4

Revenue issues and tax proposals

Tax proposals

Tax policy aims to balance the often-conflicting objectives of tax design – efficiency, equity, simplicity and administrability. The proposals outlined in this Budget will improve the efficiency and equity of the tax system but also ensure that hard work and entrepreneurship are rewarded.

Tax administration and policy

Some of these proposals are far reaching and will require considerable effort from the South African Revenue Service (SARS) to ensure that they are implemented effectively. The role played by SARS in tax design and administration is critical to the ongoing success of tax reform.

Summary of tax proposals

The tax proposals include:

- R9,9 billion in personal income tax relief
- Capital gains tax, with effect from 1 April 2001
- Phased adoption of a residence-based income tax
- Increase in the interest exemption to R3 000 a year for taxpayers under 65 and to R4 000 a year for taxpayers age 65 and over
- A 0,5 per cent tax on payroll to finance skills development and training
- Extension of tax exempt status to a broader range of non-profit organisations and the deductibility of donations to certain non-profit organisations
- Tax allowances for certain permanent structures
- A graduated rate structure for small and medium enterprises
- Increases in duties on tobacco and alcohol
- Reduced excise duty on soft drinks
- A departure tax on international air travel
- Fuel levy increases of 5 cents a litre on petrol and 3 cents a litre on diesel
- A diesel fuel rebate for the fishing and coastal shipping industries.

Consolidated national revenue estimates

Table 4.1 outlines consolidated national (Budget) revenue for 1998/99 to 2002/03.

Table 4.1 Consolidated national revenue, 1998/99–2002/03

R million	1998/99 Preliminary outcome	1999/00 Budget estimate	1999/00 Revised estimate	2000/01 Medium-term estimate	2001/02 Medium-term estimate	2002/03 Medium-term estimate
National Revenue Fund						
Taxes on income and profits	108 433	111 680	117 178	121 303	130 313	140 062
Taxes on payroll and workforce	–	–	–	1 400	3 000	3 200
Taxes on property	2 831	2 885	3 574	3 338	3 714	3 989
Domestic taxes on goods and services	66 101	71 075	70 980	79 448	84 883	90 055
Taxes on international trade and transactions	6 173	6 625	6 272	6 500	7 113	8 055
Stamp duties and fees	1 490	1 621	1 590	1 700	1 857	1 954
Total tax revenue	**185 027**	**193 886**	**199 593**	**213 689**	**230 880**	**247 315**
Non-tax revenue	3 093	3 546	3 019	3 846	4 022	4 176
Capital revenue	27	21	43	386	305	319
Recoveries of loans and repayments	780	644	844	875	826	828
Grants[2]	522	–	–	–	–	–
Less: SACU payments	-5 122	-7 197	-7 197	-8 396	-8 633	-9 038
Main budget revenue	**184 328**	**190 900**	**196 302**	**210 400**	**227 400**	**243 600**
Percentage of GDP	*24,4%*	*23,5%*	*24,2%*	*23,8%*	*23,7%*	*23,5%*
Social security funds						
Tax revenue	6 217	–	6 717	6 887	7 584	8 318
Non-tax revenue	1 129	–	1 197	1 750	1 911	2 014
Total social security revenue	***7 346***	–	**7 914**	**8 638**	**9 495**	**10 332**
National revenue[1]	**192 151**	–	**204 201**	**219 018**	**236 880**	**253 910**
RDP Fund receipts and technical cooperation[2]	951	–	760	800	700	700
Consolidated national revenue	**192 608**	–	**204 960**	**219 818**	**237 580**	**610**

1. Transfers between funds netted out.
2. Foreign grants to the RDP Fund were transferred to the National Revenue Fund up to 1998/99. With effect from 1999/00, RDP Fund expenditure will be accounted for separately.

Tax policy reform process

Katz Commission

Appointment of Commission

In 1994, the *Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa* (the "Katz Commission") was appointed, with a broad mandate to "inquire into the appropriateness and efficiency of the present tax system and to make recommendations on its improvement taking into account internationally accepted tax principles and practices".

International tax symposium

Tax reform based on policy analysis

In 1999, the Department of Finance hosted an international tax symposium to review the interim reports of the Katz Commission and assist Government in responding to its recommendations. The rigorous debate at the tax symposium informed the proposals in this Budget, as well as initiatives that will guide future tax reforms. The tax reforms will be underpinned by robust quantitative analysis.

Nine interim reports of the Katz Commission

Since 1994, the Katz Commission has released nine interim reports:

- The *first report* contained extensive recommendations for the restructuring of the revenue service into an autonomous entity, most of which have been adopted. It also focused on urgent tax reform measures to be implemented in the 1995 Budget, with specific emphasis on changes required by the Interim Constitution.
- The *second report* focused on the taxation of international transactions by South African firms in the face of globalisation and the associated risk of transfer pricing. In an environment of more open financial markets, thin capitalisation rules were proposed to enhance the stability of South Africa's tax base.
- The *third report* dealt with issues such as capital gains tax, the taxation of retirement funds, the secondary tax on companies, group income taxation, value-added tax on financial services, and dedicated charges and user fees.
- The *fourth report* addressed capital transfer taxes, including estate duty and donations tax.
- The *fifth report* considered whether South Africa should move from the source basis to a world-wide or residence basis of taxing income from international transactions.
- The *sixth report* reviewed tax provisions on medical aid schemes, friendly societies and other benefit funds. It proposed specific measures to curb tax leakage through such schemes.
- The *seventh report* provided a synthesis of policy options on provincial taxation.
- The *eighth report* evaluated the economic impact, administration factors and compliance burden aspects of a land tax.
- The *ninth report* considered the tax provisions relating to non-profit organisations.

Tax reform, 1994 to 1999

The tax reform measures introduced between 1994 and 1999 can be grouped under three broad themes – constitutional, institutional and specific policy changes.

Constitutional changes

The 1993 Interim Constitution and the final 1996 Constitution had important implications for the country's tax regime. Firstly, a phased approach was adopted to harmonise the tax systems of the former TBVC-states with that of South Africa. As the Constitution prohibits discrimination on the basis of marital status or gender, discriminatory provisions were removed from the various tax laws. The most significant amendment was the consolidation of the personal income tax tables. The procedures for search and seizure in the Acts administered by the Commissioner for SARS were also revised.

Institutional changes to reduce the tax gap

In its first report, the Katz Commission estimated the "tax gap" at between R5 billion and R15 billion and most of the report suggested ways to reduce the compliance gap. Since 1994, much has been done to implement these recommendations, materially improving the ability of the revenue authorities to apply the tax laws and collect taxes, as well as to reduce non-compliance and tax evasion.

The central reform initiative was to restructure the Inland Revenue and Customs and Excise divisions of the Department of Finance into an autonomous revenue collection agency, the South African Revenue Service. Administrative autonomy was established with the passage of the South African Revenue Service Act of 1997.

Policy changes

Policy changes introduced between 1994 and 1999 include the following:

- The personal income tax structure was changed, with the number of brackets reduced from ten to six, the separate scale for married women removed and fringe benefit provisions adjusted.
- The standard company tax rate was reduced in two stages from 40 to 30 per cent. The second stage coincided with the end of the 3-year window period on 30 September 1999 for applications to qualify for the tax holiday scheme introduced in 1996.
- In 1996, the secondary tax on companies was reduced from 25 to 12,5 per cent.
- The tax on retirement funds was introduced at 17 per cent in 1996, and subsequently increased to 25 per cent. The tax base was broadened and tax arbitrage and avoidance reduced.
- At the time of the demutualisation of Sanlam and Old Mutual, a levy of 2,5 per cent of the free reserves was imposed to finance the Umsobomvu Fund, which will support employment, youth development and training initiatives.
- In 1996, the value-added tax base was extended to include most fee-based financial services.
- The base of the income tax was extended to include foreign source investment income.
- Tax on tobacco products was progressively increased to 50 per cent of the retail price.
- Customs duties were phased down in line with World Trade Organisation commitments.
- In 1999, the taxation of the long-term insurance industry was revised. These changes limit the expenses allowable in policyholder funds; change the basis of valuation of liabilities in the policyholder funds to the “financial soundness” basis of valuation; and limit the deductibility of transfers of surpluses from policyholder funds to the corporate fund.
- The compulsory registration threshold for value-added tax was raised from the 1991 level of R150 000 to R300 000 in 1999. A new threshold of R20 000 was introduced in 1999, below which a vendor may no longer voluntarily register for value-added tax purposes.
- The tax treatment of intellectual property was revised to exclude acquired trademarks from the list of depreciable intellectual property. Furthermore, the periods over which other listed intellectual properties could be depreciated were brought into line with the periods of statutory protection afforded these properties.
- Changes to the Companies Act in 1999 allow a company to buy back its own shares. The tax laws were subsequently amended to ensure that such a buy-back will be regarded as a dividend and attract secondary tax on companies.
- An accrual basis of taxation was introduced in 1999 to neutralise the unacceptable tax deferral opportunities that existed for taxpayers who acquired option contracts and claimed the full premium or acquisition price as a deduction for tax purposes in the year of acquisition.

Tax Advisory Committee

The Tax Advisory Committee consists of tax experts from the private and public sectors, who advise the Minister on technical and legal tax matters. During 1999, the Committee considered a range of tax policy issues, including:

- The absence of broad statutory authority in the Income Tax Act for SARS to issue advance rulings
- A proposal from the National Housing Finance Corporation to introduce a special tax dispensation to promote housing finance
- Legislation regulating the buy-back by a company of its shares and whether such transactions should incur stamp duty
- Tax on financial instruments
- Rates of interest paid by and to SARS
- Expenditure that a holding company should be allowed to deduct in the calculation of its taxable income
- Deductibility of interest on overdraft facilities used by a company to pay dividends
- Taxation of income earned abroad by South African sporting representatives
- Taxation of unit trusts
- Tax implications of securities lending transactions
- Tax implications of salary sacrifice schemes
- Taxation of the long-term insurance industry
- Tax treatment of intellectual property.

Southern African Development Community

SADC tax coordination

In 1999 the South African Department of Finance was elected to chair a SADC working group on improving tax cooperation in the region. Its overarching objectives are to provide an attractive environment for foreign direct investment, encourage employment opportunities and promote stability and growth throughout the region. Consistent with these objectives, the group will work towards three goals:

- Reducing harmful tax competition
- Reducing tax-related costs of intra-SADC trade and investment
- Reducing revenue losses from smuggling and tax fraud.

Tax administration

SARS as an autonomous agency

SARS is responsible for the collection of national taxes and the administration of various revenue laws. As an administratively autonomous agency, it reports to the Minister of Finance.

Improved relations with taxpayers

Over the past three years, SARS has focused strongly on improved relations with taxpayers, more efficient internal organisation and more effective information systems and processes. Institutional autonomy has contributed to more streamlined tax administration and the promotion of tax compliance. But autonomy does not mean the separation of administration from policy; SARS has a key role in advising the Minister of Finance on tax. This Budget contains several additional policy proposals, which will be accompanied by a deepening of tax administration capacity in the years to come.

Role of SARS in the economy

Good tax enforcement and good service to the taxpayer are key to a successful tax administration, which brings many economic benefits.

The basis of the 2000 Budget framework is a healthy fiscal position. The strong revenue performance by SARS contributed significantly to this. Buoyant revenues reduce the deficit, ease the burden of debt interest and allow tax rates to be cut, while steadily increasing the resources available for the delivery of public services.

