4

Revenue issues and tax proposals

Buoyant growth in tax revenue provides scope for tax reforms to complement other fiscal and macroeconomic initiatives aimed at encouraging economic growth and social development. Measures announced in the 2001 Budget will stimulate economic activity by:

- *Raising personal disposable income through income tax cuts.*
- *Promoting employment creation through a wage incentive.*
- *Encouraging investment in the small business sector and for specific strategic investment projects through investment tax allowances.*
- *Enhancing the competitiveness of the primary production sector by providing a diesel fuel tax concession.*
- *Reducing energy costs for the poor by zero-rating VAT on illuminating paraffin.*

Overview

Tax reform is an integral part of the overall fiscal strategy. Steady economic growth accompanied by buoyant tax revenues has enabled Government to reduce fiscal deficits and increase spending on vital public goods and services.

Since 1994, considerable attention has been given to improving revenue administration and collection through the autonomous South African Revenue Service (SARS). The enhancement of SARS's revenue collection capacity has been accompanied by a fundamental review of tax policy that led to structural changes to the income tax in 2000.

Tax reform to promote economic growth and development

These measures are critical to improving the efficiency, equity and international attractiveness of the tax regime. At the same time, real tax cuts have released resources for private sector investment and consumption, further enhancing the medium-and long-term growth potential of the economy.

The 2000 *Medium Term Budget Policy Statement* set out Government's objectives for tax reform over the next three fiscal years. The key tax policy measures proposed in this Budget include:

- R8,3 billion in personal income tax cuts
- R600 million for a wage tax incentive
- Raising the annual interest and dividend income exemption by R1 000
- Reducing the estate duty and donations tax rates
- Raising provisional income tax thresholds
- Investment incentives for strategic investment projects
- Accelerated depreciation for small business investment
- Depreciation allowances for certain airport infrastructure
- Closing corporate income tax loopholes
- Extending the VAT zero-rate to illuminating paraffin
- Increasing excise duties on tobacco products and alcoholic beverages
- Below-inflation increases in the fuel levy
- Extending the diesel fuel concession to the primary production sector for off-road diesel consumption
- Reform of the *ad valorem* customs and excise duties

The residence-based income tax announced in the 2000 Budget was implemented from 1 January 2001. It is proposed that capital gains tax should be implemented from October 2001.

Consolidated revenue estimates

Table 4.1 sets out consolidated national budget revenue for 1999/00 to 2003/04.

Table 4.1 Consolidated national revenue, 1999/00 – 2003/04

	1999/00	2000/01		2001/02	2002/03	2003/04
R million	**Preliminary outcome**	**Budget estimate**	**Revised estimate**	**Medium-term estimates**		
Total tax revenue	200 959	213 689	216 786	236 808	256 959	279 092
Non-tax revenue[1]	4 817	5 107	4 996	4 835	5 019	5 195
Less: SACU payments	7 197	8 396	8 396	8 205	9 127	11 165
Main budget revenue	**198 578**	**210 400**	**213 386**	**233 438**	**252 851**	**273 122**
Percentage of GDP	24,5%	23,8%	23,8%	23,6%	23,6%	23,6%
Social security funds						
Tax revenue	7 008	6 887	6 727	7 183	7 528	7 862
Non-tax revenue	750	1 750	1 077	1 221	1 283	1 341
Total social security revenue	**7 758**	**8 638**	**7 804**	**8 404**	**8 811**	**9 204**
National revenue	**206 336**	**219 018**	**221 190**	**241 842**	**261 662**	**282 326**
RDP fund receipts and technical co-operation	861	800	978	800	800	800
Consolidated national revenue[2]	**207 181**	**219 818**	**222 150**	**242 615**	**262 443**	**283 106**

1. *Includes non-tax current revenue, capital revenue, recoveries of loans and advances and grants.*
2. *Transfers between funds have been netted out.*

Consolidated national revenue consists of main budget revenue, social security fund revenue and RDP fund receipts and technical co-operation. It is estimated that consolidated revenue will be R222,2 billion in 2000/01 or R2,3 billion more than the 2000 Budget estimate. This is estimated to grow at about 8,4 per cent a year between 2000/01 and 2003/04.

Consolidated national revenue up by R2,3 billion

Tax administration

SARS has made significant progress in enhancing its administrative capacity and overcoming important challenges to tax collection. Tax collections in 2000/01 are estimated to exceed the 2000 Budget estimate by 1,4 per cent, which is partly attributable to improvements in revenue collection.

