4

Tax policy

While tax revenue collection remains robust, the short-term impact of slower economic activity will reduce the pace of revenue growth. It is estimated that main budget revenue collection during 2008/09 will be R1.2 billion higher than the budgeted amount.

Over the medium term government will continue to promote a progressive, efficient and equitable tax system that broadens the tax base and supports accelerated economic activity. The tax proposals put forward in the 2008 Budget included a reduction in the headline corporate income tax rate to 28 per cent, initial steps to replace the secondary tax on companies with a dividend tax at shareholder level, measures to reduce the compliance costs for micro businesses, improving access to equity finance by small businesses, and incentives to support the industrial policy action plan and low-cost housing. These and other amendments to the revenue laws are currently before Parliament.

Introduction

For several years, revenue growth has exceeded economic growth, with the tax-to-GDP ratio rising by more than three percentage points in five years. The factors behind this strong revenue performance included legislative changes to broaden the tax base and reduce loopholes, and a more efficient revenue service. Through both policy reforms and improved administration, government has increased the efficiency, fairness and progressiveness of the tax system, while reducing the distorting impact of high marginal tax rates.

Government has been able to reinforce the progressive character of the tax system

Over the medium term, as economic growth slows in response to global and domestic factors, tax revenue is expected to moderate to an average of 26.3 per cent of GDP, compared with 27.1 per cent in 2007/08. Slower growth will impact particularly on tax revenues from companies, value-added tax (VAT) and customs duties.

National budget revenue, 2007/08

Audited main budget revenue for 2007/08 was R15.2 billion higher than the budget estimate

The audited main budget revenue outcome of R559.8 billion for 2007/08 was R15.2 billion higher than the original budget estimate in February 2007 and R1.8 billion higher than the revised 2008 *Budget Review* estimate. The main variances from the 2007 estimate were:

- Personal income tax collections R13.4 billion above the estimate
- Secondary tax on companies (STC) collections R4.6 billion above the estimate
- VAT collections R4.6 billion below the estimate.

Table 4.1 National budget revenue, 2007/08 estimates and audited outcome

R billion	Budget estimate	Revised estimate	Audited outcome	Deviation from Budget estimate	Deviation from Revised estimate
Taxes on income and profits	**312.2**	**332.3**	**332.1**	**19.9**	**-0.2**
Persons and individuals	155.3	168.5	168.8	13.4	0.3
Companies	138.5	141.4	140.1	1.6	-1.3
Secondary tax on companies	16.0	20.2	20.6	4.6	0.4
Interest on overdue income tax	2.3	2.0	2.3	-0.0	0.3
Other taxes on income and profits[1]	–	0.2	0.3	0.3	0.1
Taxes on payroll and workforce	**6.5**	**6.8**	**6.3**	**-0.2**	**-0.5**
Skills development levy	6.5	6.8	6.3	-0.2	-0.5
Taxes on property	**11.0**	**12.7**	**11.9**	**0.9**	**-0.8**
Securities transfer tax	3.5	4.2	3.8	0.3	-0.4
Transfer duties	7.1	7.8	7.4	0.4	-0.3
Other taxes on property[2]	0.5	0.8	0.7	0.2	-0.1
Domestic taxes on goods and services	**199.2**	**191.6**	**194.7**	**-4.5**	**3.1**
Value-added tax	155.1	147.0	150.4	-4.6	3.4
Specific excise duties	17.8	18.0	18.2	0.4	0.2
Ad valorem excise duties	1.4	1.6	1.5	0.1	-0.1
Levies on fuel	23.9	24.0	23.7	-0.2	-0.3
Other domestic taxes on goods and services[3]	1.0	1.0	0.9	-0.1	-0.1
Taxes on international trade and transactions	**27.5**	**27.0**	**27.1**	**-0.4**	**0.1**
Customs duties	27.1	26.6	26.5	-0.6	-0.1
Other taxes on international trade and transactions	0.4	0.4	0.6	0.2	0.2
Stamp duties and fees	**0.2**	**0.7**	**0.6**	**0.3**	**-0.1**
State miscellaneous revenue[4]	**–**	**–**	**0.2**	**0.2**	**0.2**
Total tax revenue	**556.6**	**571.1**	**572.9**	**16.3**	**1.8**
Non-tax (departmental) revenue[5]	11.1	11.6	11.6	0.5	0.0
Less: SACU payments	-23.1	-24.7	-24.7	-1.7	–
Main budget revenue	**544.6**	**558.0**	**559.8**	**15.2**	**1.8**

1. Includes tax on retirement funds and small business tax amnesty.

2. Includes estate duty and donations tax.

3. Includes air departure tax, plastic bags levy, mining leases and ownership and the Universal Service Fund.

4. Tax revenue received by SARS that could not be allocated to a specific tax instrument.

5. Preliminary outcome.

National budget revenue estimates, 2008/09

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 2008/09 is expected to amount to R626.5 billion, or R1.2 billion higher than the February estimate. The gross tax revenue estimate remains unchanged.