Where tax is efficiently collected, unintended distortions in the economy are minimised. An economy where tax evasion is common suffers from uncertainty and unfairness, which discourages foreign investment. Good tax administration counteracts this, as it avoids unfairness, enabling a more productive allocation of resources across the economy. Investment will, of course, also be encouraged if the burden of bureaucracy on taxpayers is eased. Therefore, good service and good enforcement are both vital.

SARS also provides customs service and control at the South African borders, an increasingly important function in the context of globalisation. An efficient customs service benefits those who wish to trade with South Africa, as well as South African enterprises that buy their goods, and prevents smugglers from undercutting legitimate traders.

Tax evasion is a crime. It is often linked to other criminal activity, including organised crime and money laundering. Tax authorities can therefore help to combat crime, making the country safer and more prosperous.

Challenges

Challenges for tax administration

South Africa's history leaves particular challenges for the tax administration. These include:

- An economy with wide disparities between the highly developed and relatively under-developed sectors
- A legacy of low tax compliance in certain sectors
- An economy in transformation, opening up new domestic and international opportunities.

Tax policy and administration

Taxes must work in practice

Policy and administration are also closely linked – a tax cannot work only in principle, but must also work in practice. Tax collection costs should be minimised relative to the revenue raised. This is a particular challenge in developing countries, as taxes can strain the limited organisational infrastructure and financial skills in the economy.

SARS has achieved an excellent ratio between revenue yield and collection costs, shown in Table 4.2. Collection costs are only slightly above 1 per cent, which compares favourably with other countries. Internationally, collection costs vary between 1 and 2,5 per cent.

Table 4.2 Tax revenue collected by SARS

R million	1996/97	1997/98	1998/99 (preliminary actual)	1999/00 (revised estimate)
Total collections	147 076,5	165 256,1	185 027,0	199 593,1
Total collection cost	1 107,5	1 225,0	1 899,3	2 316,8
Costs as percentage of collections	*0,75%*	*0,74%*	*1,03%*	*1,16%*

Better enforcement by SARS

Several SARS' initiatives are aimed at improving enforcement and collection, including the following:

- The new income tax system is starting to provide automated and integrated support to tax collection. By automating the system, enforcement checks can be quick and comprehensive. Integration with other tax databases allow cross-checks for consistency between tax returns, making evasion more difficult. An automated call centre will be installed to follow up on debts, increasing debt collection capacity by 300 per cent.
- SARS has developed an aggressive strategy of targeted enforcement. Sector-specific teams have been formed to maximise understanding of key targets. An intelligence-based approach has been adopted to gather evidence and support prosecution. This approach emphasises that no-one is above the tax law, demonstrates that evasion is punished and, by showing that the system works fairly, encourages payment.
- SARS is also strengthening its cooperation with other law enforcement agencies.
- A special tax court has been established in Johannesburg to expedite the hearing of administrative offences. This service will soon be extended to other centres.
- Strengthening the anti-avoidance provisions of the Income Tax Act; requiring 'declarations of good standing' before taxpayers can obtain government contracts or permission to invest outside the country; and publishing the names of tax offenders.
- SARS has launched a multi-pronged programme to reduce value-added tax and customs fraud, including reducing the number of international border posts.
- Trade protocols are being implemented and enforced.
- A fraud hotline has been introduced.
- Value-added tax collection at border crossings has been improved, yielding over R1 billion since January 1999. Customs control systems are now being reviewed. This will not only improve collection of duties, but will also result in greater efficiency and provide better trade statistics, supporting good economic management and trade policy.

Improved enforcement means that lower tax rates can raise the same revenue. It reduces distortions in the economy and contributes to justice and fairness.

SARS's administration strategy

Central aims enforcement and service

SARS's strategy for meeting these challenges centres on both enforcement and service. The two aims, though distinct, are closely linked. For example, automation and integration of systems brings:

- Better enforcement as auditing of several taxes can be integrated and cross-checked
- Better service as returns can be processed faster and taxpayers have fewer contact people to deal with.

Similarly, a better customs service reduces smuggling, while speeding up the clearance of legal goods.

Single taxpayer number

Ultimately it is planned to base the system on a single registration number per taxpayer. The foundation will be laid for a single taxpayer identification number system this year.

Internal transformation

Several recent changes have enhanced SARS's human resources and information technology capacity. The external enforcement campaign was reinforced by an internal anti-corruption unit, dramatically increasing the number of employees dismissed for theft and fraud. This year, SARS will focus on restructuring the organisation and re-engineering its business processes to optimally deploy resources and minimise the collection costs.

Better service by SARS

Because taxpayers have the right to expect good service, in 2000/01 SARS will launch a public discussion on a new taxpayer charter that sets out service standards.

SARS has put service at the centre of its working culture. Initiatives include improvements in the service to previously marginalised areas, such as the new office in Soweto. Taxpayers can now make their income tax payments at banks. The volume of transactions has grown rapidly from 1 160 transactions, worth R43 million, in June 1998 to 69 698 transactions, worth over R3 billion, in January 2000.

In 2000/01, SARS will:

- provide for electronic submission of value-added tax, PAYE and provisional tax returns, including making all registration forms available on the Internet
- streamline and expedite processing of objections and appeals
- improve income tax assessment times by 400 per cent
- reduce the number of tax forms for small businesses
- implement a national tax education and awareness programme.

Tax reform poses administrative challenges

The ambitious tax reforms of this Budget pose formidable administration challenges for SARS. To these must be added the implementation of the skills development levy in April 2000, and the possibility of SARS assuming responsibility for collecting other types of levies.

In its efforts to become a highly efficient revenue service, SARS received valuable assistance from international partners, including Sweden, the United Kingdom, the United States and Germany, for which Government is most grateful.

Results of improved administration

Over the last five years, improvements in tax administration have resulted in buoyant revenue collection, consistently exceeding targets, as detailed in Table 4.3.

Table 4.3 Tax revenue collected by SARS

R million	1995/96	1996/97	1997/98	1998/99	1999/00 estimate
Target	125 282,0	145 246,0	164 232,0	179 197,6	193 897,0
Collections	127 179,0	147 051,7	165 344,6	185 027,0	199 593,0
Above target	1 897,0	1 805,7	1 112,6	5 829,4	5 696,0
Efficiencies built into target	100,0	1 500,0	2 500,0	2 000,0	2 735,0
Total additional collections	**1 997,0**	**3 305,7**	**3 612,6**	**7 829,4**	**8 431,0**

Agreements on double taxation

During 1999/00, more agreements were reached with other countries on avoiding of double taxation of income accruing to South African taxpayers from foreign sources or to foreign taxpayers from South African sources. The current position is as follows:

- *Comprehensive agreements are in place* with Australia, Austria, Belgium, Botswana, Canada, Croatia, Cyprus, the Czech Republic, Denmark, Egypt, Finland, France, Germany, Hungary, India, Indonesia, Iran, Ireland, Israel, Italy, Japan, Korea, Lesotho, Malawi, Malta, Mauritius, Namibia, the Netherlands, Norway, Pakistan, Poland, Romania, Singapore, Slovak Republic, Swaziland, Sweden, Switzerland, Taiwan, Thailand, Tunisia, the United Kingdom, the United States of America, Zambia and Zimbabwe. The treaty with the United Kingdom also extends to Grenada, the Seychelles and Sierra Leone.
- *Comprehensive agreements have been ratified in South Africa* with Algeria, Greece, Luxembourg, the Russian Federation and Uganda.
- *A comprehensive agreement has been signed, but not ratified,* with the Seychelles.
- *Comprehensive agreements have been negotiated or renegotiated, but not signed*, with Botswana, Estonia, Ethiopia, Gabon, Germany, Latvia, Lithuania, Malawi, Malaysia, Morocco, Netherlands, People's Republic of China, Portugal, Spain, Swaziland, Tanzania, Turkey, Ukraine, Zambia and Zimbabwe.
- *Comprehensive agreements are being negotiated or renegotiated but have not been finalised* with Kuwait, Mozambique, Nigeria, Qatar, United Arab Emirates and the United Kingdom.
- *Limited sea and air transport agreements* exist with Brazil, Greece, Portugal and Spain.

A number of other countries have expressed the desire to negotiate double taxation agreements with South Africa.

Agreements on mutual administrative assistance between customs administrations

These agreements cover all aspects of assistance including exchange of information, technical assistance, surveillance, investigations and visits by officials. Agreements are in place with Algeria and France and have been negotiated but not signed with the Czech Republic and the United States of America. The network of agreements will be expanded in future as a number of other countries have expressed the desire to negotiate similar agreements.

Rewrite of the Income Tax Act and Customs and Excise Act

Income Tax Act review

The 1997 *Budget Review* announced Government's proposal that the Income Tax Act should be simplified to make the tax code accessible to all citizens while maintaining clarity and certainty in its details. Substantial work has been done to reorganise, reorder and restructure the Act to facilitate accessibility and convenience of references.

The far-reaching tax reform proposals set out in this Budget, necessitated a review of this process. The new proposals will affect the fundamental principles of the Income Tax Act and will profoundly influence the drafting process. It has, therefore, been decided to suspend the process until the new principles have been incorporated into the Act.

Customs and Excise Act

Before 1964, customs and excise were governed by separate Acts. When the Customs and Excise Act of 1964 was initially drafted, it overemphasised the then government policy of import administration, with practically no provisions on exports. Since South Africa's readmission to the international arena, the focus of customs has moved to some extent from revenue collection to trade facilitation and control.

Rewrite of Customs and Excise Act

A rewrite of the Customs and Excise Act will commence this year, taking into account regional economic integration, the Kyoto Convention, the distinct differences between customs, excise, anti-dumping, countervailing and safeguard duties; and other trends linked to globalisation of trade.

National budget revenue

Table 4.4 compares budget estimates with the projected outcome in 1998/99 and 1999/00. Details are set out in Tables B1 and B2, Annexure B.

Table 4.4 Budget estimates and revenue outcome, 1998/99 and 1999/00

R million	1998/99 Budget estimate	1998/99 Outcome	1998/99 Deviation	1999/00 Budget estimate	1999/00 Revised estimate	1999/00 Deviation	1998-99 Increase (%)
Taxes on income and profits, including	100 968	108 433	7 465	111 680	117 178	5 498	8,1
Personal income tax	71 800	78 052	6 252	82 650	86 200	3 550	10,4
Company tax (other than mining)	21 200	20 418	-782	19 690	20 000	310	-2,0
Tax on retirement funds	4 618	5 099	481	5 100	5 700	600	11,8
Other	3 350	4 864	1 514	4 240	5 278	1 038	8,5
Taxes on property[1]	2 916	2 831	-85	2 885	3 574	689	26,2
Domestic taxes on goods and services, including	66 878	66 101	-777	71 075	70 980	-95	7,4
Value-added tax	43 444	43 677	233	47 200	46 540	-660	6,6
Excise duties	8 959	8 573	-386	9 350	9 095	-255	6,1
Levies on fuel	14 409	13 640	-769	14 444	15 162	718	11,2
Other	67	211	144	81	183	102	-13,3
Taxes on international trade and transactions	6 702	6 173	-529	6 625	6 272	-353	1,6
Stamp duties and fees	1 700	1 490	-210	1 621	1 590	-31	6,7
Total tax revenue	179 164	185 027	5 863	193 886	199 593	5 707	7,9
Non-tax revenue	3 037	3 093	56	3 546	3 019	-527	-2,4
Capital revenue	7	27	20	21	43	22	59,3
Recoveries of loans and repayments	969	780	-189	644	844	200	8,2
Grants	–	522	522	–	–	–	–
Less: SACU payments	-5 577	-5 122	455	-7 197	-7 197	0	40,5
Main budget revenue	177 600	184 328	6 728	190 900	196 302	5 402	6,5

1. Including demutualisation charge

Preliminary outcome, 1998/99

R5,9 billion more tax revenue in 1998/99

In the 1998 Budget, it was estimated that Government would raise R179,2 billion in tax revenue in 1998/99. At the time of the 1999 Budget, this figure was revised upward to R181,1 billion. The preliminary outcome for the 1998/99 fiscal year is R185,0 billion, or R5,9 billion above the original budget estimate. This is largely attributable to higher than anticipated revenue from taxes on persons and individuals, which continue to be exceptionally buoyant revenue instruments.