Enhanced administrative performance facilitates growing revenue

Key achievements

In 2000, SARS was tasked with implementing the most extensive set of tax reforms in South African history, including the residence-based income tax system. Other achievements included:

Key achievements in 2000/01

- The implementation of new trade agreements
- A successful campaign against tax fraud in the retail industry
- The launch of a major internal restructuring programme known as Siyakha.

Siyakha project

The Siyakha ("we are building") project will be piloted in KwaZulu-Natal during 2001. It is expected to improve service for taxpayers and ensure a sustained crackdown on tax evaders, building on recent successes in this area. This is made possible by more efficient use of resources achieved through the re-organisation of work processes and introducing new technologies. Siyakha underpins SARS's efforts consistently to meet and exceed collection targets, improve border controls and facilitate international trade.

Siyakha project to improve service levels

New profile

Over the next three years, SARS's profile will change considerably. It will operate from six processing centres, seven compliance centres, and more than 45 service centres, in addition to the 47 customs ports of entry.

Organisational restructuring

Processing centres will be responsible for the registration of taxpayers, file management, assessments and payments, refund checking and account maintenance. Economies of scale, re-engineered processes, and the introduction of team-based work will reduce costs, improve turn-around times and eliminate backlogs.

Processing centres to manage taxpayer service

Compliance centres will undertake collections, audits and special investigations. SARS intends to double the number of auditors in these centres. Additional capacity will come from specialists with industry-specific expertise and from sophisticated risk-profiling

Compliance centre to improve collection software. Integrated audits and a new emphasis on field audits will further enhance efficiency.

Service centres focus on taxpayer education

Service centres will focus on educating South Africans about their tax obligations to improve compliance. Previously neglected communities and key players in the cash economy will receive special attention.

Other efficiency-enhancing initiatives include:

- An "electronic filing" project that allows for the electronic processing of bills of entry and the electronic submission of tax returns
- Introducing call centres to improve taxpayer query response times and to enable more effective debt recovery

In addition, a new focus on customs and excise control includes:

- Introducing a duty-at-source policy under which excise duty is payable at the point of manufacture, instead of at the point of sale
- Electronic processing of bills of entry
- An inventory management system for bonded warehouses, which facilitates inspections and reduces opportunities for fraud
- Increasing customs controls on goods in transit and on exports

Legislative programme

Last year, the Revenue Laws Amendment Act, 2000 and the Taxation Laws Amendment Act, 2000 were introduced to give effect to the tax reforms announced in the Budget. It is envisaged that at least three Bills will be tabled in 2001. These will include changes to give effect to the capital gains tax, to enable Siyakha-related changes to the way SARS conducts business, to allow SARS to collect Unemployment Insurance Fund contributions and to implement the Budget proposals.

National budget revenue

Table 4.2 reviews the budget estimates and projected outcomes for the major revenue instruments for 1999/00 and 2000/01. Additional detail is given in Annexure B, Tables 2 and 3.

Preliminary outcome, 1999/00

R7,1 billion more tax revenue in 1999/00

In the 1999 Budget, it was estimated that Government would raise R193,9 billion in tax revenue. This was revised at the time of the 2000 Budget to R199,6 billion. Preliminary indications show that actual tax collections have exceeded the budget estimate by R7,1 billion, 3,6 per cent, over the 1999 Budget estimate.

Main Budget Revenue R7,7 billion more

Main budget revenue, including tax and non-tax revenue and providing for payments to SACU member states, is anticipated to be R7,7 billion more than the 1999 Budget estimate.