Main budget revenue is expected to be R1.2 billion above budget

Table 4.2 National budget revenue, 2008/09 – 2011/12

	2008/09				2009/10	2010/11	2011/12
R billion	Budget estimate	Revised estimate	Deviation	Actual Apr to Sep	Medium-term estimates		
Taxes on income and profits	**369.8**	**380.6**	**10.9**	**178.6**	**416.3**	**457.1**	**511.1**
Persons and individuals	191.0	201.0	10.0	93.6	226.0	252.2	282.2
Companies	156.5	158.9	2.5	75.3	168.7	190.4	212.8
Secondary tax on companies	20.0	18.2	-1.8	8.3	19.0	11.8	13.2
Interest on overdue income tax	2.2	2.3	0.0	1.2	2.5	2.7	3.0
Other taxes on income and profits	–	0.3	0.3	0.2	–	–	–
Taxes on payroll and workforce	**7.5**	**7.9**	**0.4**	**3.5**	**8.4**	**9.3**	**10.3**
Skills development levy	7.5	7.9	0.4	3.5	8.4	9.3	10.3
Taxes on property	**14.2**	**10.3**	**-3.9**	**5.0**	**11.2**	**12.4**	**13.6**
Securities transfer tax	4.7	3.5	-1.2	1.8	3.9	4.3	4.8
Transfer duties	8.6	6.0	-2.6	2.8	6.5	7.1	7.8
Other taxes on property	0.9	0.8	-0.1	0.4	0.9	1.0	1.1
Domestic taxes on goods and services	**218.6**	**215.9**	**-2.7**	**94.3**	**233.5**	**256.5**	**278.7**
Value-added tax	167.0	167.0	-0.0	71.7	180.3	199.8	219.6
Specific excise duties	20.4	20.5	0.1	8.9	21.1	22.1	23.0
Ad valorem excise duties	1.7	1.7	0.0	0.6	1.8	1.8	1.9
Levies on fuel	26.4	25.5	-0.9	12.1	26.3	27.5	28.6
Electricity levy	2.0	–	-2.0	–	2.8	4.0	4.2
Other domestic taxes on goods and services	1.1	1.2	0.2	1.0	1.3	1.4	1.4
Taxes on international trade and transactions	**31.5**	**26.9**	**-4.6**	**11.9**	**29.6**	**33.9**	**39.0**
Customs duties	31.1	26.5	-4.6	11.2	29.2	33.4	38.5
Other taxes on international trade and transactions	0.4	0.4	–	0.7	0.4	0.5	0.6
Stamp duties and fees	**0.7**	**0.6**	**-0.1**	**0.3**	**–**	**–**	**–**
State miscellaneous revenue	**–**	**–**	**–**	**0.6**	**–**	**–**	**–**
Total tax revenue	**642.3**	**642.3**	**0.0**	**294.3**	**699.0**	**769.2**	**852.8**
Non-tax (departmental) revenue[1]	12.0	11.3	-0.7	5.6	11.1	10.6	11.0
Less: Estimate of SACU payments[2]	-28.9	-27.1	1.8	-14.5	-27.3	-28.7	-30.4
Main budget revenue	**625.4**	**626.5**	**1.2**	**285.4**	**682.9**	**751.1**	**833.4**
Percentage of GDP	*27.3%*	*26.5%*			*26.3%*	*26.2%*	*26.3%*
GDP	*2 286.9*	*2 366.7*			*2 598.6*	*2 870.2*	*3 170.3*
Tax/GDP multiplier	*1.11*	*0.82*			*0.90*	*0.96*	*1.04*