Revenue of 24,4% of GDP

Main budget revenue, after providing for payments to other Customs Union member countries, was R184,3 billion, or 24,4 per cent of GDP.

Revised estimates, 1999/00

In the 1999 Budget, total tax revenue for 1999/00 was estimated at R193,9 billion. The revised estimate is R199,6 billion, which is 2,9 per cent higher than the original estimate and 7,9 per cent higher than the preliminary outcome for 1998/99. This increase is again largely attributable to higher than expected revenue from taxes on income and profits, which are expected to raise R5,5 billion in additional revenue.

Taxes on income and profits

Taxes on persons and individuals 4,3% higher than expected

The bulk of the increase in the revised estimate can be ascribed to taxes on persons and individuals. Personal income tax is expected to rise to R86,2 billion in 1999/00, or 4,3 per cent more than the Budget estimate of R82,7 billion. Contributing factors include higher than expected wage settlements and significant progress by SARS in narrowing the tax compliance gap.

R20 billion from taxes on companies

Estimated revenue from taxes on companies (other than mining) is raised from R19,7 billion to R20 billion.

Lower revenue from mining

Income tax from gold mines is projected to be R228 million, or 9,1 per cent lower than the Budget estimate of R250,7 million. This can primarily be ascribed to the lower gold price and continued restructuring within an industry that has to mine lower grade ore at greater depths. Income tax revenue from other mines is estimated at R1,5 billion, which is 11,3 per cent lower than the Budget estimate, largely because of lower than anticipated sales volumes in the diamond and coal industry.

STC receipt due to Sasria conversion

The estimate of revenue from the secondary tax on companies has increased, primarily through the once-off secondary tax on companies of R820 million levied on the realisation of reserves associated with the conversion of Sasria into a state-owned company. The anticipated receipts from this tax instrument are R2,7 billion, or R1,0 billion more than the original Budget estimate.

Increased tax on retirement funds

The tax on retirement funds is anticipated to generate R600 million more than estimated in the 1999 Budget, an increase of 11,8 per cent. This is attributable to a period of unusually high interest rates.

Taxes on property

Inclusion of the demutualisation charge

The revised estimate of taxes on property is 23,8 per cent above the original Budget estimate. A main component of this increase is the marketable securities tax, which increased by 22,9 per cent over the Budget estimate due to greater than anticipated share market activity.

Another more technical reason for the increase was the inclusion of the demutualisation charge as a tax on property, which increased the total estimate by R577 million over the Budget estimate.

Domestic taxes on goods and services

Sluggish growth in value-added tax revenue collection

The value-added tax is projected to realize slightly lower revenue than estimated in the Budget. Receipts are anticipated to be R46,5 billion, or 1,4 per cent lower than the Budget estimate.

Excise taxes below Budget estimate

The revised estimate for receipts from specific excise duties is R8,5 billion, or R255 million lower than the Budget estimate. This is largely attributable to declining sales of spirits and cigarettes.

No change is envisaged in revenue from ad valorem excise duties from the Budget estimate of R560 million.

Fuel levy 5% more than Budget estimate

Levies on fuel are estimated to generate R15,2 billion, which is 5 per cent more than the Budget estimate of R14,4 billion. This increase is attributable to higher than anticipated growth in fuel consumption, increased volumes of car sales and more efficient collection by SARS.

Taxes on international trade and transactions

Revenue from taxes on international trade and transactions is expected to be 5,3 per cent lower than the Budget estimate. The reduction in the estimate from R6,7 billion to R6,3 billion can be ascribed to lower than expected import growth.

Revenue trends, 1996/97 to 2002/03

Table 4.5 reviews actual revenue collections for 1996/97 and 1997/98, the preliminary outcome for 1998/99, the revised estimate for 1999/00 and the forward estimates for 2000/01 to 2002/03. This is set out in detail in Tables B1 and B2, Annexure B.

Tax revenue to grow by 9,1% a year

Between 1996/97 and 1999/00, total tax revenue has grown at an average annual rate of 10,5 per cent. It is anticipated to grow at an annual average rate of 7,2 per cent between 1999/00 and 2002/03. Total budget revenue has grown from R146,4 billion in 1996/97 to an estimated R196,3 billion in 1999/00, and is anticipated to grow to R243,6 billion in 2002/03.

Buoyant income tax revenue

Over 90 per cent of tax revenue is derived from taxes on income and profits, and domestic taxes on goods and services. The income tax has been a particularly buoyant source of tax revenue, growing at an average annual rate of 11,9 per cent between 1996/97 and 1999/00.

Domestic taxes on goods and services are also stable revenue sources for Government, having grown at an average annual rate of 9,7 per cent between 1996/97 and 1999/00.

Table 4.5 Tax revenue, 1996/97–2002/03

R million	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03
	Actual collections		Preliminary outcome	Revised estimate	Medium-term estimate		
Taxes on income and profits	82 876	95 004	108 433	117 178	121 303	130 313	140 062
Taxes on payroll and workforce	–	–	–	–	1 400	3 000	3 200
Taxes on property	2 359	2 618	2 831	3 574	3 338	3 714	3 989
Domestic taxes on goods and services	53 438	60 512	66 101	70 980	79 448	84 883	90 055
Taxes on international trade and transactions	7 201	5 639	6 173	6 272	6 500	7 113	8 055
Stamp duties and fees	1 202	1 484	1 490	1 590	1 700	1 857	1 954
Total tax revenue	**147 077**	**165 256**	**185 027**	**199 593**	**213 689**	**230 880**	**247 315**
Non-tax revenue	3 368	3 161	3 093	3 019	3 846	4 022	4 176
Capital revenue	15	18	27	43	386	305	319
Recoveries of loans and repayments	154	123	780	844	875	826	828
Grants	268	169	522	–	–	–	–
Less: SACU payments	-4 363	-5 237	-5 122	-7 197	-8 396	-8 633	-9 038
Main budget revenue	**146 519**	**163 490**	**184 328**	**196 302**	**210 400**	**227 400**	**243 600**
Gross domestic product	633 787	699 292	754 729	809 683	885 189	958 162	1 036 679
Tax as a percentage of GDP	*23,2%*	*23,6%*	*24,5%*	*24,7%*	*24,7%*	*24,1%*	*23,9%*

Estimates of revenue before tax proposals

Main budget revenue increase by 9,9% before tax proposals

Based on the macroeconomic assumptions set out in Chapter 2 and the existing tax rates and brackets, it is estimated that main budget revenue in 2000/01 will be R215,7 billion (see Table 4.6), an increase of 9,9 per cent over the revised estimate for 1999/00. In 2000/01, total tax revenue is estimated to increase by 9,7 per cent over the revised estimate for 1999/00 from R199,6 billion to R219,0 billion. The details of *first print* are set out in the Estimate of Revenue (RP3) and summarised in Table 4.6.

Taxes on income and profits

R96,9 billion from income tax

Without any adjustments to the income tax rates, it is anticipated that R96,9 billion would be raised from taxes on persons and individuals. While this is partly attributable to the effects of inflation on earnings and tax liability, continued strong growth in real wages will also contribute. The base of the personal income tax was increased to correct for the underestimation of revenue and the inherent buoyancy of this tax base.

10% increase in taxes on companies

Revenue from taxes on companies (other than mining companies) is anticipated to grow by 10 per cent over the 1999/00 revised estimate, from R20 billion to R22 billion. The anticipated increase in corporate earnings results from stronger economic growth, reflected in increases in both domestic expenditure growth and exports.

Table 4.6 Total revenue (before tax proposals), 2000/01

R million	Revised estimate 1999/00	Before tax proposals 2000/01	Percentage change
Taxes on income and profits	**117 178**	**129 714**	**10,7**
Personal income tax	86 200	96 899	12,4
Company tax (other than mining)	20 000	22 000	10,0
Tax on retirement funds	5 700	5 800	1,8
Other	5 278	5 015	-5,0
Taxes on payroll and workforce	–	**1 400**	–
Taxes on property	**3 574**	**3 338**	**-6,6**
Domestic taxes on goods and services	**70 980**	**76 375**	**7,6**
Value-added tax	46 540	51 400	10,4
Excise duties	9 095	9 444	3,8
Levies on fuel	15 162	15 300	0,9
Other	183	231	26,2
Taxes on international trade and transactions	**6 272**	**6 500**	**3,6**
Stamp duties and fees	**1 590**	**1 700**	**6,9**
Total tax revenue	**199 593**	**219 026**	**9,7**
Non-tax revenue	3 019	3 846	27,4
Capital revenue	43	386	797,7
Recoveries of loans and repayments	844	875	3,7
Grants	–	–	–
Less: SACU payments	-7 197	-8 396	16,7
Total budget revenue	**196 302**	**215 737**	**9,9**

34% increase in tax revenue from gold mines

The first print estimate of tax revenue from gold mines is R305,5 million, or 34,0 per cent higher than the 1999/00 revised estimate. This takes account of further restructuring in that sector to contain costs, as well as a higher rand price of gold. Income tax revenue from non-gold mines is projected at R1,6 billion, which is 11 per cent higher than the 1999/00 revised estimate.

Stable STC receipts

Revenue from the secondary tax on companies is estimated at R2,1 billion, which is 22,2 per cent lower than the revised estimate. The revised estimate for 1999/00 is inflated by receipts from secondary tax on companies levied on the distribution of Sasria reserves, which was an extraordinary receipt and is accordingly excluded from the base for the 2000/01 estimate.

Taxes on property

Taxes on property are estimated at R3,3 billion, which is 6,6 per cent down on the 1999/00 revised estimate. This arises because the demutualisation charge, which was a one-off receipt, was included in the 1999/00 revised estimate, as a tax on property.

Domestic taxes on goods and services

Strong growth in value-added tax receipts

Value-added tax revenue is estimated to grow by 10,4 per cent to 51,4 billion in 2000/01, reflecting strong growth in domestic consumption expenditure.

Before tax changes, revenue from specific excise duties is estimated to grow by 3,2 per cent due to growth in real GDP, while ad valorem excise duties are expected to grow by 14,3 per cent to R640 million, reflecting strong consumption expenditure on excisable commodities.

Slow growth in fuel levy

The first print estimate of revenue from levies on fuel is R15,3 billion, which represents sluggish growth of 0,9 per cent, taking account of an anticipated slowdown in fuel sales in the context of high international oil prices.

Taxes on international trade

Moderate growth in customs receipts

Customs duty collections of R6,3 billion are expected, which are 3,3 per cent higher than the 1999/00 revised estimate and are driven largely by anticipated economic growth and, consequently, import demand.

Stamp duties

The first print estimate of revenue from stamp duties is R1,7 billion, or an increase of 6,9 per cent over the 1999/00 Budget estimate.

