4

Taxation

Within Government's overall fiscal framework, and in the context of rapid globalisation, Government's tax reform efforts since 1994 have sought to improve the efficiency, equity and international competitiveness of the South African tax system. Over the next three years:

- *Economic recovery and continued revenue buoyancy provide scope for further income tax reductions*
- *Tax reform will continue to be aimed at broadening the tax base while promoting the competitiveness of the economy*
- *A programme of regional tax co-operation will be advanced, enhancing regional economic development.*

Introduction

Far-reaching tax reform in 2000

The far-reaching changes that have been implemented in the tax system since 1994 are informed both by domestic fiscal policy priorities and the imperatives of globalisation.

Domestic priorities

National tax reforms are an integral part of a broader reform programme, which includes social security financing and revenue policy across the three spheres of government.

Broadening tax bases and reducing statutory tax rates are central pillars of Government's tax reform agenda, improving the efficiency and equity of the overall tax system. As outlined in Chapter 3, reducing the overall tax burden plays an important role in providing impetus to investment and economic growth.

Tax amendment proposals have been guided by the central tenets of good tax design and fundamentally sound tax principles. These are:

- Equity and fairness

- Efficiency
- Inter-sectoral neutrality
- Certainty and consistency
- Simplicity in administration
- A lighter compliance burden for taxpayers.

Challenges of globalisation

The opening up of international trade and finance has exerted a profound influence on the nature and role of fiscal policies in general and tax design in particular. Government policy responses address a number of key issues:

- The need to protect the income tax base against continued erosion by the avoidance opportunities that accompany capital mobility and advances in e-commerce
- The influence of taxation on the location of direct investment and the consequent need to move to a residence-minus income tax system
- The imperatives of Southern African economic integration and the need for tax co-ordination across the region.

National budget revenue

Preliminary outcome, 1999/00

Revenue collection exceeds budget forecasts

Preliminary indications show that national budget revenue for 1999/00 exceeded the February revised estimate by R1,9 billion.

Details are set out in table 4.1, which compares the estimates of revenue for the major categories of tax revenue set out in the 1999 Budget with the preliminary outcome for the year.

R7,2 billion more tax revenue in 1999/00

The 1999 Budget estimated that Government would raise R193,9 billion in tax revenue in 1999/00. This was subsequently revised upward to R199,6 billion in the 2000 Budget. Preliminary analysis indicates that total tax revenue collected was R201,1 billion, or 3,7 per cent more than the initial budget estimate.

In addition to enhanced collection efficiency by the South African Revenue Service (SARS), this increase in revenue can be attributed to higher nominal growth in the economy. The main increases were:

- Direct taxes on persons and individuals – personal income tax raised R86,0 billion, which is approximately 4 per cent higher than the original budget estimate and 10,1 per cent more than 1998/99 receipts

Table 4.1: National budget revenue, 1999/00 estimates and outcome

R million	Budget Estimate	Revised Estimate	Preliminary outcome
Taxes on income and profits	**111 680**	**117 178**	**116 696**
Persons and individuals	82 650	86 200	85 954
Companies	21 576	21 678	21 488
Secondary tax on companies	1 700	2 700	2 639
Other	5 754	6 600	6 615
Taxes on property	**2 885**	**3 573**	**3 812**
Domestic taxes on goods and services	**71 075**	**70 980**	**72 220**
Value-added tax	47 200	46 540	48 330
Specific excise duties	8 790	8 535	8 859
Levies on fuel	14 444	15 162	14 290
Other	641	743	741
Taxes on international trade and transactions	**6 625**	**6 272**	**6 777**
Stamp duties and fees	**1 621**	**1 590**	**1 619**
Total tax revenue	**193 886**	**199 593**	**201 122**
Non-tax revenue and repayments	4 211	3 906	4 250
Less: SACU payments	-7 197	-7 197	-7 197
Main budget revenue	**190 900**	**196 302**	**198 175**

- Secondary tax on companies (STC) – mainly due to a receipt arising from the realisation of reserves associated with the conversion of SASRIA into a state-owned company
- Tax on retirement funds – an increase of R734 million over the 1999 Budget estimate of R5,1 billion
- Taxes on property – revenue of R3,8 billion was almost R1 billion more than the original budget estimate
- Value-added tax – about R1,1 billion more than the 1999 Budget estimate was raised through robust VAT collections.

Revised estimates, 2000

The revenue estimates presented in the 2000 Budget have been updated to reflect actual revenue collections during 1999/00, revenue trends during this year and the revised macroeconomic forecasts set out in Chapter 2. Table 4.2 sets out the revised revenue projections alongside those of the 2000 Budget.