1. Preliminary outcome for 2008/09.

2. The revised estimate for 2008/09 includes adjustment payments to Southern African Customs Union member countries.

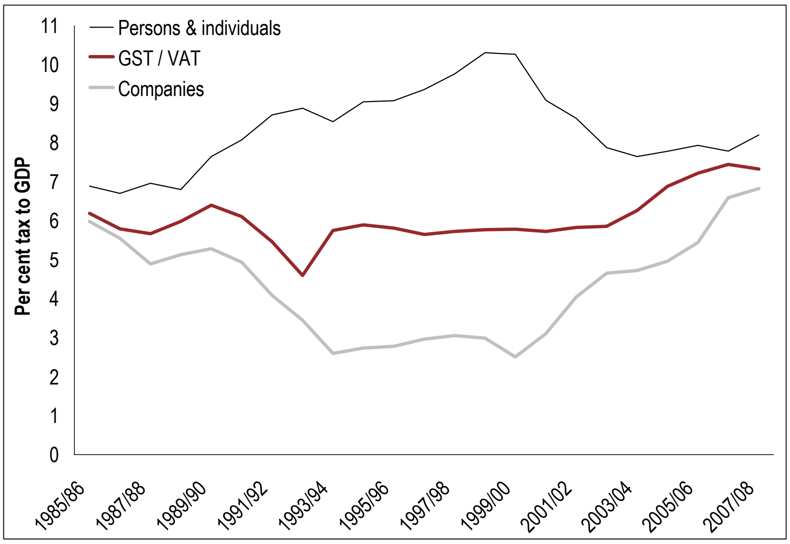
However, the composition of projected revenue has been revised. Taking into account their buoyancy in the first six months of the year, personal income tax and company tax receipts are expected to be R10 billion and R2.5 billion higher for the full year. Revenues from customs duties, transfer duties and STC are expected to be below budget. The estimated R2 billion from the proposed electricity tax will not be collected this year.

Revenue trends and tax reforms

Three taxes account for most government revenue

South Africa's main sources of tax revenue are personal income tax, VAT and corporate income tax. Figure 4.1 illustrates historical revenues from these instruments expressed as a percentage of GDP.

Figure 4.1 Tax-to-GDP ratio, 1985/86 – 2007/08



A decade of significant tax reforms for individuals and businesses

Improved revenue administration and a growing economy have enabled government to make significant tax reforms over the past decade. These included the introduction of capital gains tax, the shift to a residence-based income tax system, the elimination of the regional services council levies and the retirement fund tax, personal income tax relief and reduced transfer duties. Tax reforms currently under way include replacement of STC with a dividend tax. It is proposed that the general fuel levy should be shared with metropolitan municipalities, and further tax instruments to fund local governments are being investigated.

Personal income tax

Tax relief has included full compensation for effects of inflation

Government has granted significant personal income tax relief since 2000/01. Over this period, the income tax brackets and the primary and secondary personal income tax rebates were increased to fully compensate for the effects of inflation, and in a number of years provided relief beyond inflation. In addition, the top marginal personal income tax rate was reduced from 45 to 40 per cent. These reforms have brought relief for individuals across the board, with a bias towards low- and middle-income earners. The taxable income threshold of the bottom personal income tax bracket (at 18 per cent) increased from R40 000 in 2002/03 to R122 000 in 2008/09, and that of the top personal income tax bracket (at 40 per cent) from R240 000 to R490 000 during the same period.

Individuals younger than 65 years with an annual taxable income below R46 000 and those 65 years and older with an annual taxable income below R74 000 during 2008/09 do not pay any income tax.

Reforms have made personal income tax more efficient and more equitable

The net result of the personal income tax reforms – rate reductions, adjustments to brackets, base broadening in the form of capital gains tax, closing of various loopholes and improved enforcements – is a personal income tax regime that is more efficient and more equitable.

The number of people registered for income tax has grown from 3.6 million in 2002/03 to 5.2 million in 2007/08. Four million individuals with annual taxable income below R60 000 per year, who are liable for standard income tax on employees, are not required to register for income tax or to file annual returns.