SACU payments

SACU payments increasing strongly

Payments in terms of the SACU agreement are estimated to be R8,4 billion, which is 16,7 per cent higher than the 1999/00. This amounts to 4 per cent of main budget revenue.

Summary effects of tax proposals

Table 4.7 sets out the revenue effects of the 2000 Budget tax proposals.

Increased revenue from efficiency

SARS anticipates that improved efficiencies in tax collection will yield an additional R3,1 billion in revenue.

The net effect of this year’s tax proposals is a revenue loss of R8,5 billion.

Table 4.7 Summary of revenue effects of tax proposals

R million	Revenue gain (+) / loss (-)	
Tax revenue		219 026,4
Other non-tax current revenue		3 845,9
Capital revenue		386,0
Recoveries of loans and repayments		875,0
Less SACU payments		-8 396,0
Main budget revenue (first print)		**215 737,3**
Budget 2000/01 tax proposals		-8 476,6
Additional collections		3 139,3
Direct tax proposals		
Phased approach to residence-based income tax system		
Taxation of foreign source dividends	200,0	
Personal income tax		
Adjustment to personal income tax rates, brackets and rebates	-9 858,2	
Increase in interest income exemption	-220,0	
Non-profit organisations		
Increased scope of income exemptions and donation contribution deductibility	-100,0	
Company tax		
Graduated rates structure for SMEs	-100,0	
Closing tax loopholes	186,5	
Indirect tax proposals		
Excise taxes		
Increase in duties on beer, wine, spirits and cider	233,4	
Increase in duties on tobacco products	416,7	
Reduce duties on soft drinks by 4c/l	-85,0	
Diesel rebate for fishing and coastal shipping (from 1 June 2000)	-66,0	
Increase fuel levy by 5c/l on petrol and 3c/l on diesel	736,0	
Departure tax on international air travel (from 1 August 2000)	180,0	
Main Budget Revenue (second print)		**210 400,0**

Direct tax proposals

Personal income tax

R9,9 billion relief

Income tax relief to individuals amounts to R9,9 billion, providing real tax cuts across the income spectrum. The total income tax relief granted since 1995 will reach a cumulative total of over R25 billion, as shown in Table 4.8.

Tax rate and bracket adjustments

The current single rate structure of income tax is amended, as set out in Table 4.9. In terms of the new structure, individuals will pay 18 per cent of each R1 of income up to R35 000, rising to 42 per cent on income in excess of R200 000. In addition:

- The primary rebate for individuals is increased from R3 710 to R3 800, which increases the income tax threshold from R19 526 to R21 111.
- The secondary rebate is increased from R2 775 to R2 900, which increases the threshold for taxpayers age 65 and over from R33 717 to R36 538, an increase of 8,4 per cent.

Table 4.8 Personal income tax relief, 1995–2000

Year	R billion
1995	2,0
1996	2,0
1997	2,8
1998	3,7
1999	4,9
2000	9,9
Total	**25,3**

Tax relief across the income spectrum

Individuals with taxable income below R30 000 a year, but more than the tax threshold of R21 111, receive a reduction in their tax liability of more than 19 per cent. The taxable income groups R30 000 to R40 000 and R40 000 to R50 000 receive tax reductions of over 18 and 12 per cent, respectively.

Taxpayers with income between R50 000 and R200 000 will have their tax liability reduced by about 10 per cent. The tax liability of taxpayers with taxable income in excess of R200 000 a year is reduced by about 8 per cent.

Table 4.9 Tax rates for natural persons

1999/00		2000/01	
Taxable income (R)	**Rates of tax**	**Taxable income (R)**	**Rates of tax**
0 – 33 000	19% of each R1	0 – 35 000	18% of each R1
33 001 – 50 000	R6 270 + 30% of the amount above R33 000	35 001 – 45 000	R6 300 + 26 % of the amount above R35 000
50 001 – 60 000	R11 370 + 35% of the amount above R50 000	45 001 – 60 000	R8 900 + 32% of the amount above R45 000
60 001 – 70 000	R14 870 + 40% of the amount above R60 000	60 001 – 70 000	R13 700 + 37% of the amount above R60 000
70 001 – 120 000	R18 870 + 44% of the amount above R70 000	70 001 – 200 000	R17 400 + 40% of the amount above R70 000
120 001and above	R40 870 + 45% of the amount above R120 000	200 001 and above	R69 400 + 42% of the amount above R200 000
Rebates		**Rebates**	
Primary	R3 710	Primary	R3 800
Age 65 and over (additional to primary rebate)	R2 775	Age 65 and over (additional to primary rebate)	R2 900
Tax threshold		**Tax threshold**	
Below age 65	R19 526	Below age 65	R21 111
Age 65 and over	R33 717	Age 65 and over	R36 538

Table 4.10 illustrates that the relief is concentrated in the lower income groups, with taxpayers with taxable income below R70 000 a year receiving about 41 per cent of the total tax reduction. Middle-income taxpayers, with taxable income of between R70 000 and R150 000, receive 38 per cent of the tax reduction. The remaining 21 per cent benefits taxpayers with taxable income in excess of R150 000.

Table 4.10 Distribution of income tax relief

Income bracket	Percentage of tax relief
R0 – R70 000	40,6
R70 000 – R150 000	38,1
R150 000+	21,3

Benefits of current income tax reform

The income tax adjustments will improve the efficiency and equity of the tax system. By alleviating the compression in the income tax brackets, work effort, entrepreneurship and saving are encouraged. Reducing the difference between the top personal income tax rate and the company tax rate will reduce tax arbitrage opportunities.

Cost of adjustments

The personal income tax reforms will result in an estimated revenue loss of R9,9 billion.

Interest income exemption

Increased exemption level

The Income Tax Act currently allows an exemption for the first R2 000 a year of interest income accruing to an individual. This exemption level is raised to R3 000 a year for all taxpayers under the age of 65 and R4 000 a year for taxpayers age 65 and over.

Promoting equity and encouraging saving

The primary beneficiaries of this proposal will be individuals over the age of 65 earning a modest fixed-interest income. In addition, because lower income taxpayers tend to save primarily in interest-bearing investments such as bank deposits, increasing the exemption level will considerably improve the overall equity of the income tax system, as other savings instruments enjoy more tax privileges. The proposal also signals Government’s intention to encourage household saving.

Revenue loss

This proposal will result in a reduction in revenue collection of R220 million.

Skills development strategy

Levy on payroll assigned to skills funds

As foreseen in the 1999 Budget, a skills development levy will be introduced at a rate of 0,5 per cent of payroll on 1 April 2000, with a subsequent increase to 1,0 per cent on 1 April 2001. The levy income, which will be used to defray the costs of training expenditure programmes, is expected to raise R1,4 billion in 2000/01, R3,0 billion in 2001/02 and R3,2 billion in 2002/03. The strategy determines that 80 per cent of levy collections should be used to fund the various sector education and training authorities and 20 per cent allocated to the National Skills Fund. The levy will be deductible for income tax purposes, resulting in a reduction in company tax revenues.

Tax relief for non-profit organisations

Changing roles of non-profit organisations

Non-profit organisations play a vital role in promoting development and extending democracy. Recognising this, the Income Tax Act grants tax-exempt status to approved non-profit organisations and allows donations to some bodies to be deducted from taxable income, subject to prescribed limits.

Government accepts that the current provisions do not acknowledge the changed role of these organisations in South Africa. It is accordingly proposed that:

- A new definition of public benefit organisations should be included in the Income Tax Act.
- The deductibility of donations should be extended to include donations to a broader range of entities.
- The limits applied to the deductibility of donations by individuals should be raised.

Income tax exemptions and related revenue laws

Having considered the report by the Katz Commission and the preliminary findings of the Portfolio Committee on Finance, as well as the information obtained from foreign jurisdictions, it is proposed that consideration be given to the following:

- A comprehensive list of acceptable public benefit activities, which must include the activities of the majority of non-profit organisations in the Republic, should be developed and included in the Act.
- Similar provisions in other revenue laws may have to be changed.
- Several non-profit organisations engage in business activities for which they are provided an income tax exemption. This gives such organisations a competitive advantage over taxpaying business competitors. In principle, business income that is unrelated to the core public benefit activity should be taxed. Should a non-profit organisation wish to trade extensively, such activities must be conducted in a separate legal entity, subject to the normal tax principles. Occasional business transactions and trading activities not related to the core public benefit activity will be permitted to a limited degree. Where income accrues to a non-profit organisation from a taxable trust, consideration will be given to making such income taxable in the hands of the trust.

SARS will focus on developing the capacity for a comprehensive evaluation of all applications for approval and for reporting on the cost of the benefit granted to non-profit organisations.

Penalty provisions

If a non-profit organisation engages in activities contrary to the conditions for which the exemption was granted, penalty provisions may apply, possibly including the withdrawal of the exempt status and/or monetary penalties.

Deductibility of donations

Current practice only allows deductions of donations for income tax purposes in respect of certain educational institutions and funds. This range can only be broadened if SARS develops sufficient capacity to prevent abuse.

Tax relief extended

Government is acutely aware of the cash constraints being experienced by certain non-profit organisations. It is therefore proposed that as a first step the existing provisions relating to the deductibility of donations be extended to the following categories of public benefit organisations:

- Pre-primary schools that offer an approved educare programme
- Primary schools

- Organisations mainly involved in preventing HIV infection or providing care to those whose livelihoods have been impoverished by Aids
- Children's homes providing care to abandoned, abused or orphaned children
- Organisations mainly involved in caring for destitute aged persons.

It is further proposed that the tax deduction in respect of individuals and companies be limited to the larger of 5 per cent of taxable income or R1 000.

Cost to fiscus of extending deductibility

It is estimated that the cost to the fiscus will be an additional R100 million in 2000/01, and R300 million to R500 million in subsequent years.

Residence-based taxation

Source vs residence

There are two alternative approaches to taxation of income – the source or residence (world-wide) basis. In pure source-based taxation, tax is levied on income earned from a source within the country, irrespective of whether it was earned by a resident or non-resident. Under pure residence-based taxation, tax is levied on the residents of a country, irrespective of where in the world that income was earned.

In practice, tax systems contain elements of both regimes. The South African tax system is currently based on the source principle. In 1997, provisions were introduced into the Income Tax Act that deem some categories of foreign income to be from a South African source. These are primarily investment income in the form of annuities, interest, rental income, royalties or income of a similar nature.

Tax planning and avoidance

The current basis of taxation provides opportunities for tax planning and avoidance, as taxpayers seek to reclassify as untaxed foreign-source income, income that would normally be taxed in South Africa. This is facilitated by the increasing globalisation of the economy and the relaxation of exchange controls, which provide considerable scope for taxpayers to avoid South African tax by conducting business and providing services in low or zero tax rate countries. The generous tax holiday schemes in some countries in the region add to the leakage.

Residence based taxation from January 2001

It is proposed to move to a residence-based income tax for South African residents for years of assessment commencing on or after 1 January 2001. This will significantly broaden South Africa's income tax base, limit opportunities for tax arbitrage and bring the tax system in line with generally accepted norms for taxing international transactions.

Deferring the implementation date will allow for further consultation and enable SARS to draft appropriate legislation, modify its information technology systems and train its personnel.