Table 4.2 Budget estimates and revenue outcome, 1999/00 and 2000/01

R million	1999/00 Budget Estimate	1999/00 Outcome	1999/00 Deviation	2000/01 Budget Estimate	2000/01 Revised estimate	2000/01 Deviation	99/00 – 00/01 change (%)
Taxes on income and profits, including:	**111 680**	**116 504**	**4 824**	**121 303**	**122 925**	**1 622**	**5,5**
Personal income tax	82 650	85 954	3 304	87 821	86 400	-1 421	0,5
Company taxes	21 576	21 263	-313	24 583	26 025	1 442	22,4
Secondary tax on companies	1 700	2 640	940	2 100	3 800	1 700	43,9
Tax on retirement funds	5 100	5 834	734	5 800	5 800	0	-0,6
Other	654	813	159	1 000	900	-100	10,7
Taxes on payroll and workforce[1]	**0**	**0**	**0**	**1 400**	**1 300**	**-100**	**-**
Taxes on property	**2 885**	**3 812**	**927**	**3 338**	**4 004**	**666**	**5,0**
Domestic taxes on goods and services, including:	**71 075**	**72 248**	**1 173**	**79 448**	**78 868**	**-580**	**9,2**
Value-added tax	47 200	48 330	1 130	52 858	54 000	1 142	11,7
Excise duties	9 350	9 470	120	10 210	9 721	-489	2,6
Levies on fuel	14 444	14 290	-154	15 970	14 900	-1 070	4,3
Other	81	158	77	411	247	-164	56,3
Taxes on international trade and transactions	**6 625**	**6 777**	**152**	**6 500**	**8 189**	**1 689**	**20,8**
Stamp duties and fees	**1 621**	**1 619**	**-2**	**1 700**	**1 500**	**-200**	**-7,4**
Total tax revenue	**193 886**	**200 959**	**7 073**	**213 689**	**216 786**	**3 097**	**7,9**
Non-tax current revenue	3 546	4 701	1 155	3 846	4 870	1 024	3,6
Capital revenue	21	42	21	386	35	-351	-16,7
Recoveries of loans and repayments	644	74	-570	875	90	-785	21,6
Less: SACU payments	7 197	7 197	0	8 396	8 396	0	16,7
Main budget revenue	**190 900**	**198 578**	**7 678**	**210 400**	**213 386**	**2 986**	**7,5**

1. Skills development levy introduced on 1 April 2000 at a rate of 0,5 per cent on payroll, raised to 1 per cent from 1 April 2001.

These increases are mainly attributable to higher receipts from:

- Personal income taxes – R3,3 billion
- Secondary tax on companies – R940 million
- Tax on retirement funds – R734 million
- Taxes on property – R927 million
- Value-added tax – R1,1 billion
- Non-tax current revenue – R1,2 billion.

Revised estimates 2000/01

The 2000 Budget estimate for total tax revenue was R213,7 billion, after taking account of the tax proposals. Main budget revenue was estimated to be R210,4 billion.

In the *Medium Term Budget Policy Statement*, a preliminary revised estimate of revenue for 2000/01 was presented. At that time, it was estimated that total tax revenue would be R215,7 billion, or R2 billion more than estimated in the 2000 Budget. The estimate of main budget revenue was also revised upward to R212,2 billion.

Estimate of tax revenue revised upward by 1,4 per cent

Taking account of changes to the macroeconomic projections, changing revenue collection trends and adjustments made in the course of implementing tax policy changes, the estimate of total tax revenue has been raised by 1,4 per cent over the original estimate to R216,8 billion. This is 7,9 per cent more than the preliminary outcome for 1999/00.

Main budget revenue is anticipated to be R213,4 billion, which is about R3 billion more than the original budget estimate. These revised estimates are discussed in more detail below.

Taxes on income and profits

Personal income tax R1,4 billion lower

Estimated revenue from personal income tax is reduced by R1,4 billion. This reduction is mainly due to slower than anticipated growth in current income received by individuals. Receipts are also reduced because of higher than anticipated refunds.

R1,4 billion more in company taxes

Taxes from companies, including mining companies, are estimated at R26 billion, which is R1,4 billion, or 5,9 per cent more than the original budget estimate. The 22,4 per cent increase over the 1999/00 preliminary outcome can be attributed to robust growth in corporate earnings and improved audits and collection by SARS.

R1,7 billion more STC

Estimates of revenue from secondary tax on companies have been revised upward to R3,8 billion from the original budget estimate of R2,1 billion. The revised estimate represents 43,9 per cent growth on the 1999/00 preliminary outcome. This rapid growth has resulted from considerably higher corporate earnings distributions and receipts associated with restructuring transactions.

R5,8 billion from retirement fund tax

The tax on retirement funds is anticipated to raise R5,8 billion, marginally lower than the 1999/00 outcome and about in line with the original budget estimate.

Taxes on payroll – skills development levy

Skills development levy R100 million lower than budgeted

The estimate of revenue from the skills development levy, which was levied at a rate of 0,5 per cent of payroll from 1 April 2000 has been revised down by R100 million to R1,3 billion. This is mainly due to delays between the introduction of the levy and the cash flows to the fiscus.

Taxes on property

Taxes on property 20 per cent higher than Budget estimate

Estimated taxes on property have been revised to R4,0 billion. This is 5 per cent higher than the 1999/00 preliminary outcome, which included a non-recurring demutualisation charge of R577 million. The increase is largely attributable to increased estimates for transfer duties and estate duty receipts, which have been revised upward by 33 and 47 per cent respectively since the 2000 Budget.