Total tax revenue up by R2 billion

The revised estimate of main budget revenue in 2000/01 is R212,2 billion, or R1,8 billion more than the original budget estimate. Anticipated total tax revenue is R2 billion higher than the Budget estimate. This is largely attributable to:

- A R1,3 billion increase in the estimate of revenue from taxes on income and profits

- A R1,7 billion increase in the estimate of revenue from taxes on international trade and transactions
- A reduction in the estimates of domestic taxes on goods and services of R1,4 billion.

Table 4.2: National budget revenue – medium term estimates

R billion	1999/00 Outcome	2000/01 Budget	2000/01 Revised Estimate	2001/02	2002/03	2003/04
				Medium term estimates		
Taxes on income and profits	**116,7**	**121,3**	**122,6**	**134,1**	**145,6**	**157,9**
Persons and individuals	86,0	87,8	87,8	95,5	103,3	111,6
Companies	21,5	24,6	24,4	27,2	29,9	32,8
Secondary tax on companies	2,6	2,1	3,0	3,3	3,6	3,9
Other	6,6	6,8	7,4	8,2	8,8	9,6
Taxes on payroll and workforce	**0,0**	**1,4**	**1,4**	**3,0**	**3,2**	**3,5**
Taxes on property	**3,8**	**3,3**	**3,8**	**3,9**	**4,3**	**4,6**
Domestic taxes on goods and services	**72,2**	**79,4**	**78,0**	**85,7**	**93,0**	**100,2**
Value-added tax	48,3	52,9	53,0	58,8	63,9	68,6
Specific excise duties	8,9	9,6	9,1	9,9	10,7	11,6
Levies on fuel	14,3	16,0	15,0	16,0	17,3	18,8
Other	0,7	1,1	1,0	1,0	1,1	1,2
Taxes on international trade and transactions	**6,8**	**6,5**	**8,2**	**7,5**	**7,4**	**8,4**
Stamp duties and fees	**1,6**	**1,7**	**1,7**	**1,9**	**2,0**	**2,2**
Total tax revenue	**201,1**	**213,7**	**215,7**	**236,2**	**255,5**	**276,8**
Non-tax revenue and repayments	4,2	4,2	4,9	5,0	5,1	5,4
Less: SACU payments	-7,2	-8,4	-8,4	-9,0	-9,1	-11,2
Main budget revenue	**198,2**	**210,4**	**212,2**	**232,2**	**251,5**	**271,0**
Per cent of GDP	24,3	23,8	23,8	23,8	23,7	23,6
Changes from 2000 Budget						
Total tax revenue			**2,0**	**5,3**	**8,2**	
Main Budget revenue			**1,8**	**4,8**	**7,9**	

2000 Budget tax proposals

A number of tax policy related changes were announced in the 2000 Budget. These include:

- R9,9 billion of personal income tax relief, through the restructuring of the personal income tax schedules
- An increase in the interest income exemption to R3 000 for taxpayers under the age of 65 and to R4 000 for those over 65
- A 0,5 per cent of payroll Skills Development Levy, which is to increase to 1 per cent on 1 April 2001

- Extension of tax-exempt status to a broader range of non-profit organisations, and widened deductibility of donations to certain non-profit organisations
- An air passenger tax on international air travel
- A lower tax rate of 15 per cent for qualifying small and medium enterprises
- Increases in the excise duties on tobacco and alcohol and further reductions in the specific duty on soft drinks
- A diesel rebate for the fishing and coastal shipping industries.

In addition, it was announced that from 1 January 2001, the source-based income tax system would be replaced by a residence-based system. A phased approach to this was adopted, with foreign dividends becoming taxable from 23 February 2000.

Government also plans the phased introduction of a capital gains tax.

The residence-based income tax

Since 1994, South Africa has rapidly integrated into the global economy. The residence-based income tax system addresses the fact that South African residents are able to invest and work outside the country.

Under the proposed residence-based income tax, South African residents are subject to taxation on their income in South Africa, regardless of where in the world that income arises, with appropriate relief to prevent double taxation of this income.

Benefits of a residence-based tax

The advantages to South Africa from this reform include the following:

- The tax base is broadened
- The income tax system is aligned with those of South Africa's major trading partners
- Residents make an appropriate contribution to meeting the cost of providing government services, thereby enhancing the fairness of the tax system
- The integrity of the income tax base is protected.

This reform is also necessitated by the expansion of e-commerce and the international mobility of capital and skilled labour.