Basic structure

As is common international practice, a "residence minus" system will be adopted, i.e. taxpayers will be taxed on their world-wide income, but some categories of income and activities undertaken outside South

Africa will be exempt from South African tax. Elements of the proposed tax structure include the following:

- Except as noted below, the income tax base will be extended to include all income of residents of South Africa. Foreign taxes paid by these residents will be allowed as a credit against the South African tax liability.
- The existing provisions of Section 9D of the Income Tax Act will be extended in order to impute all income of controlled foreign entities to the residents with an interest in such entities.
- Business profits attributable to a permanent establishment of a controlled foreign entity or resident in designated countries will, in certain instances, not be included in the income of the South African resident. The designated countries will be limited to those with whom South Africa has a tax treaty and that have a similar basis and level of taxation as South Africa.
- Foreign residents will continue to be taxed on their South African source income only.

Taxation of foreign source dividends

Interim steps to tax foreign dividends

As an interim step, foreign dividends will become taxable immediately. The core features of the taxation of foreign dividends are set out in more detail in Annexure C. The basic elements of this proposal include the following:

- All dividends from foreign-registered or incorporated companies will form part of the income of South African residents, except those from certain designated countries, under certain circumstances.
- Residents who are taxed on foreign dividends will be able to claim a credit of foreign tax paid on the dividends against their South African income tax liability.
- Local companies will not be able to claim foreign dividends as a credit in the calculation of their liability for secondary tax on companies.
- The proposal to increase the interest exemption as described above will be extended to include foreign dividend earnings that would otherwise be taxable. Individuals under the age of 65 will receive a R3 000 exemption for interest and dividend income (including income from unit trusts and foreign source dividends). The exemption for taxpayers age 65 and over is R4 000.
- This measure will apply to all foreign dividends from 23 February 2000.

The additional revenue accruing to the fiscus from this proposal is estimated at R200 million in 2000/01.

Depreciation of permanent structures

Current approach

At present, the South African income tax system does not provide for depreciation allowances for works of a permanent nature. The rationale behind this has been that investments such as railway tracks and electricity lines have such long economic lives that depreciation allowances are unjustified.

Changing needs and investment requirements

Recent changes in economic and institutional conditions necessitate amendments to this practice, for reasons that include the following:

- In the past, most of the investment in permanent structures was undertaken directly by Government or its agencies. With the privatisation of many public utilities and the increasing use of public-private partnerships to meet the country's infrastructure requirements, an appropriate depreciation regime must be designed to accommodate such investments.
- The development of the Southern African region is critically dependent on massive infrastructural investment. Depreciation allowances offered to foreign and local private investors can attract such investment, enabling Government to provide positive public benefits and the investors to realize a reasonable rate of return on their investment. This will make Southern Africa an attractive investment destination for capital-intensive infrastructure projects.

Depreciation allowances for certain permanent structures

It is proposed that taxpayers be allowed to deduct the following wear and tear allowances:

- Pipelines for transporting oil or gas and their derivative products: 10 per cent a year of the cost of the asset (10-year straight line)
- Electricity transmission lines: 5 per cent a year of the cost of the asset (20-year straight line)
- Telephone transmission lines: 5 per cent a year of the cost of the asset (20-year straight line)
- Railway tracks: 5 per cent a year of the cost of the asset (20-year straight line).

Preventing tax avoidance

Taxpayers will be allowed to deduct the depreciation allowances in respect of all new and unused structures, which are contracted for and the construction or erection of which commences on or after 23 February 2000 and are brought into use for the first time on or after that date, to the extent that they are used in the production of income. These allowances will only be available to taxpayers where the structure is owned by the taxpayer and used directly by the owner(s) thereof for transportation or transmission in the carrying on of their primary and principal business. The tax allowances will not be available to taxpayers whose core business is not the utilisation of the permanent structure, with special reference to taxpayers in the financial sector.

Graduated company tax rate for small business corporations

Support for small businesses

Internationally, it is recognised that small and medium enterprises have an important role in economic development and employment creation. In view of this sector's capacity to create jobs, a graduated company rate structure is proposed for such enterprises.

The lower rate structure will only be available to qualifying small businesses, for tax years commencing on or after 1 April 2000. The businesses qualifying for the graduated rate are those where:

- during the entire year of assessment, the entire shareholding of or interest in the company is held by shareholders that are natural persons
- the gross income for the year of assessment does not exceed R1 million
- none of the shareholders, at any time during the year of assessment, holds any shares or interest in any other company except a listed company or investment in a unit portfolio
- not more than 20 per cent of the company's gross income consists collectively of investment income and income from personal services
- the company is not an employment company, as defined in Annexure C.

These enterprises will be subject to tax as follows:

- 15 per cent on the first R100 000 of taxable income
- 30 per cent on taxable income in excess of R100 000.

Encouraging job creation

This measure is intended to benefit small labour-intensive businesses primarily in the manufacturing and tourism sectors. This explains the limit of 20 per cent on the level of investment income or income from personal services.

Minimising avoidance opportunities

For the purposes of this proposal:

- Personal service means any service that is performed personally by any person who holds an interest in the company or close corporation, in the field of accounting, actuarial science, architecture, auctioneering, auditing, broadcasting, broking, commercial arts, consulting, education, engineering, entertainment, health, information technology, journalism, law, management, performing arts, real estate, sport, surveying, translation, valuation or veterinary science
- Investment income includes income from interest, rentals, annuities, royalties, dividends or from trading and investment in financial instruments, marketable securities or immovable property.

Withdrawal of Eskom's tax exempt status

Eskom to become a taxpayer

Eskom enjoyed exemption from the payment of income tax in terms of the Eskom Act, 1989. Although the section in the Act granting exemption to Eskom was repealed with effect from 18 December 1998, Eskom also qualifies for an income tax exemption in terms of section 10 (1)(cA) of the Income Tax Act. As Government has resolved that Eskom should become a taxable entity, it is proposed that Eskom's tax exempt status be withdrawn with effect from the commencement of its 2000 financial year, i.e. 1 January 2000.

Tax treatment of "repatriation" of surplus pension fund assets

"Repatriation" of surplus assets in pension funds

In terms of the Pension Funds Act, pension funds are required to hold sufficient assets to satisfy the rights and reasonable benefit expectations of the members of the funds. Over time, a substantial volume of surplus assets – about R80 billion – has accumulated in pension funds. In the past, the Registrar of Pension Funds refused to allow employers to participate in the surplus assets of pension funds, other than by reducing their contributions to the funds. Following judgements in this regard, some employers have been allowed to register rules allowing them to "repatriate" surplus pension fund assets, subject to various conditions imposed by the Financial Services Board.

Taxation of surplus assets on "repatriation"

Although the existing provisions of the Income Tax Act allow for the taxation of the recoupment of contributions "repatriated" from pension funds, specific legislation will be introduced to tax the full amount of any "repatriation", without offsetting any assessed losses. This proposal will apply to any amount "repatriated" on or after 23 February 2000.

Closing tax loopholes

Erosion of the tax base

Loopholes in the tax legislation are an unintended consequence of the complexity of all modern tax regimes. When used to avoid tax, such loopholes undermine the corporate and personal income tax bases. To reduce the tax compliance gap and maintain a broad tax base, Government seeks to eliminate loopholes. Accordingly, this Budget proposes measures to close loopholes in the current tax system.

Matching of expenditure deduction and benefit

Matching income / benefit and expenditure

Taxpayers increasingly structure transactions to allow immediate deductions of expenditure, while postponing the accrual of income for tax purposes. Such activities effectively defer the taxpayer's tax liability, which results in reduced taxes flowing to the National Revenue Fund. To prevent this erosion of the corporate tax base, it is proposed that the following restrictions apply with effect from 23 February 2000:

- The deduction of expenditure incurred in terms of any agreement shall be limited to expenditure relating to goods supplied, services rendered or other benefits received during the relevant year of assessment. This provision, which is consistent with measures in other jurisdictions, effectively ensures that taxpayers match the timing of expenditure deductions allowed for tax purposes and the benefits derived from such expenditure. The timing of expenditure regulated in terms of Sections 24 I to 24 L of the Income Tax Act will not be affected by this proposal.

- Any deduction in respect of trading stock that was disposed of by the taxpayer in the ordinary course of trade, will be limited to the extent that the consideration for which it was so disposed of is included in gross income.

Restraint of trade

Because a payment in restraint of trade and a payment for services are closely substitutable, taxpayers attempt to manipulate the capital-revenue boundary that distinguishes these payments, with important tax implications. Furthermore, such a narrow distinction is undesirable from the perspective of maintaining certainty in tax policy.

Proposed tax treatment of restraints of trade

It is proposed that restraints of trade paid to natural persons or "employment companies" be included as income in the hands of the recipient and deducted in the hands of the payer over the period of the restraint or 3 years, whichever period is longer. This provision will apply to agreements entered into on or after 23 February 2000.

Employment company

It continues to be a popular tax saving method for employees to offer their services to their employers through private companies or close corporations.

In 1990 provisions were inserted in the Fourth Schedule to the Income Tax Act to ensure that people providing personal services (i.e. labour brokers), are subject to employees' tax, unless an exemption certificate is granted. These provisions do not, however, address the circumstances where a company is not a labour broker, but still provides the services of an individual who would normally have been an employee of the client of the company.

Proposal to tax the income of an "employment company" at 35%

To discourage the use of a corporate entity (employment company) to provide a service to a client which is, in essence, provided in terms of a contract of employment, it is proposed that:

- the remuneration payable to such an employment company by the client be subject to employees' tax
- the allowable deductions of an employment company for tax purposes be limited to the amount of the remuneration paid for services rendered by the shareholder, member or other employees of the company
- the income of an employment company be taxed at a rate of 35 per cent and any dividend declared will be subject to secondary tax on companies.

The companies in respect of which these provisions apply, as well as the dates from which the new provisions become applicable, are set out in detail in Annexure C.

Concern has also been expressed about the incorporation of professional practices in order to take advantage of the lower corporate tax rate. SARS will monitor this trend to determine the impact thereof on the tax base and whether legislative responses are required to address the matter.

Capital gains tax

Tax Commission views on capital gains tax

South Africa does not presently have a capital gains tax. However, various tax commissions have considered its possible introduction. The Franzsen Commission in 1969 proposed a limited capital gains tax on immovable property and marketable securities. The majority recommendation of the Margo Commission was that capital gains should not be subject to tax. The Katz Commission, on the other hand, acknowledged the case for a capital gains tax, while recommending that it should not be implemented due to its complexity and the capacity of the tax administration at that time (1995).

Efficiency and equity in taxation

The absence of a capital gains tax introduces many distortions into the economy, encouraging taxpayers to convert otherwise taxable income into tax-free capital gains, with negative implications for the efficiency and equity of the overall tax system. A capital gains tax can protect the integrity of the personal and corporate income tax bases and contribute considerably to the overall equity of the tax system.

International best practice

Taxes on capital gains are well established in other countries, including Australia, Canada, the United Kingdom and the United States of America. Its introduction would bring South Africa in line with those of its major trading partners. It would make the overall tax regime more efficient by limiting the benefit from transactions designed to convert ordinary income into tax-free capital gains.

Implementation on 1 April 2001

In view of the enhanced administrative capacity at SARS, South Africa can now implement a capital gains tax. To avoid undue disruption, it will only become effective as from 1 April 2001. In the interim, further consultation will occur and draft legislation will be made available for comment by all interested parties.

An outline of the proposed capital gains tax provisions is set out in a guide produced jointly by the Department of Finance and SARS to encourage debate around the details of the proposal. This document is now available on the web sites of SARS and the Department of Finance and will be available shortly at SARS offices.