Domestic taxes on goods and services

The value-added tax is anticipated to raise R54 billion or R1,1 billion more than estimated in the 2000 Budget. This is 11,7 per cent higher than the preliminary outcome for 1999/00. This increase can be ascribed to higher growth in private consumption expenditure, which has been buoyed by income tax reductions. Improved audit and enforcement by SARS have also contributed to improved VAT collections.

Solid growth in VAT revenue

The revised estimate for revenue from excise duties is R9,7 billion. Specific excise duties account for R9,0 billion of this, which is 5,6 per cent lower than the budget estimate. Growth in consumption of excisable products was slower than anticipated at the time of the budget, mainly due to structural shifts in household consumption patterns.

R9,7 billion from excise duties

The revised estimate of revenue from levies on fuel is R1,1 billion lower than the budget estimate, though it is still R610 million more than the 1999/00 preliminary outcome. This can largely be attributed to the declining sales resulting from the rapid increases in the fuel price over the period.

Lower fuel consumption reduces revenue

Taxes on international trade and transactions

Taxes on international trade and transactions are estimated at R8,2 billion. This increase of R1,7 billion over the original budget estimate arises from higher than anticipated receipts from customs duties and can mainly be ascribed to increases in the value of imports by about 24 per cent, due to the depreciation of the rand.

Strong growth in customs duties

Revenue trends, 1997/98 – 2003/04

Table 4.3 sets out actual collections for 1997/98 and 1998/99, the preliminary outcome for 1999/00, the revised estimate for 2000/01 and the forward estimates for 2001/02 to 2003/04. More detail regarding these data is contained in Tables 2 and 3 of Annexure B.

Between 1997/98 and 2000/01, main budget revenue grew at an annual average rate of 9,3 per cent, or 2,5 per cent in real terms. Revenue from income taxes has grown at a nominal annual average rate of 9,0 per cent and taxes on domestic goods and services at an annual average of 9,2 per cent. South Africa’s continued opening up to international trade can be seen in the robust growth of taxes on international trade and transactions, which increased at an annual average rate of 13,2 per cent, despite some easing of tariffs.

9,3 per cent average nominal revenue growth from 97/98 – 00/01

Over the medium-term, nominal total tax revenue and nominal main budget revenue are forecast to grow at an annual average rate of 8,8 and 8,6 per cent respectively. The estimates of tax revenue take account of policy changes announced in the 2001 Budget and forecasts of key macroeconomic variables for the period 2001/02 to 2003/04.

Continued revenue stability in the medium-term

Table 4.3 Main budget revenue, 1997/98 – 2003/04

R million	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
	Actual collections		Preliminary outcome	Revised estimate	Medium- term estimates		
Taxes on income and profits	95 004	108 433	116 504	122 925	131 582	143 641	157 608
Taxes on payroll and workforce	-	-	-	1 300	2 800	3 000	3 200
Taxes on property	2 618	2 831	3 812	4 004	4 709	5 127	5 540
Domestic taxes on goods and services	60 512	66 101	72 248	78 868	86 705	92 673	98 691
Taxes on international trade and transactions	5 639	6 173	6 777	8 189	9 427	10 792	12 188
Stamp duties and fees	1 484	1 490	1 619	1 500	1 585	1 726	1 865
Total tax revenue	**165 256**	**185 027**	**200 959**	**216 786**	**236 808**	**256 959**	**279 092**
Non-tax current revenue	3 161	3 159	4 701	4 870	4 712	4 884	5 050
Capital revenue	18	27	42	35	30	33	35
Recoveries of loans and repayments	123	780	74	90	93	102	110
Grants	169	456	-	-	-	-	-
Less: SACU payments	5 237	5 122	7 197	8 396	8 205	9 127	11 165
Main budget revenue	**163 491**	**184 328**	**198 578**	**213 386**	**233 438**	**252 851**	**273 122**
Per cent of GDP	23,4%	24,6%	24,5%	23,8%	23,6%	23,6%	23,6%
Gross domestic product	*698 128*	*748 988*	*811 884*	*897 900*	*987 200*	*1 069 300*	*1 154 900*

Estimates of revenue before tax proposals

Table 4.4 sets out the estimates of revenue, based on the macroeconomic assumptions set out in Chapter 2 and the existing tax structure. These estimates are set out in detail in the Estimate of Revenue for the Financial Year ending 31 March 2002.

Before tax proposals, revenue to grow 12,2 per cent

Based on the macroeconomic forecasts set out in Chapter 2, before any tax changes, main budget revenue is estimated to be R239,5 billion. Total tax revenue is anticipated to increase by 12 per cent, with personal income tax revenue estimated to grow by 14,6 per cent, given the existing income tax rates and brackets. Taxes on domestic goods and services, comprised primarily of the VAT, excise taxes and the fuel levy are anticipated to grow moderately to R84,4 billion from the revised estimate for 2000/01 of R78,9 billion.