Neutral impact on foreign direct investment

The principle of taxing foreign direct investment into South Africa only on the South African source income is retained. In other words, the transition from a source-plus to a residence-minus system is neutral with respect to foreign direct investment into South Africa.

Capital gains tax

Government will introduce a capital gains tax with effect from April 2000. This will strengthen the foundations of the corporate and individual income tax system. Government's proposals are currently being refined by SARS on the basis of the large number of representations made on this matter.

Taxation of public-benefit organisations

Tax-exempt status of public benefit organisations

New measures will regulate the granting of tax-exempt status to public benefit organisations in a more consistent and systematic manner and extend the range of organisations that can qualify for tax-exempt status. The Minister of Finance will publish a range of "public benefit activities" in which an organisation must engage in order to qualify for exempt status. Activities that qualify for inclusion on this list will be of a philanthropic and benevolent nature, having regard to the needs, interests and well-being of the general public.

Deductibility of donations

Tax-deductible contributions will include those made to:

- Pre-primary schools that offer an approved educare programme
- Primary schools
- Organisations involved in preventing HIV infection or providing care to those impoverished by Aids
- Children's homes providing care to abandoned, abused or orphaned children
- Organisations involved in caring for destitute aged persons.

In addition, the limit applicable to tax-deductible donations made by individuals has been increased to the greater of 5 per cent of taxable income or R1 000.

Tax exempt status of Eskom

Following Government's decision that Eskom should become a taxable entity, it was proposed in the Budget that its tax-exempt status would be withdrawn from 1 January 2000. The withdrawal of Eskom's tax-exempt status raised the question of the value of company assets that would qualify for deductions and allowances in terms of the Income Tax Act. After consultation, a coherent tax depreciation regime has been agreed, which takes cognisance of Eskom's investment plans, and any potential impact on the pricing of electricity.

The subsidisation of Government's electrification programme will now be advanced through the budget of the Department of Minerals and Energy.

Departure tax on international air travel

In the 2000 Budget it was announced that a R100 departure tax on international air travel would be introduced from 1 August 2000. Subsequent to the Budget, certain changes have been made to this measure, including the following:

- The implementation date was deferred from 1 August 2000 to 1 November 2000
- Tax will not be levied on tickets sold before the promulgation of the Revenue Laws Amendment Act, which gives effect to the tax
- Recognising the relatively higher effective tax burden on international flights to neighbouring countries, the tax on international air departures to Botswana, Lesotho, Namibia and Swaziland has been reduced from R100 to R50.

Fuel levy

The recent increases in the crude oil price have highlighted the sensitivity of economies around the world to high fuel prices.

In South Africa, as elsewhere, the fuel tax is a specific levy – i.e. a fixed amount per litre of fuel purchased. Thus, as fuel prices increase, the tax element relative to the pump price declines.

International crude oil price changes and SA pump price fluctuations

Petrol price changes in South Africa are affected by fluctuations in the international price of crude oil and by changes in the rand/US dollar exchange rate. Since these are influenced by international market forces, South Africa's petrol price fluctuations are largely beyond Government's control.

Although the price of oil and petroleum products and the exchange rate fluctuate daily, adjusting the petrol price this frequently is impractical. South Africa's petrol price is thus adjusted monthly, taking into account the fluctuations of the preceding month.

International comparison

In table 4.3, South African fuel taxes and prices of petrol (95 octane) are compared with several representative countries from the European Union (as of 3 April 2000) and Africa (as of May 1999). The comparison shows that South Africa's fuel taxes are moderate by European standards, and that several African countries are broadly in line with fuel taxes in South Africa.

In the 2000 Budget, the specific excise on fuel was increased by 5 cents a litre on petrol and by 3cents a litre on diesel fuel. These increases were below the expected inflation rate. A diesel fuel rebate was introduced for the fishing and coastal shipping industries, consistent with international best practice, in order to improve their competitives.

Additional diesel rebates

Until 1998, a similar rebate was granted to the agricultural sector. The Treasury and SARS have been consulting with representatives of the agriculture, mining and forestry industries to explore the possibility of introducing diesel fuel tax relief for off-road fuel consumption. A technical committee is currently investigating cost-effective administrative and compliance mechanisms to ensure that any diesel rebate can be effectively administered. The preconditions for such a rebate include the development of an appropriate administrative regime to minimise the risk of fuel tax fraud, and means of accommodating, and a mechanism to address, the potentially significant revenue losses within the broad fiscal framework.