Basic structure of capital gains tax

The capital gains tax will only apply to gains accruing after the effective date; there will be no tax on gains accruing prior to 1 April 2001. From then on, capital gains tax will apply to assets held on the effective date and assets acquired after the effective date. This rule was applied in Canada (1971) and the UK (1965) when they adopted their capital gains tax regimes.

Persons liable to pay capital gains tax

The following taxpayers will be liable for capitals gain tax:

- Any individual or entity resident in South Africa, as to be defined for the purposes of the proposed residence basis of taxation, in respect of capital assets held both inside and outside the country
- Where an individual or an entity is not resident in the country, a liability for capital gains tax will arise only on immovable property or interests in immovable property in South Africa, as well as on the assets of a branch, permanent establishment, fixed base or agency in the country, through which a trade, profession or vocation is being carried on.

Affected capital assets

Affected capital assets are property of any kind including assets that are movable or immovable, tangible or intangible, excluding any trading stock.

Assets acquired by taxpayers before the effective date and disposed of thereafter will only be taxed on the capital gains that accrue during the period after the effective date.

Base cost of an affected capital asset

The base cost of an affected capital asset includes those costs actually incurred in acquiring, enhancing or disposing of such capital asset. Current costs may not form part of the base cost.

Triggering of CGT

Capital gains tax will be triggered upon disposal or deemed disposal of a capital asset.

Key exemptions

Some of the assets that will be exempt from capital gains tax include:

- A primary or principal owner-occupied residence
- All private motor vehicles
- Personal belongings and effects, e.g. effects commonly found within a home including clothing, art, antiques and jewellery *but excluding boats, caravans, aircraft, share certificates and coins minted in either silver or gold*
- Lump sum benefits in respect of most superannuation and life assurance policies, where the recipient was the original beneficial owner or the nominee or dependent of the original beneficial owner of the policy or instrument
- Assets owned by institutions fully exempt from normal taxation, such as Government departments, local authorities and approved public benefit organisations.

Deferral (‘rollover’) of certain capital gains

In order not to hamper business activities and reinvestment, a number of transactions will not trigger an immediate capital gains tax liability. These include:

- Certain transfers of property in establishing or reorganising a business
- Transfers from a deceased estate
- Donations of property and transfers between spouses.

Special rules will apply in the event of an involuntary disposal (e.g. a fire or flood).

Treatment of capital gains / losses

Capital losses may only be deducted against capital gains and may not be offset against income from other sources. For individuals, a basic R1 000 a year primary exclusion will apply to chargeable (net) capital gains or losses for all capital assets disposed of during the course of the tax year, before any inclusion rate relief is given.

Example of a capital gains tax transaction

An individual taxpayer paying tax at the maximum marginal rate of 42 per cent acquired shares listed on the Johannesburg Stock Exchange for investment purposes 6 months after the implementation of capital gains tax. The taxpayer initially paid R10 000 and disposed of all those shares two years later for R12 000. Assuming that the taxpayer was not considered to be a trader of shares, that there were no changes to the tax rate over this period and that there were no other capital gains transactions in the year, how would capital gain tax work?

- Is the asset on revenue account?
  No, therefore the capital gain falls within the capital gains tax regime.
- Did a capital gains tax event occur?
  Yes, the shares were disposed of, i.e. ownership changed.
- Does an exemption or rollover relief apply?
  No, shares disposed of fall within the capital gains tax regime and no rollover relief applies.
- Do the capital proceeds exceed the base cost?
  Yes, by R2 000 (R12 000 minus R10 000) – therefore a capital gain exists.
- Was the asset held before the effective (implementation) date?
  No, the asset was acquired 6 months after the effective date.
- Does the R1 000 primary exclusion apply for the tax year?
  Yes, as the taxpayer is a natural person. Applying the R1 000 primary exclusion means that only R1 000 of the capital gain is subject to capital gains tax.
- Did the capital asset belong to a natural person?
  Yes, therefore only 25 per cent of the gain or R250 (R1 000 x 25 per cent) is included in normal taxable income.
- How much tax is payable?
  The taxpayer pays tax at the maximum marginal rate of 42 per cent, therefore R105 (R250 x 42 per cent) is payable in respect of capital gains tax. (Effective rate of tax = 5,25 per cent)

Other issues of concern to taxpayers

The guide mentioned above expands on other issues that might concern taxpayers, including the effect of capital gains tax on the unit trust, long-term insurance and retirement industries.

Table 4.11 Examples of capital gains tax rates

Taxpayer	Percentage of gain included (1)	Normal tax rate (%) (2)	Effective tax rate (%) (1 X 2)
Individuals	25	0(–)42	0(–)10,5
Retirement funds	25	25	6,25
Unit trusts (Resident funds)	25	30	7,5
Life assurers (Individual policy holder fund)	25	30	7,5
Life assurers (Company policy holder fund)	50	30	15
Life assurers (Corporate policy holder fund)	50	30	15
Life assurers (Untaxed policy holder fund) – retirement fund business	25	25	6,25
Life assurers (Untaxed policy holder fund) – other business	–	–	–
Companies (Not qualifying for any special treatment)	50	30	15

Inclusion rates and effective tax rates

Inclusion rate relief is to be applied to net capital gains only. In the case of a natural person or a special trust, the portion of the gain to be included in taxable income will be 25 per cent, and in the case of a company or trust, 50 per cent. Only this portion of the net capital gain will be subject to normal taxation. The effective capital gains tax rates are set out in Table 4.11.

Indirect tax proposals

Specific excise duties

4% of gross revenue

The specific excise duties on tobacco and alcohol, together with the duty on soft drinks, are significant contributors to the fiscus. In 1999/00 these duties are forecast to raise about 4 per cent of gross revenue. Taxes on tobacco and alcohol are motivated in part by health and public welfare considerations. However, Government is also mindful that these taxes fall more heavily on poorer consumers.

The measures proposed in this Budget, in particular the standstill on sorghum beer and sorghum flour and the lower excise on soft drinks', will reduce the regressivity of these excise duties. Rate increases are proposed to maintain Government's policy on the taxation of tobacco products and to compensate for inflation in respect of duties on alcoholic drinks that are not sorghum based.

R565,1 million additional revenue

The proposed adjustments, which will take effect from 23 February 2000, are summarised in Table 4.12 and set out in detail in Annexure C. The net effect of the changes is R565,1 million in additional revenue in 2000/01.

50% tax incidence on tobacco products

In recognition of health considerations, Government aims to maintain a total (excise plus value-added tax) tax incidence of 50 per cent on all significant forms of tobacco products: cigarettes, hand-rolling and pipe tobacco, and cigars. This policy was announced in the 1994 Budget. The target was reached in 1997 for cigarettes and in 1999 for other tobacco products. Consumption of cigarettes on which tax payment is recorded has declined significantly in this period, from over 36 billion cigarettes in 1993/94 to about 30 billion in 1998/99.

It is proposed to increase excise duty on tobacco products to restore the 50 per cent tax incidence benchmark, following changes in recommended retail prices since the last Budget. The resulting tax increases, set out in Table 4.12, will produce an additional R416,7 million in 2000/01.

Table 4.12 Proposed changes to specific excise duties and additional revenue collections

Product	Current excise duty rate	Proposed increase or decrease in excise duty	Estimated additional revenue R million	Nominal change in excise duty %	Real change in excise duty %
Malt beer	R21,22/ litre of absolute alcohol (36 c/ average 340 ml can)	R1,17/ litre of absolute alcohol (2 c/ average 340 ml can)	151,2	5,5	0
Sorghum beer	7,45 c/ litre	0,0 c/ litre	0	0	-5,5
Sorghum flour	33 c/ kg	0,0 c/ kg	0	0	-5,5
Unfortified wine	64,4 c/ litre	3,5 c/ litre	15,0	5,5	0
Fortified wine	145,6 c/ litre	8,0 c/ litre	0,6	5,5	0
Sparkling wine	178,3 c/ litre	9,8 c/ litre	0,1	5,5	0
Mineral water and soft drinks	12,0 c/ litre	-4,0 c/ litre	-85,0	-33,3	-38,8
Ciders and alcoholic fruit beverages	108,0 c/ litre	5,9 c/ litre	8,5	5,5	0
Spirits	R28,76/ litre of absolute alcohol (R9,27/average 750 ml bottle)	R1,58/ litre of absolute alcohol (51 c/ average 750 ml bottle)	58,0	5,5	0
Cigarettes	245,0 c/ 20 cigarettes	38,0 c/ 20 cigarettes	292,0	15,5	10
Cigarette tobacco	229,0 c/ 50g	91,6 c/ 50g	0,1	40,0	34,5
Pipe tobacco	62,3 c/ 25g	35,0 c/ 25g	122,0	56,1	50,6
Cigars	752,5 c/ 23g	558,3 c/ 23g	2,6	74,2	68,7

5,5% increase in duties on most alcoholic drinks

Government policy is to tax drinks with a high alcohol content, such as spirits, more heavily than drinks with a lower alcohol content, such as beer, wine and cider, and to set rates roughly in line with international benchmarks for wine-producing countries.

This policy has been progressively realized over several years. Table 4.13 shows year-on-year percentage changes in the main drinks duties in real terms since 1994. Duties on sorghum beer (from a very low initial rate), wines and cider have been increased substantially above inflation. Duties on spirits have been raised slightly above inflation, recognising the declining consumption trend. Duty on malt beer has been adjusted broadly in line with inflation.

Structure of alcohol taxes retained

Government will retain, in real terms, the alcohol tax structure achieved in the last Budget. Accordingly, it is proposed to apply an across-the-board increase of the forecast inflation rate (5,5 per cent) to the specific excise duties on malt beer, wines, ciders and spirits. These changes (nil in real terms) will yield an additional R233,4 million.

During 2000/01, SARS and the Department of Finance will review several technical aspects of the alcohol tax structure, including:

- The tax points at which excise liability occurs and becomes payable
- The rebates provided for under Schedule 6 to the Customs and Excise Act of 1964
- The adequacy of current provisions for taxing certain new products such as mixtures of alcoholic drinks and fruit juices

- Whether duty on alcoholic fruit beverages such as cider should be charged at a flat rate, as at present, or in direct proportion to alcoholic content.

Table 4.13 Real percentage year-on-year changes in main alcohol excise duty rates

Budget:	1994	1995	1996	1997	1998	1999	2000
Malt beer	-1,1	0,7	-0,2	1,4	Change in tax base	-1,0	0,0
Sorghum beer	24,2	17,2	1,8	27,9	-7,6	-5,5	-5,5
Unfortified wine	17,0	16,3	9,9	17,5	7,2	0,0	0,0
Fortified wine	0,9	16,0	1,3	17,4	12,4	0,0	0,0
Sparkling wine	16,0	17,3	2,1	17,4	7,0	0,0	0,0
Cider	13,1	16,4	11,3	42,4	28,5	2,5	0,0
Spirits	0,7	1,8	1,8	1,4	2,0	1,0	0,0

No duty increase on sorghum beer and flour

As mentioned earlier, excise taxes on alcoholic drinks are generally regressive. The excise duties on sorghum beer and sorghum flour are the most regressive, as these products are consumed mainly by low-income groups.

It is appropriate for sorghum beer to bear some tax burden, as it has a similar alcohol content (4,2 per cent on average) to malt beer. However, for equity reasons it is proposed to leave the rates of duty on sorghum beer and sorghum flour unchanged in 2000/01. In real terms this represents an excise tax reduction of 5,5 per cent on these products.