Table 4.4 Estimates of revenue before tax proposals, 2001/02

R million	2000/01 Revised estimate	2001/02 Before tax proposals	Percentage change (%)
Taxes on income and profits	**122 925**	**139 600**	**13,6**
Personal income tax	86 400	99 000	14,6
Company tax	26 025	29 100	11,8
Secondary tax on companies	3 800	4 200	10,5
Tax on retirement funds	5 800	6 300	8,6
Other	900	1 000	11,1
Taxes on payroll and workforce	**1 300**	**2 800**	**115,4**
Taxes on property	**4 004**	**4 760**	**18,9**
Domestic taxes on goods and services	**78 868**	**84 413**	**7,0**
Value-added tax	54 000	59 000	9,3
Excise duties	9 721	9 793	0,7
Levies on fuel	14 900	15 200	2,0
Other	247	420	70,0
Taxes on international trade and transactions	**8 189**	**9 690**	**18,3**
Stamp duties and fees	**1 500**	**1 600**	**6,7**
Total tax revenue	**216 786**	**242 863**	**12,0**
Non-tax current revenue	4 870	4 711	-3,3
Capital revenue	35	30	-14,3
Recoveries of loans and repayments	90	93	3,3
Less: SACU payments	8 396	8 205	-2,3
Main budget revenue	**213 386**	**239 493**	**12,2**

Summary effects of tax proposals

Tax reform to support economic growth

Tax proposals set out here consolidate the fundamental tax changes introduced in the 2000 Budget. Buoyant tax revenue and steady economic growth underpin the tax reform measures proposed. These include:

- Further restructuring of the personal income tax to reduce the burden of tax on individuals, particularly in the lower- and middle-income brackets. In addition, the annual interest and dividend income exemption is raised by R1 000.
- Developing economically and administratively efficient tax measures to reduce the cost of employment and encourage job creation.
- Investment incentives for strategic investment projects and a more generous depreciation regime for small businesses.
- Diesel fuel concessions for the primary production sector that will improve competitiveness, especially in export markets.
- Restructuring the *ad valorem* excise system and reducing duties with the expectation of lowering prices to consumers.
- Zero-rating VAT on illuminating paraffin to help alleviate poverty, especially for the rural poor.

Table 4.5 sets out the anticipated revenue effects of the 2001 Budget tax proposals.

The net effect of these proposals is a reduction in tax revenue of R9,1 billion from the estimate of revenue before tax proposals. It is anticipated that R3 billion of this reduction will be recovered through improved collections, as SARS enhances its audit and administrative capacity.

Table 4.5 Summary effects of tax proposals

R million	Effect of tax proposals	Improved revenue collection	Revenue gain (+) Revenue loss (-)
Tax revenue			242 863
Non-tax revenue			4 835
Less: SACU payments			-8 205
Main budget revenue, before tax proposals			**239 493**
Budget 2001/02 proposals	**-9 055**	**3 000**	
Direct tax proposals[1]	**-9 319**		
Personal income tax adjustments	-8 308	350	
Wage incentive	-600		
Interest and dividend income exemption	-160,0		
Raising provisional tax threshold: taxpayer age 65 and over	-20,0		
Raising provisional tax threshold: individuals	-140,0		
Reducing estate duty and donations tax	-51,0		
Company income tax		900	
Small business depreciation	-40,0		
Indirect tax proposals	**264**		
VAT		1 750	
VAT zero-rating of illuminating paraffin	-400		
Specific excise taxes: Net Impact	*779*		
Increase in duties on beer (6%)	163		
Increase in duties on sorghum beer and sorghum flour (5%)	1		
Increase in duties on fortified wine (10%)	4		
Increase in duties on sparkling wine (10%)	1		
Increased duties on unfortified wine (10%)	20		
Increase in duties on cider (6%)	13		
Increase duties on spirits (10%)	129		
Increase in excise duties on tobacco products (50% incidence)	490		
Decrease in duties on soft drinks (-2c/l)	-42		
Diesel fuel concession	-253		
General fuel levy (2,4c/l on leaded and unleaded petrol)	254		
General fuel levy (1,9c/l on diesel)	109		
Restructuring of *ad valorem* excise duties	-210		
Removing stamp duties on certain items	-15		
Main budget revenue (after tax proposals)			**233 438**

1. Estimates of revenue from capital gains tax are included in the income tax estimates, as the capital gains tax forms part of the general income tax.