Table 4.3 International comparison of taxes on 95-Octane petrol

(1) Country	Fuel taxes (as at 3 April 2000)	Other costs (as at 3 April 2000)	Retail price (as at 3 April 2000)	Fuel tax as percentage of retail price
	Euro / Litre	Euro / Litre	Euro / Litre	
Belgium	0,687	0,347	1,034	66,4%
Greece	0,414	0,352	0,766	54,0%
Spain	0,482	0,318	0,800	60,3%
France	0,777	0,321	1,098	70,8%
Ireland	0,523	0,310	0,833	62,8%
Italy	0,696	0,359	1,055	66,0%
Luxembourg	0,460	0,360	0,820	56,1%
Portugal	0,418	0,470	0,888	47,1%
UK	1,013	0,324	1,337	75,8%
	Rand / Litre	Rand / Litre	Rand / Litre	
RSA- coast	1,030	1,810	2,840	36,3%
(2) Country	**Fuel taxes (average for May 1999)**	**Other costs (average for May 1999)**	**Retail price (average for May 1999)**	**Fuel tax as percentage of retail price**
	Rand / Litre	Rand / Litre	Rand / Litre	
Kenya	2,287	1,669	3,956	57,8%
Mozambique	2,039	1,421	3,460	58,9%
Namibia	0,803	1,421	2,224	36,1%
Tanzania	1,669	2,225	3,894	42,9%
Zimbabwe	0,247	1,360	1,607	15,4%
RSA- coast	1,174	1,112	2,286	51,3%

Source:1: International Energy Agency, April 2000.
2. World Bank, May 1999.

Determining the petrol price

The South African petrol price, based on the Gauteng October petrol price of R3,72 per litre for 93 octane can be broken down as follows:

Non-tax components

The non-tax cost components of the petrol price amount to R2,58 per litre, or 69,3 per cent of the retail petrol pump price. These include:

- The basic price – 52,8 per cent. This consists of an average international refinery price, freight, insurance, ocean leakage, evaporation, landing and wharfage charges, Thus is deemed to be the price of petrol as it leaves a South African refinery.
- The wholesale margin – 4,9 per cent. This is aimed at granting wholesale marketers a guaranteed return of 15 per cent on the depreciated book value of assets.
- The retail margin – 7,1 per cent. This is determined on the basis of the costs incurred by the average service station operator in marketing petrol.
- Transport and delivery costs – 4,5 per cent. Transport and delivery costs to the different pricing zones are based on the most economical cost of transporting and delivering petrol from the coast to inland areas.

Tax components

The fuel tax on petrol is R1,14 per litre, or 30,7 per cent of the retail petrol pump price. The revenue obtained from this tax is distributed in the following way:

- The general fuel levy – 25,7 per cent. A general fuel levy of 95,6 cents a litre is used to finance general government expenditure. This raises about R9,4 billion a year to provide essential services to all South Africans. (R610 million of this amount is used for national road maintenance).
- The Road Accident Fund levy – 3,9 per cent. A Road Accident Fund levy of 14,5 cents a litre, which raises about R1,4 billion a year, finances the third party insurance scheme for all motorists.
- The customs and excise levy – 1,1 per cent. A customs and excise levy of 4 cents a litre assists South Africa's Customs Union neighbours (Botswana, Lesotho, Namibia and Swaziland) through the customs pool. The customs and excise levy raises R390 million a year.

Social security funding

South Africa's main social security grants – including the old age grant – are financed out of general government expenditure through the budgets of provincial departments of welfare. Several other social security benefits are financed through earmarked taxes. Social security funds include the Unemployment Insurance Fund, the Compensation Funds and the Road Accident Fund.

UIF reforms strengthen financial position

Reform of the Unemployment Insurance Fund (UIF) will be undertaken, following the recommendations of the Comprehensive Labour Market Commission and a separate UIF review. These changes, which aim to strengthen the administration of the Fund, included extending the coverage of the fund to all private sector employees. Previously only those earning R93 288 or less a year contributed to, and benefited from the Fund.

Social Security Funds

Several social programmes rely on mandatory levies or taxes. These include the social security funds. Such programmes are, by design, self-funding, with both their revenue flows and spending appropriated by separate statute or regulation, and not in the annual budget votes. These financial flows are nonetheless part of the wider public finances and are important instruments of Government's social and income policies.

Last year, Government expanded the scope of budget documentation to include the social security funds. These funds include the Unemployment Insurance Fund, Workmen's Compensation Fund, Road Accident Fund and the Mines and Works Compensation Fund.

As the table below shows, these funds ran a combined surplus of R1,1 billion in 1999/00. The Unemployment Insurance Fund is currently in deficit, while the Road Accident Fund and Compensation Fund run cash surpluses. The consolidated surplus is expected to decline in 2000/01 as the Road Accident Fund addresses its claims backlogs.