4c/l reduction in duty on soft drinks

The specific excise duty on soft drinks and mineral waters is more regressive than excises on alcoholic drinks, except on sorghum beer. Research suggests that, as a proportion of income, the poorest 20 per cent of the population spends about 1,6 times as much as the richest 20 per cent on soft drinks consumed at home. The estimated differential is larger for soft drinks consumed in restaurants and bars.

It is proposed to reduce the excise on soft drinks and mineral waters by a third, from 12,0 to 8,0 cents a litre, at a cost to the fiscus of R85 million in 2000/01. The lower tax burden should benefit consumers and contribute to growth and job creation in the downstream small enterprise sector.

Departure tax on international air travel

Promoting tourism

Tourism-related revenue sources have been analysed in depth since Government's strong commitment to tourism promotion in the 1998 Jobs Summit. The Department of Environmental Affairs and Tourism, as well as several provinces, submitted proposals for levies on the hospitality industry to support tourism growth. However, these proposals would have fragmented tourism promotion.

Additional funding

The Department of Finance has resisted the dedicated allocation of a tourism-related tax to tourism promotion, because such a revenue source would not constitute a market-related user charge and the dedicated funding arrangement would bypass the budget process. It has now been agreed that such a tax would be inappropriate and that additional funding should be made available to the Department of Environmental Affairs and Tourism as a normal budgetary allocation for tourism promotion. In consultation with the provincial MECs and tourism departments, this allocation will be used to support provincial tourism promotion, to maximise international impact and avoid administratively inefficient arrangements.

New R100 a passenger departure tax on international flights

Airport and air travel taxes are widely used as general revenue sources. Given that value-added tax is charged on domestic air travel and not on international travel, the local tax burden on international travel to and from South Africa is moderate. A departure tax on international air travel from South Africa is therefore proposed at a rate of R100 a passenger. As is common international practice, the tax will be payable by the airline carriers, who will recover the cost from travellers as an integral element of ticket prices.

R180 million additional revenue

Some 2,7 million international travellers leave South African airports annually, which means that the tax is expected to raise about R270 million in a full year. For 2000/01, it is proposed that the departure tax be introduced with effect from 1 August 2000, yielding approximately R180 million.

Diesel fuel taxation

The current level of taxation on diesel fuel in South Africa is higher than in some competing countries. It has contributed to downsizing in some fuel-intensive primary production industries. The cost to the economy in terms of the loss of employment and of foreign exchange earnings has necessitated the restructuring of the current diesel fuel tax system.

Fishing industry

The fishing industry is the most intensive user of diesel fuel, with usage estimated at 85 million litres a year, yielding R76 million in fuel taxes. The contribution of fuel levies to total production costs in the fishing sector ranges up to 21 per cent. This cannot be recovered from international markets due to fierce competition and resulted in the suspension of certain fishing activities.

Most other major fishing countries do not require their domestic fishing industries to bear the cost of any fuel levy or similar tax on the consumption of fuel for their vessels. Foreign-flagged vessels, fishing South African resources, using South African ports and targeting the same markets, operate in a fuel tax free environment.

Shipping industry

The total diesel usage by the coastal shipping sector is estimated at 3,87 million litres a year, which translates to R3,5 million in fuel taxes. The total burden to the coastal shipping industry of the diesel fuel imposts is equal to 22 per cent of its vessel operating costs. A significant portion of the diesel fuel imposts is redirected to subsidise road maintenance, road safety and third party insurance. The shipping industry is therefore forced to subsidise its main opposition mode of transport.

Foreign shipping lines that call at South African ports *en route* to their ultimate destinations often bid for inter-port cargo between South African ports. These foreign vessels therefore compete directly with the dedicated South African coastal trading ships, but purchase their diesel free of the South African imposts. They are thereby granted a decisive competitive price advantage over the local shipping industry. The coastal freight charge of these foreign-owned "cross traders" is paid in foreign currency and therefore also affects South African foreign exchange reserves.

Diesel fuel rebate for fishing and coastal shipping

It is therefore proposed that the fishing and coastal shipping industries receive a full diesel rebate of the new general diesel fuel levy of 79,1 cents a litre, the Road Accident Fund levy of 10,3 cents a litre and the Equalisation Fund levy (currently 0 cents a litre). This amounts to a total diesel tax rebate of 89,4 cents a litre. The total cost to the fiscus in terms of fuel taxes foregone is estimated at R79,5 million a year. It is expected, however, that around R18 million will be recovered by way of higher income taxes on the enhanced profits. The commencement date for the fishing and shipping diesel rebate will be 1 June 2000, resulting in a loss to the fiscus of about R66,0 million in 2000/01.

Fuel levy

Current fuel levies

Currently the fuel levy is fixed at 90,6 cents per litre on leaded petrol, 76,1 cents per litre on distillate fuel (diesel) and 84,4 cents per litre on unleaded petrol. Three other imposts on the same tax base include:

- the Road Accident Fund contribution (14,5 c/l for petrol and 10,3 c/l for diesel)
- the Equalisation Fund contribution (0 c/l for petrol and diesel)
- the customs and excise charge of 4 c/l for both petrol and diesel.

Consolidation of the fuel levies

For tax purposes, the consolidated tax amounts to 109,1 c/l on leaded petrol, 102,9 c/l on unleaded petrol and 90,4 c/l on diesel. The possible consolidation of these levies is being considered and a decision in this regard is expected by mid-2000, once the Departments of Transport and Minerals and Energy have completed their respective reviews of the Road Accident Fund and the Equalisation Fund.

Increase in the fuel levy

It is proposed to increase the fuel levy on leaded and unleaded petrol by 5 cents a litre and on diesel fuel by 3 cents a litre with effect from 5 April 2000. The decision to strengthen the levy differential in favour of diesel is due to the fact that diesel constitutes a more efficient fuel than petrol and forms an important intermediate production cost for most primary production sectors. The proposed increases are below the expected inflation rate and will yield an additional R736 million in revenue.

R610 million for National Road Agency appropriation

In terms of a Cabinet decision of 3 December 1997, the National Road Agency will receive appropriations for road construction and maintenance, converted to a dedicated assignment of part of the existing fuel levy. In the 2000 Budget, the national Department of Transport is allocated R610 million for national roads, which translates into a 3,7 c/l share of the total fuel levy.

Other consumption taxes

Value-added tax and ad valorem duties

No changes are proposed in this Budget to the rates or scope of value-added tax, or of the ad valorem customs and excise duties.

Southern African Customs Union

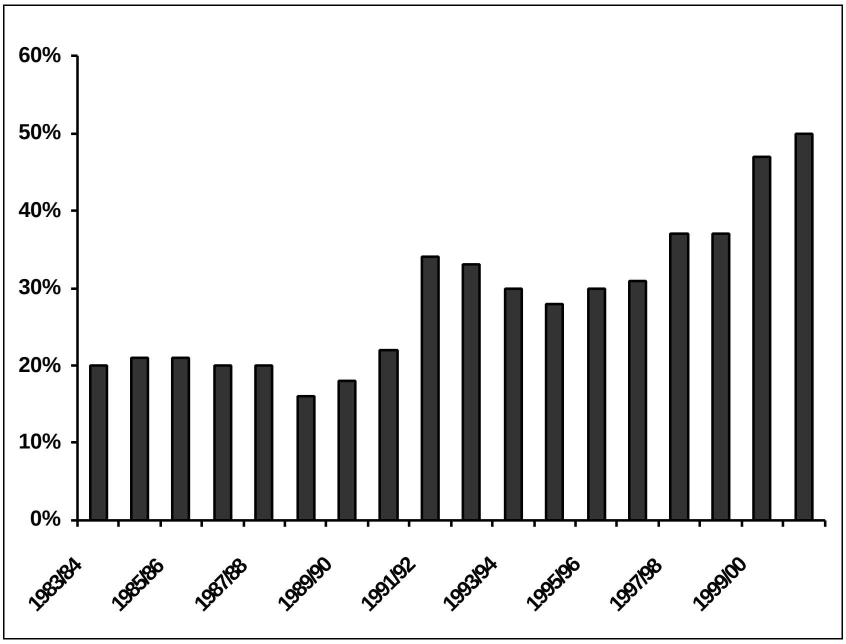
SACU objectives

From its inception, the Southern African Customs Union (SACU) was intended to accomplish diverse objectives. It was considered efficient for countries in the region to share a common administrative infrastructure with South Africa. In return, these countries (currently Botswana, Lesotho, Namibia and Swaziland) were to be compensated for the loss of revenue and fiscal autonomy implied by the creation of a customs union. This required a revenue-sharing formula to allocate shares of the common revenue pool of customs and excise duties. It ended up financing large shares of certain SACU member states' budgets, well above the level that would have pertained on the basis of their imports (see Figure 4.1).

SACU revenue-sharing formula

To maintain fiscal stability, the existing SACU revenue-sharing formula contains stabilisation factors, which guarantee that the revenue shares of Botswana, Lesotho, Namibia and Swaziland should not be less than 17 per cent of the value of all SACU imports and all SACU consumption of excisable goods.

Figure 4.1 Proportion of SACU common revenue pool accruing to BLNS countries



The stabilisation provisions no longer reflect the trading environment in which SACU operates. The trade-weighted tariff rate on SACU imports was reduced dramatically over the last decade, from more than 30 per cent in 1988 to below 7 per cent in 1998. Over the last few years in particular, the revenue shares due to Botswana, Lesotho, Namibia and Swaziland have accelerated, and payments to these countries are scheduled to exceed 50 per cent of the total customs and excise pool in 2000/01. This is clearly unsustainable and negotiations on a new and more equitable revenue-sharing formula have been initiated.

Consolidated revenue

Fiscal integrity

To ensure the integrity of fiscal and financial management of the economy, both the executive and legislative levels of government need to be fully informed of relevant developments in public finances. The budget is an important instrument of accountability in this sense, as are the various audit and reporting requirements to which public entities are subject.

Maintaining fiscal transparency

The Katz Commission recommended that, at the time of the annual budget, the Department of Finance should submit to Parliament a statement of estimated consolidated revenue and expenditure of the entire general government sector, including extra-budgetary funds and agencies. This implies the inclusion of income and expenditure estimates of extra-budgetary entities in terms of the medium-term financial planning requirements of the Department.

Systematic accounting

Chapter 3 of the *Review* contains a summary of estimates and projections of income and expenditure of the national budget, provincial accounts, extra-budgetary accounts and funds, social security funds and local government accounts. The Department of Finance has now embarked on the systematic and comprehensive collection of the information required to compile these aggregated estimates systematically, as part of its commitment to improved financial accountability and transparency. The initial focus on the extra-budgetary social security funds is reflected in Table 4.1, with additional detail provided in Table 3.8.

Unemployment Insurance Fund

Payroll contributions fund unemployment insurance

All employees who earn less than R93 288 a year are expected to contribute 1 per cent of their salary to the Unemployment Insurance Fund, and their employers are required to match this contribution. These contributions effectively constitute a tax of 2 per cent of payroll, the burden of which is shared between employees and employers.

Road Accident Fund

Third party cover funded by tax on fuel

The Road Accident Fund is currently financed through the Road Accident Fund fuel levy of 14,5 c/l on petrol and 10,3 c/l on diesel. The Katz Commission noted reservations about this dedicated financing mechanism in its third report and hinted that this may have contributed to the management and accountability problems experienced in the past. It accordingly recommended that the financing arrangement be re-examined along with the review by the Road Accident Fund Commission of the cash flow management and operation of the Fund. The review should be completed in June 2000.