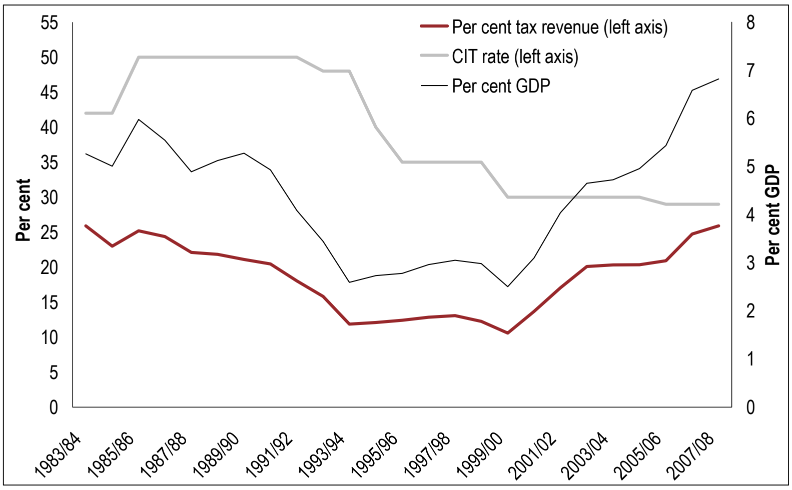
The 2009 Budget will again provide relief for individuals to compensate for the effects of inflation.

Corporate income tax

Corporate income tax rate was reduced but revenues have increased

Figure 4.2 illustrates that although the headline corporate income tax rate has been reduced from 50 per cent in the early 1990s to 28 per cent in 2008/09, corporate tax revenue has increased as a percentage of GDP.

Figure 4.2 Corporate income tax and GDP, 1983/84 – 2007/08



It is apparent that a considerable erosion of the company tax base occurred when the rate was above 40 per cent, while a broadening of the tax base, higher growth and improved compliance efforts have resulted in significant increases in this revenue category since 2000/01. By removing various loopholes and by introducing capital gains tax, the revenue system has become more efficient, increasing the effective tax rate on companies.

Commodity and exchange rate fluctuations make fiscus more vulnerable to revenue shifts

Given the weight of the resources sector in the South African economy, commodity price and exchange rate fluctuations can have a significant impact on corporate profits, making corporate income tax revenue less predictable than personal income tax and VAT revenues.

One consequence of the greater reliance on corporate tax in recent years is that the fiscus is more vulnerable to sudden shifts in revenue. Recognition of this factor contributed to the decision to adopt a cyclically adjusted budget balance, which ensures that revenues that are likely to be of a cyclical nature are not permanently built into the expenditure base or given away in tax relief.

The relative contributions to corporate tax of the main economic sectors and subsectors are indicated in Table 4.3.

Table 4.3 Corporate income tax revenue by sector, 2000/01 – 2007/08

Sector	2000/01	2002/03	2005/06	2007/08
Agencies and other services	2.7%	2.2%	2.7%	2.9%
Coal and petroleum products	9.2%	8.4%	5.5%	5.2%
Construction	0.9%	0.9%	1.6%	2.1%
Financing, insurance, real estate and business services	27.0%	24.8%	26.8%	29.9%
Food, drink and tobacco	5.0%	4.2%	4.8%	3.9%
Long-term insurers	9.2%	6.2%	4.7%	6.3%
Metal	2.3%	3.1%	3.8%	3.3%
Mining and quarrying	14.5%	18.5%	6.2%	10.5%
Retail trade (including mail order)	3.5%	3.4%	6.3%	5.4%
Transport, storage and communication	4.6%	5.3%	11.6%	8.1%
Vehicles, parts and accessories	1.1%	2.6%	4.4%	3.1%
Wholesale trade	3.1%	2.8%	3.3%	2.9%
Other[1]	16.9%	17.6%	18.5%	16.4%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**

1. Includes other sectors.

Value-added tax

Evidence suggests that higher-income groups benefit more than the poor from VAT zero-rating

While the VAT zero-rating of basic foodstuffs and paraffin is intended to assist the poor, higher-income households also benefit from these concessions. Evidence suggests that existing VAT zero-ratings and exemptions, in almost all cases, confer substantially more benefits on middle- and higher-income groups than on lower-income groups. In addition, depending on market structure, producers and suppliers may capture a large percentage of the benefit of VAT zero-rating.

These facts reinforce the case against further VAT zero-rating of goods in a context where public expenditure can provide more effective and targeted relief. Furthermore, revenue lost through the VAT zero-rating of goods and services would have to be made up elsewhere.

Implementation of the 2008 tax proposals

2008 tax proposals aimed to promote economic growth, investment and job creation

The 2008/09 tax proposals supported government's broad macroeconomic policy objectives by promoting economic growth, real fixed investment and job creation. An update is provided below.

