals included income tax relief for both individuals and companies, and significant changes aimed at reducing compliance costs and providing an enabling environment for small businesses. Small businesses received direct income tax relief of R1,4 billion, and VAT cash flow relief through an extension of the payment period from every two months to every four months. Individuals received R6,8 billion of income tax relief and a further R310 million in respect of investment income. Tax relief relating to home ownership amounted to R450 million and relief in relation to taxes on banking transactions (stamp duties) amounted to R350 million.

Medical scheme membership

Reforms ensure a more equitable health dispensation

Following consultation with the Department of Health, the National Treasury released a discussion document on the proposed tax treatment of medical scheme contributions and other medical expenses for public comment on 1 September 2005. The proposed reforms are in line with Government's objectives to ensure a more equitable health dispensation and broader medical scheme coverage, and to cap the effective tax subsidy on medical expenses.

After an extensive evaluation of comments received, the following amendments will be enacted and become effective from 1 March 2006:

- Tax-free monthly contributions to medical schemes will be capped at R500 each for both the principal member and the first beneficiary, and at R300 for each additional beneficiary
- The annual threshold for deductibility of medical expenses will be increased from 5 per cent to 7,5 per cent of taxable income
- The R500 minimum threshold rule for handicapped persons is to be scrapped, and these persons will be allowed to deduct all their medical expenses

- Medical treatment provided by an employer will be tax-free, subject to appropriate criteria.

Motor vehicle allowance and company cars

Deemed annual private kilometre figure will increase

The deemed annual private kilometre figure where actual travel is not recorded is increased from 14 000 to 16 000 for individuals in the 2005/06 tax year and will increase to 18 000 in 2006/07. As of 1 March 2005, the deemed method for calculating fixed business travel cost was adjusted by introducing a residual value element and by capping the car value at 360 000.

The monthly fringe benefits in relation to a company car will be increased from 1,8 per cent to 2,5 per cent with effect from 1 March 2006. Where an individual with a company car is required to pay for fuel, the deemed monthly fringe benefit will be decreased by 0,22 percentage points and by a further 0,18 percentage points where such an individual is also responsible for the maintenance of the vehicle.

Visiting entertainers and sportspersons

Withholding tax on payments to entertainers and athletes

A final withholding tax of 15 per cent will be introduced on all payments made by South African residents to foreign visiting entertainers and sportspersons who perform in South Africa.

In the 2005 Budget a split rate was proposed: 5 per cent on visiting artists resident in the rest of Africa and 15 per cent on all other international visiting artists. After further consultation, it has been decided to introduce one uniform rate of 15 per cent. The proposed split rates would have been in breach of Article II of the General Agreement on Trade in Services, to which South Africa is a signatory.

Visiting skilled expatriates

Changes remove undue tax impediments on visiting skilled expatriates

Changes have been made to the income tax system that will remove undue tax burdens on visiting skilled expatriates. The definition of the term “resident” for income tax purposes has been amended to allow for a period that a person is physically present in South Africa before s/he becomes a “resident” to be extended from three to five years. These changes are in line with the tax treatment of expatriates in other jurisdictions.

Offshore banking centres

Exemption criteria for South African foreign subsidiary banking operations relaxed

The objective of Controlled Foreign Company rules is to strike a balance between the prevention of artificial outflows and maintaining international competitiveness. Foreign-controlled subsidiary banking operations require a particular balancing process. Genuine active income of South African foreign subsidiary banking operations is exempt from income tax, subject to certain requirements. The criteria to qualify for this exemption have been relaxed. The exemption is to be extended to situations where legitimate financing and banking operations are conducted abroad without the need to register or obtain a licence. At the same time, measures will be introduced to guard against harmful tax practices by certain countries.

Company restructuring and company formations

Provisions relating to the restructuring of companies are relaxed

The threshold to qualify for intragroup tax-free transfers is reduced from 75 per cent to 70 per cent. This will ease the tax burden associated with company restructuring and the tax consequences of certain Black Economic Empowerment transactions. In addition, the more than 25 per cent threshold for tax-free company formations is reduced to 20 per cent. The more than 25 per cent participation exemption threshold for foreign dividends and foreign share gains is reduced to at least 20 per cent. However, in the case of the latter, the equity requirement of at least 20 per cent is supplemented with a requirement of voting rights of at least 20 per cent.

Anti-avoidance rules

Discussion paper on anti-avoidance rules to be released for comment

Reforms to the General Anti-Avoidance Rules are required to counteract aggressive tax avoidance that could undermine the tax system. SARS will release a discussion paper on revised anti-avoidance rules for public comment.

Film incentive schemes

Refinements aim to prevent abuse of tax incentives for film industry

Internationally, special allowances and other tax incentives targeting the film industry have been subject to abuse. The 2005 Budget highlighted the need for such incentives to be refined. Proposed changes will include:

- Limiting the allowance to production and post-production expenditure incurred – and paid or payable – in South Africa
- Addressing the artificial increase in the cost of films for allowance purposes through transactions between connected persons.

Further amendments to film industry incentives may follow after consultation with relevant stakeholders.

Tax depreciation for urban development zones

Incentive aims to support inner city development projects

In the 2003 Budget, the Minister of Finance announced a tax incentive in support of inner city development projects. This incentive allows taxpayers to receive accelerated depreciated allowances for investment in new and refurbished buildings in urban development zones (UDZ).

The UDZ legislation will be amended by extending the tax incentive to first purchasers who buy from bona fide developers, and by allowing subdivision of buildings. This allows first purchasers to qualify for the tax incentive as long as the purchaser owns the building (or a part of it) and uses it solely for trade.

Permitting first purchasers to qualify for the incentive will enable developers to attract new clients, contributing to the development of the target area. In addition, subdivision of buildings will allow taxpayers to purchase units within a building and still qualify for this incentive, as opposed to purchasing the whole building.