Workmen's Compensation Fund

Compensation funds financed through assessments

The Workmen's Compensation Fund is the major source of compensation for occupational injuries and diseases. However, employers are allowed to insure themselves against their liabilities to employees independently of the Workmen's Compensation Fund. The mining and construction industries have opted for such separate compensation insurance schemes. The income of these Compensation Funds are derived from assessments that are calculated individually for each employer. These assessments are based on the employment risk profile specific to each employer and currently distinguish 42 risk categories.

Tax structure and incidence

South African tax structure, 1983/84 to 2000/01

Shifts in tax structure

Table 4.14 illustrates the composition of South African tax revenue accruing to national government between 1983/84 and 2000/01. Over this period, the share of direct and indirect taxes in total tax revenue has been relatively stable, with direct taxes accounting for about 58 per cent of total tax revenue. However, marked shifts have occurred within the major revenue categories since 1984:

- The share of total tax revenue contributed by individuals has increased, from 30,1 to 43,2 per cent in 1999/00.
- The share of taxes on companies has fallen from about 17 per cent in the 1980s to around 10 per cent in the 1990s.
- The share of taxes contributed by the gold mining industry has fallen considerably from the peak of 8,9 per cent in 1983/84 (just after the gold price peak in the early 1980s) to a low of 0,1 per cent in 1999/00.
- The broad-based consumption taxes contributed slightly more in the 1990s than in the 1980s. The contribution of excise duties, comprising specific and ad valorem excise duties, is estimated to decline in 1999/00 to about half of the 1983/84 level.
- Levies on fuel (excluding the dedicated fuel levy) have increased as a share of total tax revenue from 0,9 per cent in 1983/84 to 7,6 per cent in 1999/00.

International comparison of tax structure

South Africa in international comparison

International comparisons of the tax mix reflect the position of South Africa relative to other countries, especially those at similar stages of economic development. However, such comparisons must be treated with caution, as many subtle differences in individual tax regimes are not captured in broad comparisons.

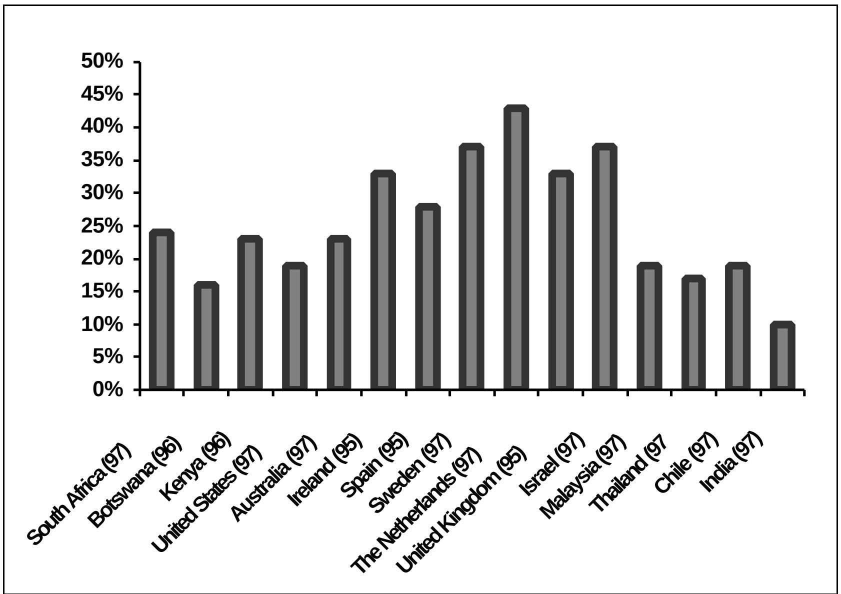
Table 4.14 Composition of national tax revenue

Tax instrument	1983/84	1989/90	1994/95	1999/00	2000/01 (after tax proposals)
	Percentage of total tax revenue				
Direct taxes					
Persons and individuals	30,1	30,9	39,6	43,2	41,1
Gold mines	8,9	1,6	1,0	0,1	0,1
Other mines	1,0	2,8	0,4	0,7	0,8
Companies (other than mines)	17,1	17,0	10,5	10,0	10,6
Secondary tax on companies	0,0	0,0	1,1	1,4	1,0
Tax on retirement funds	0,0	0,0	0,0	2,9	2,7
Donations tax	0,0	0,0	0,1	0,0	0,0
Estate duty / inheritance tax	0,5	0,1	0,1	0,1	0,1
Other	1,7	0,9	1,0	0,7	1,1
Total – Direct taxes	***59,3***	***53,3***	***53,9***	***59,1***	***57,6***
Indirect taxes					
Value-added tax / General sales tax[1]	20,5	25,9	25,8	23,3	24,7
Excise duties	9,3	4,4	5,1	4,6	4,8
Fuel levy	0,9	6,3	7,4	7,6	7,5
Customs duties and import surcharges	6,9	7,4	4,8	3,1	2,9
Marketable securities tax	0,2	0,4	0,4	0,5	0,6
Transfer duties	1,7	1,0	1,2	0,9	0,8
Stamp duties and fees	1,1	1,1	0,8	0,8	0,8
Other	0,2	0,1	0,6	0,2	0,3
Total – Indirect taxes	**40,7**	**46,7**	**46,1**	**40,9**	**42,4**
Total tax revenue	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**

1. Value-added tax replaced the General Sales Tax in 1991.

Figure 4.2 illustrates the ratio of national tax revenue to GDP for a number of countries, including South Africa.

Figure 4.2 Tax-GDP ratios for selected countries



Determinants of tax-GDP ratio

The tax-GDP ratio can be affected by three broad factors. Firstly, countries at higher levels of economic development generally have higher tax-GDP ratios, although there is no consensus on the direction of causality of this relationship. Secondly, the constitutional structure of the jurisdiction can exert an important influence. To reflect the true overall tax burden on individuals in a country, the tax revenue take at all levels of government should therefore be considered. The third factor that influences the tax-GDP ratio is tax policy at national government level.

Lowering tax-GDP ratio

In recent years, there has been a broad trend to reduce the tax-GDP ratio, particularly at national government level. In terms of the medium-term framework outlined in Chapter 3, the tax-GDP ratio is gradually being reduced in South Africa. This will ensure that South Africa remains in line with general international trends, particularly in other developing countries, where the tax-GDP ratios at national government level are generally lower than 25 per cent of GDP.

Tax mix comparisons

A second important dimension of international tax analysis is the composition of national tax revenue, or the balance of contributions from different tax instruments. Table 4.15 outlines the composition of national tax revenues for the same sample of countries as Figure 4.2.

Table 4.15 Composition of national tax revenue in selected countries

		Percentage of total tax revenue			
Country	**Year**	**Income, profits and capital gain**	**Social security**	**Goods and services**	**International trade and transactions**
Botswana	1996	51,3	0,0	11,3	37,2
Kenya	1996	38,9	0,0	43,0	17,1
United States	1997	59,4	34,5	3,6	1,2
Australia	1997	72,6	0,0	22,2	2,6
Ireland	1995	40,9	15,0	40,6	0,0
Spain	1995	32,8	41,4	25,5	0,0
Sweden	1997	12,8	44,8	31,8	0,6
The Netherlands	1997	26,6	44,1	24,3	0,0
United Kingdom	1995	38,9	18,6	35,3	0,1
Israel	1997	42,1	15,7	37,0	0,5
Malaysia	1997	44,4	1,5	32,2	15,4
Thailand	1997	35,5	1,7	47,4	13,5
Chile	1997	21,3	7,3	55,2	9,9
India	1997	29,5	0,0	36,0	34,2
South Africa	**1997**	**58,3**	**1,7**	**37,1**	**0,3**

Source: International Monetary Fund, Government Finance Statistics Yearbook, 1998.

Direct taxes

Jurisdictions differ in the extent to which they rely on various tax instruments to raise national taxes. South Africa can be grouped with countries such as Australia, Botswana, United States, which all raise more than 50 per cent of their tax revenue from taxes on income, profit and capital gains. This contrasts with countries such as Chile, Sweden, India and the Netherlands, which raise less than 30 per cent of their national tax revenue from taxes on income, profit and capital gains. However, the share of taxes raised from income taxes should be seen in conjunction with social security taxes, which are insignificant in South Africa, but important in other countries such as the United States, Spain, Sweden and the Netherlands.

Indirect taxes

In the increasingly open world economy, only a few developed countries still realize significant revenue from taxes on international trade and transactions. Another significant feature of most tax systems in developed countries is the reliance on broad-based domestic consumption taxes, (e.g. sales taxes, value-added tax and excise duties).

Tax incidence analysis

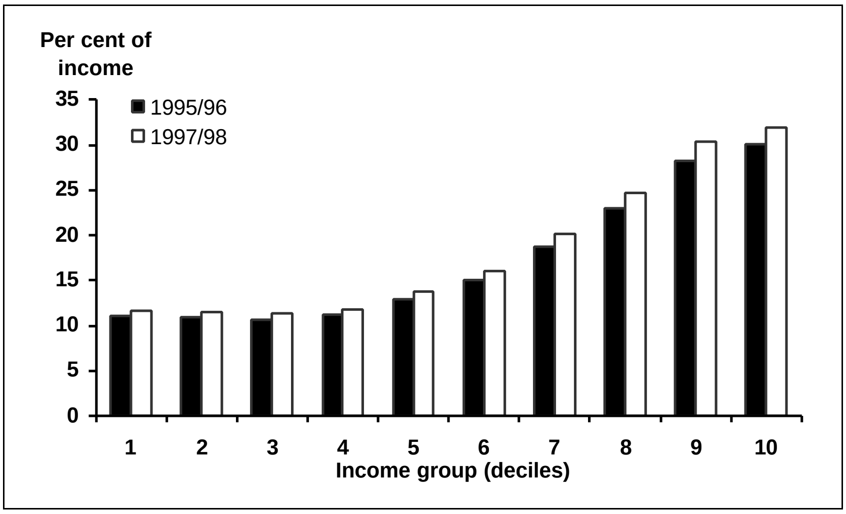
Who bears the tax burden?

Tax incidence analysis investigates which taxpayers bear the burden of taxation in a particular jurisdiction. Incidence studies are critical to determining whether the broad spectrum of government policies are effectively targeted to meet distributional objectives. By late 1999, the Department of Finance commissioned a tax and expenditure incidence study, the preliminary results of which are reported here (the results of the expenditure incidence analysis are reported in Chapter 7).

Four main taxes reviewed

The study focused on four major tax instruments – the personal income tax, the value-added tax, specific excise taxes and the fuel levy. The broad goal of the study (using limited methodological techniques and data) was to determine how the distribution of these taxes is shared among households at different income levels over time.

Figure 4.3 Distribution of tax burden by income group



Tax regime is broadly progressive

The results are depicted in Figure 4.3, which shows the tax burden on each income group from the four taxes analysed, expressed as a percentage of total income, for the 1995/96 and the 1997/98 tax year. In Figure 4.3, average income increases from income group 1 to 10. The South African tax regime is broadly progressive in that the average tax rate rises as income rises. The highest income group pays approximately 30 per cent of their income on the four taxes included in the study, while the lowest income group pays just over 11 per cent.

In respect of the four individual taxes, the results indicate the following general patterns:

- The personal income tax is strongly progressive.
- The fuel levy is mildly progressive.
- The value-added tax is mildly regressive.
- The excise duties on alcohol, tobacco products, soft drinks and mineral water are strongly regressive.