Taxation of pre-retirement withdrawals from savings

In 2007, a simplified tax treatment of lump sum payments on retirement was introduced. Forthcoming legislation will extend this reform to include taxation of pre-retirement withdrawals on a cumulative basis. The proposed schedule, to take effect from 1 March 2009, is shown in Table 4.4. Accumulated pre-retirement withdrawals will be taken into account in determining the tax liability on a lump sum at retirement.

Forthcoming legislation to extend reforms

Table 4.4 Proposed rate structure of pre-retirement withdrawals from retirement savings[1]

Lump sum	Tax liability
R 0 – R 22 500	0%
R 22 501 – R 600 000	18% of the amount above R 22 500
R 600 001 – R 900 000	R 103 950 + 27% of the amount above R 600 000
R 900 001 and above	R 184 950 + 36% of the amount above R 900 000

1. Effective from 1 March 2009.

Presumptive turnover tax for micro businesses

A new turnover tax regime for micro businesses with an annual turnover of up to R1 million, effective 1 March 2009, will reduce the compliance burden. Qualifying firms will be allowed to opt out of the income tax and VAT systems. This is complemented by an increase in the compulsory VAT registration threshold to R1 million per year.

New turnover tax regime reduces compliance burden for very small businesses

Table 4.5 Proposed turnover tax for micro businesses[1]

Annual turnover	Tax liability
R 0 – R 100 000	0%
R 100 001 – R 300 000	1% of the amount above R 100 000
R 300 001 – R 500 000	R 2 000 + 3% of the amount above R 300 000
R 500 001 – R 750 000	R 8 000 + 5% of the amount above R 500 000
R 750 001 – R 1 000 000	R 20 500 + 7% of the amount above R 750 000

1. Effective from 1 March 2009.

Venture capital companies

To assist small and medium-sized companies and junior mining exploration firms to overcome the difficulty of accessing equity finance and to encourage entrepreneurship, an incentive to invest in such firms through venture capital companies will be introduced. Investment in a venture capital firm will qualify for a 100 per cent deduction for the initial investment, subject to an annual limit of R750 000 for individuals, with a lifetime limit of R2.25 million.

Incentives support venture capital for small and medium-sized companies

Reform of the secondary tax on companies

The second phase of STC reform is scheduled for late 2009 or early 2010 and entails converting the STC into a dividend tax at shareholder level. Individual and non-resident shareholders will be liable for the dividend tax, while resident corporate shareholders will be exempt, as will institutions such as pension funds and public benefit organisations that are exempt from income tax.

Industrial policy incentives

Incentives support government's industrial policy action plan

An amount of R5.6 billion over five years has been budgeted for tax incentives to support government's industrial policy projects. The tax incentive consists of two elements: an additional deduction for real fixed investment and one for training. The maximum additional deduction for real fixed investment will be R900 million per project and R30 million per project for training.

Low-cost housing

Employers and landlords are encouraged, by way of incentives in the form of accelerated depreciation, to increase the stock of housing units valued at less than R200 000 (excluding land) and apartments valued at R250 000 or less. The purpose of this incentive is to increase access to housing for low- and middle-income families.

Urban development zones

Five-year extension of urban development zone tax incentives

Urban development zones provide accelerated depreciation for new and refurbished buildings. The incentive, which was due to expire in March 2009, will be extended for five years. Depreciation allowances for new buildings in these zones will be enhanced.

Learnership and apprenticeship and artisan training

Amendments to the Income Tax Act (1962) are proposed to make allowances for short-term learnerships and longer-term apprenticeships more equitable, enabling employers to get the full allowance for time-based and competency-based modular-training programmes.

Environmental fiscal reform (an electricity levy)

A step towards a comprehensive carbon emissions tax

To begin addressing the challenges of climate change and to increase energy efficiency given South Africa's electricity supply shortage, a 2c/kWh environmental levy on electricity generated from non-renewable resources, to be collected at source by the generators of electricity, was announced during the 2008 Budget. Electricity produced from renewable sources (e.g. wind, water and solar) will be exempt from the levy, as will power produced through co-generation.

The electricity levy should be seen as the first step towards the introduction of a more comprehensive emissions-based carbon tax. Implementation of the levy has been postponed to 1 July 2009 to coincide with the commencement of the next municipal financial year.

Conclusion

In the context of a global economic slowdown and lower corporate profits, moderate revenue growth is expected over the period ahead. South Africa's sound tax structure and healthy revenue administration enhance government's ability to manage the fiscal challenges ahead and maintain an environment conducive to investment and growth.