Bribes, penalties and fines

Bribes explicitly denied as tax-deductible expenses

As announced in the 2005 Budget, bribes, penalties and fines will be explicitly denied as deductible expenses for income tax purposes. This is part of Government's efforts to combat corruption and promote good governance.

VAT treatment of international services

Government addresses VAT on international trade in services

The VAT treatment of international trade in services poses challenges worldwide. Some countries have introduced "place of supply" rules to deal with these challenges. Amendments to the VAT legislation before Parliament aim to deal with problems encountered with warranties issued by overseas manufactures. Consultation is underway to address difficulties in telecommunications, especially international roaming. South Africa is also monitoring the deliberations of the Organisation for Economic Cooperation and Development on this subject.

Biofuels

Revised fuel tax regime for biodiesel to be ready by end of the year

The 2002 Budget proposed a rebate of 30 per cent of the general fuel levy on mineral diesel fuel in respect of biodiesel. The implementation of this fuel tax concession was delayed to allow the South African Bureau of Standards to develop local biodiesel standards and specifications and to obtain the endorsement thereof by the National Association of Automobile Manufacturers of South Africa. The necessary customs and excise rules to give effect to the concession are being drafted by SARS and the revised fuel tax regime for biodiesel should be ready for implementation by the end of the year.

Tonnage tax

Tonnage tax legislation to be tabled in 2006

The 2005 Budget proposed the introduction of a tonnage tax regime for the shipping industry. The National Treasury is compiling a South African Tonnage Tax Framework policy document. The document will specify criteria for qualifying companies, ring-fencing of relevant shipping profits, treatment of capital gains/losses upon entry and exit from the regime, rules for election into the regime, the lock-in period, tax avoidance measures and so on.

Treasury is working closely with the Department of Transport to resolve related matters, such as amendments to ship registration and ownership, and amendment of basic conditions of employment for seafarers. These matters, which have an effect on the competitiveness of the maritime industry, need to be addressed in time for the implementation of the tax. It is expected that the tonnage tax legislation will be tabled in 2006 and will be incorporated as a separate schedule to the Income Tax Act.

Mineral and Petroleum Royalty Bill

Revised draft Bill to be released for comment in 2006

Government is keenly aware that the release of the revised Mineral and Petroleum Royalty Bill is important for purposes of investor certainty. However, some complex issues with regard to existing mineral rights holders and a possible review of certain income tax issues related to the mining sector require attention. It is envisaged that this revised draft Bill will be released for comment during 2006.

Enabling small business

Administrative measures in support of small businesses underway

Several of the administrative initiatives to assist small businesses announced in the 2005 Budget have already been put in place, and the remainder are on track for implementation by the end of the fiscal year. The small retailer VAT package was implemented in April, while the option of filing VAT returns every four months for vendors with a turnover of up to R1 million was implemented by SARS in August.

Online applications for tax clearance certificates through the SARS e-filing service were implemented in September and additional work on improving the speed of the approval process is in progress. SARS branch offices around the country have deployed staff into the field to assist small businesses.

Tax policy considerations for the 2006 Budget

The 2006 tax policy proposals include inflation adjustments to monetary thresholds, including the brackets for the income tax system, transfer duties and the graduated rate structure of small companies.

Reforms related to retirement funds will be considered

Tax reforms addressing retirement funds will also be considered. The Retirement Fund Reform discussion paper released in 2004 has been updated based on input from a wide range of stakeholders and will be released, together with the Tax Reform on Retirement Savings discussion paper, later this year.

Public benefit activities

Contributions to conservation and the environment may become tax-deductible

Consideration is being given to extend provisions of section 18A of the Income Tax Act to all activities listed under the heading: "Conservation, Environment and Animal Welfare," in Part II of the ninth schedule of the Act. This would effectively make such contributions tax-deductible. In addition, the date of the current 18A provisions in relation to establishing and managing transfrontier conservation areas will be extended to 31 March 2010.

Replacement of RSC levies

Treasury is exploring alternative instruments to replace RSC levies

The RSC and JSB levies will be abolished on 30 June 2006. The National Treasury is consulting with the Department of Provincial and Local Government, the South African Local Government Association, the Financial and Fiscal Commission (FFC), SARS and others on the need for an appropriate alternative tax instrument, combination of instruments, and/or funding arrangements.

The following have emerged as possible alternatives:

- Zero-rating of property rates, thereby allowing municipalities to claim input VAT credits, which would yield about R1 billion of revenue for Category A and B municipalities, and simplify the administration of VAT
- Allocation of a share of the general fuel levy to municipalities, distributed on the basis of the total fuel sales within each municipality
- A municipal electricity levy

- Distribution of transfer duties to municipalities, based on the revenue generated per municipality
- Introduction of a local business tax.

All these options will result in a degree of revenue loss for the national fiscus.

Of the various alternatives considered the preferred options are the zero-rating of property rates and allocating municipalities a share of the general fuel levy. The latter option would take the form of a revenue-sharing arrangement in 2006/07, converted into a tax-sharing arrangement in 2007/08. The necessary legislative amendments would be enacted to specify that a municipality would get a certain number of cents per litre of fuel sold within its jurisdiction.

Western Cape provincial fuel levy proposal

Government is evaluating the Western Cape fuel levy proposal

The Constitution allows provinces to impose taxes and/or surcharges on certain national tax instruments, provided this does not prejudice national economic policies, economic activities across provincial boundaries, or the national mobility of goods, services, capital or labour. The Western Cape Province is contemplating the introduction of a provincial fuel levy. The Minister of Finance, the Budget Council and the FFC are evaluating this proposal in terms of the Provincial Tax Regulation Process Act and the relevant constitutional provisions.