Direct tax proposals

Residence-based income tax

Residence-based income tax from 1 January 2001

From 1 January 2001, South Africa's source-based income tax system was replaced by a residence-based income tax. Under this regime, South African residents are taxed on their income, irrespective of where in the world that income is earned. Appropriate measures are in place to avoid potential double taxation on income earned outside South Africa. These are complemented by South Africa's extensive network of agreements for the avoidance of double taxation, which are listed in the box below.

International tax agreements

In the 2000/01 fiscal year, considerable progress was once again made in reaching agreements with other countries for the avoidance of double taxation in respect of income accruing to South African taxpayers from foreign sources or to foreign taxpayers from South African sources. The present position is as follows:

- Comprehensive agreements are in place with Algeria, 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, Luxembourg, Malawi, Malta, Mauritius, Namibia, the Netherlands, Norway, Pakistan, the People's Republic of China, Poland, Romania, the Russian Federation, Singapore, the Slovak Republic, Swaziland, Sweden, Switzerland, Thailand, Tunisia, the United Kingdom, the United States of America, Zambia and Zimbabwe. The treaty with the United Kingdom extends also to Grenada, the Seychelles and Sierra Leone.
- Limited sea and air transport agreements exist with Brazil, Greece, Portugal and Spain.
- Comprehensive agreements have been ratified in South Africa with Greece, Nigeria 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, Bulgaria, Estonia, Ethiopia, Gabon, Germany, Kuwait, Latvia, Lithuania, Malawi, Malaysia, Morocco, the Netherlands, New Zealand, Oman, Portugal, Spain, Swaziland, Tanzania, Turkey, Ukraine, the United Arab Emirates, the United Kingdom, Zambia and Zimbabwe.
- Comprehensive agreements are being negotiated or renegotiated but have not been finalised with Bangladesh, Mozambique, Qatar, and Sri Lanka. Where treaties are being renegotiated, the existing treaties remain effective until a new agreement is finalised.
- A number of other countries have expressed the desire to negotiate double taxation agreements with South Africa.

Agreements for 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. During the period under review, the text of agreements with the Netherlands and Norway was finalised. It is envisaged that a comprehensive network will be established in the future, as a number of other countries have expressed the desire to negotiate similar agreements.

International VAT agreements

During the period under review, an agreement for the avoidance of double taxation, exchange of information and mutual assistance on VAT was signed with Lesotho. Another is in the negotiation phase with Malawi and a number of other countries in Southern Africa have expressed the desire to negotiate similar agreements.

Globalisation demands changes

The residence-based income tax system broadens the tax base, ensuring that all South African residents contribute to the cost of providing public goods and services, according to their ability to pay. Furthermore, South Africa's rapid reintegration into the world economy requires a tax system able to keep pace with the impact of globalisation on domestic tax bases – in particular e-commerce and enhanced international factor mobility.

Capital gains tax

Capital gains tax announced in 2000 Budget

In the 2000 Budget, it was announced that a capital gains tax would be introduced from 1 April 2001. Preliminary proposals were set out in the *Guide to Capital Gains Tax*. After reviewing the public submissions received, and conducting intensive discussions with a number of stakeholders, the capital gains tax proposals have been translated into draft legislation currently before Parliament.

Thorough review by Parliament

The thorough review by the Parliamentary Portfolio Committee on Finance of the capital gains tax has added significantly to the broad consultation process that Government has followed in developing effective legislation.

Correcting structural weaknesses in income tax

The absence of a capital gains tax has long been a structural weakness of the South African tax system, especially in view of the inequalities of income and wealth distribution and the sophistication of South Africa's financial markets. The introduction of this tax is part of a broad tax reform effort that enhances the South African tax system in line with the central objectives of tax policy.

Benefits to South African tax system

Capital gains tax will:

- Enhance the efficiency of the income tax system by reducing the incentive to convert ordinary income into tax-free capital gains.
- Improve the equity of the tax system by ensuring taxpayers with similar income levels bear a similar burden of taxation, regardless of the form in which their income is received. To the extent that capital gains accrue primarily to upper income taxpayers, the progressivity of the income tax and, hence, vertical equity of the tax system is also enhanced.
- Raise revenue directly through taxing capital gains and indirectly by protecting the integrity of the income tax base. It is estimated that once the tax is fully operational, it could raise about R1 to R2 billion a year directly. This provides scope to advance Government's overall tax reform strategy of broadening tax bases and reducing statutory tax rates.
- Reduce distortions of real economic activity so that risk capital is allocated more efficiently, through the proposed capital loss offsetting rules.
- Bring the South African tax regime into line with the many other countries that tax capital gains.