Consolidated social security funds : 1996/97 – 1999/00

	1996/97	1997/98	1998/99	1999/00	
R Million				2000 Budget Estimate	Preliminary Outcome
Total revenue	5 586	6 489	7 418	7 914	7 922
Per cent change		*16.2%*	*14.3%*	*6.7%*	*7.7%*
Total expenditure	4 852	5 362	5 996	6 733	6 819
Per cent change		*10.5%*	*11.8%*	*12.3%*	*15.8%*
Deficit (-) / Surplus (+)	734	1 126	1 422	1 180	1 103

Future tax reform initiatives

Future tax reform will advance Government's general fiscal policy. Continued robust revenue collections and the broadening of tax bases provide scope for further income tax relief in the 2001 Budget.

Investment incentives

The Department of Trade and Industry (DTI) has developed a range of incentives to encourage investment in industry, and job creation. The Department has already announced three programmes that will be funded through the Budget:

- An expanded small and medium enterprise development programme
- A skills support programme
- Investment in infrastructure critical to industrial development.

Tax incentives for strategic projects

The National Treasury and DTI have explored the possibility of targeted tax incentives for strategic investment projects. These will be announced in due course.

Regional tax co-operation

Southern African Customs Union

In September 2000, the Southern African Customs Union (SACU) Trade and Finance Ministers agreed on a new formula for the distribution of SACU customs and excise revenues. The revenue share accruing to each member state will be calculated from three basic components:

- A share of the customs pool
- A share of the excise pool
- A share of a development component.

The customs pool distributed according to intra-SACU imports

The first component is distributed according to each country's share of intra-SACU imports. Botswana, Lesotho, Namibia and Swaziland (the BLNS) obtain most of their customs and excise revenue from this component, since they all record significant trade deficits with South Africa. This component therefore entails considerable implicit compensation to the BLNS countries for any cost-raising effect or loss of fiscal discretion resulting from the Customs Union. The extent of this compensation will fall in relative terms as SACU external tariff barriers decline.

80 per cent of excise revenues retained by South Africa

Excise revenue will be distributed according to relative GDP. South Africa will receive most of its revenue allocation from this element, retaining about 80 per cent of total excise revenue.

Development fund by per capita GDP

A development fund will be created from 15 per cent of total excise collections. It will be distributed in relation to the inverse of each country's per capita GDP. This development fund will raise the revenue shares of the poorer SACU member states and help to stabilise future flows to the BLNS countries.

Certainty in revenue flows

In terms of the new formula, South Africa's share of the total revenue pool should rise from below 50 per cent in 2000/01 to close on 55 per cent in 2001/02. Future payments to BLNS countries are likely to be more predictable than in the past and will be better targeted in support of regional development.

SADC tax co-ordination

Southern African Development Community (SADC) Ministers of Finance and Investment have on several occasions expressed a common desire to advance a programme of tax co-ordination within the region.

Such an initiative is given impetus and urgency by the desire of SADC to harness the potential of its combined market. In particular, tax co-ordination has important roles to play in creating an attractive investment environment in the region, and in managing the revenue risks associated with the transition to a free-trade environment, as envisaged in the SADC Free Trade Protocol.

The formation of the SADC Tax Working Group under the auspices of the SADC Macroeconomic Subcommittee in November 1999 and the establishment of the SADC Tax Subcommittee in July 2000 provide a forum to advance this agenda.

Objectives of the SADC Tax Subcommittee

The SADC Tax Subcommittee, which is chaired by South Africa, came into being on 5 July 2000. Its core objective is defined as "the co-ordination of taxation policies to the extent necessary to improve efficiency in tax collection, safeguard the regional tax base and reduce obstacles to intra-SADC trade and investment."

Some of the initial focus areas of the Subcommittee will include.

- Creating a SADC tax database, covering key aspects of the primary tax instruments in each member state
- Determining a common SADC stance on tax incentives, especially in respect of tax incentives for foreign direct investment. This will minimise the risk to regional tax bases and to the efficient allocation of regional investment resources arising from harmful tax competition
- Devising a road map for the progressive elimination of internal tax barriers to intra-SADC trade
- Determining the compliance gap in respect of the major excise duties within the region, to reduce the revenue loss from cross-border tax fraud
- Identifying areas in which co-ordination of direct taxation might be appropriate
- Building capacity in tax policy-making and revenue collection, especially through the development of training institutes and tax seminars, in close co-operation with multilateral institutions.