Effective from 1 October 2001

It is proposed that the effective date for implementation of the capital gains tax be postponed until 1 October 2001. This will provide sufficient time for taxpayers, particularly the financial services industry, to develop and implement necessary management information systems.

The box below outlines the key design features of the capital gains tax.

Overview of capital gains tax

- Residents are subject to the tax on the disposal of their assets held worldwide, while non-residents are taxed on certain assets in South Africa.
- Capital gains tax will not apply to retirement funds until a holistic review of retirement fund taxation is complete.
- "Assets" include property of whatever nature, whether movable or immovable, corporeal or incorporeal.
- Gains accruing after 1 October 2001 will be subject to the tax, which will be levied on a realisation basis. Realisation occurs on disposal of an asset. Death, emigration and donation of an asset are deemed to be disposals.
- The first R10 000 a year of capital gain or loss realised by individuals is excluded.
- Certain exemptions apply to primary residences, personal use assets, assurance and retirement benefits, assets of a small business disposed of for retirement, compensation for personal injury, lottery receipts, foreign currency converted for personal use, diplomats and diplomatic missions, gains arising on assets donated to certain public-benefit organisations.
- Rollover relief is provided for assets in certain circumstances, e.g. certain transfers between spouses or involuntary disposals.
- Capital gains will be taxed with other income, with a portion of the net capital gain being included in taxable income, depending on the nature of the taxpayer. The following rates will apply:

Taxpayer	Inclusion rate (%)	Statutory rate (%)	Effective rate (%)
Individuals	25	0 – 42	0 – 10,5
Trusts			
Unit	-	30	-
Special	25	0 – 42	0 – 10,5
Other	50	32 – 42	16 – 21
Companies			
Ordinary	50	30	15
Small business corporation	50	15 – 30	7,5 – 15
Permanent establishment	50	35	17,5
Employment company	50	35	17,5
Life assurers			
Individual policyholder fund	25	30	7,5
Company policyholder fund	50	30	15
Untaxed policyholder fund	-	-	-
Corporate fund	50	30	15

Personal income tax

Personal income tax relief resulting from the restructuring of income tax brackets amounts to R8,3 billion.

Income tax rate and bracket adjustments

The income tax rates and brackets are amended and are set out in Table 4.6. The primary focus in adjusting the rate brackets is to provide relief to middle-income taxpayers, with considerable relief granted to lower income taxpayers through increases in the primary and secondary rebates.

The main amendments are:

- The primary rebate for individuals is increased by 8,9 per cent from R3 800 to R4 140, increasing the threshold for taxpayers under age 65 to R23 000.
- The secondary rebate is increased to R3 000, raising the threshold for taxpayers age 65 and over to R39 154, or by 7,2 per cent.
- The brackets are adjusted and the existing rates retained.

Table 4.6 Personal income tax rate and bracket adjustments

2000/01		2001/02	
Taxable income (R)	**Rates of tax**	**Taxable income (R)**	**Rates of tax**
0 – 35 000	18% of each R1	0 – 38 000	18% of each R1
35 001 – 45 000	R6 300 + 26% of the amount above R35 000	38 001 – 55 000	R6 840 + 26% of the amount above R38 000
45 001 – 60 000	R8 900 + 32% of the amount above R45 000	55 001 – 80 000	R11 260 + 32% of the amount above R55 000
60 001 – 70 000	R13 700 + 37% of the amount above R60 000	80 001 – 100 000	R19 260 + 37% of the amount above R80 000
70 001 – 200 000	R17 400 + 40% of the amount above R70 000	100 001 – 215 000	R26 660 + 40% of the amount above R100 000
200 001 and above	R69 400 + 42% of the amount above R200 000	215 001 and above	R72 660 + 42% of the amount above R215 000
Rebates		**Rebates**	
Primary	R3 800	Primary	R4 140
Secondary	R2 900	Secondary	R3 000
Tax threshold		**Tax threshold**	
Below age 65	R21 111	Below age 65	R23 000
Age 65 and over	R36 538	Age 65 and over	R39 154

Tax relief mainly for low and middle income earners

These rate and bracket adjustments provide real tax relief to all taxpayers, but particularly for those in the middle income group earning between R50 000 and R100 000. Further, the increase in the primary rebate by R340 will ease the tax burden for individuals in the lower-income category. By raising the income tax threshold by about 9 per cent, a number of taxpayers currently paying income tax will not in 2001/02.

Improving efficiency and equity

The personal tax cuts seek to ensure that ordinary South Africans benefit from prudent fiscal management and buoyant revenue collections. These tax cuts and further measures to reduce statutory tax rates, while broadening bases, enhance the efficiency and equity of the South African tax system.

Wage incentive

Fiscal system focussed on reducing poverty

Alleviating poverty and securing a more equitable distribution of income, wealth and resources are critical challenges facing Government. Since 1994, a variety of measures have been introduced to reduce the incidence of poverty in the short-term, while building medium-term capacity for sustainable growth and development.

Addressing poverty through job creation

In the 2001 Budget, Government is expanding its efforts to address poverty through job creation and economic growth. Expenditure programmes on basic economic and social infrastructure provide an enabling environment for human capacity development and employment creation. The National Treasury and SARS are investigating economically and administratively efficient tax measures that will:

- Encourage job creation by reducing the cost of hiring new workers and of offering learnerships.
- Encourage the formalisation of employment that is currently in the informal sector. This will have positive effects on other government programmes – for example, the UIF - and ensure their benefits are more widely available.

It is envisaged that this tax relief measure will be fully operational from 1 October 2001 and will result in a revenue loss of R600 million in 2001/02.

Skills development levy

Skills development levy increase to 1 per cent

On 1 April 2000, a skills development levy was introduced. This levy is used to fund training and education programmes. It was initially set at 0,5 per cent of payroll and is increased to 1 per cent from 1 April 2001. The levy increase is expected to raise collections from R1,3 billion in 2000/01 to R2,8 billion in 2001/02.

Interest and dividend income exemption

Exemption raised by R1 000

In the 2000 Budget, the interest and dividend income exemption was raised from R2 000 for all taxpayers to R3 000 for taxpayers under 65, and R4 000 for taxpayers age 65 and over. It is proposed to increase these exemptions by a further R1 000.

Benefits to the elderly and lower-income taxpayers

As before, the primary beneficiaries of this proposal will be individuals age 65 and over living on modest fixed-interest investments and lower-income taxpayers who save mainly in interest bearing accounts. This change will result in a revenue loss of R160 million.

Reductions in estate duty and donations tax

Death and donations trigger capital gains tax

Under the capital gains tax system, when an asset is donated or the owner of an asset dies, there will be a deemed realisation of the asset, triggering a capital gains tax event. This ensures that when the ownership of an asset passes from one taxpayer to another, the capital gain that has accrued over the life of the asset is effectively brought to tax. These measures are necessary to prevent indefinite deferral of capital gains tax until actual realisation.

Taxing gains at death a major strength of the proposed capital gains tax

The taxation of capital gains upon death and donation is a major strength of the South African capital gains tax. In the USA, where capital gains are effectively exempt upon death, it has been estimated that up to 50 per cent of the potential tax revenue is lost. This exemption is a primary cause of the so-called "lock-in effect" – the incentive for taxpayers not to sell assets on which capital gains have accrued in order to avoid paying the tax.

Estate duty and donations tax reduced

When the capital gains tax legislation was released for public comment, it was suggested that some adjustments could be introduced to the estate duty and donations tax. It is proposed that the estate duty and donations tax be reduced from the current 25 per cent to 20 per cent, with effect from 1 October 2001 (the same effective date as the capital gains tax). It is estimated that this will result in a revenue loss of about R50 million in 2001/02.

Raising provisional tax thresholds

Taxpayers under age 65 threshold up R1 000

At present, individual taxpayers below the age of 65 who earn taxable non-employment income of more than R1 000 a year must register as provisional taxpayers. Removing taxpayers with such non-employment income from the provisional tax system will release valuable administrative resources for other revenue collection purposes and reduce the compliance costs for these taxpayers. It is proposed to raise the threshold from which individuals must register for provisional tax to R2 000 a year. This will not result in a permanent loss of revenue, but will defer the collection of R140 million from 2001/02 to 2002/03.

Over 65 threshold up R30 000

Presently, individuals older than 65 are exempt from the payment of provisional tax if their annual taxable income does not exceed R50 000 and consists exclusively of remuneration, interest, dividends or rent from the lease of fixed property. It is proposed to raise this threshold to R80 000 a year, reducing the compliance burden for these taxpayers. This will result in a revenue loss of R20 million in 2001/02.

Investment incentives for strategic projects

Investment allowances for strategic industrial projects

In 2000, the Department of Trade and Industry announced a number of industrial incentives to facilitate investment in South Africa. It is proposed in this budget to expand the range of available policy tools to encourage investment by introducing investment allowances for strategic industrial projects. These incentives will provide a targeted instrument to encourage projects that have significant direct and indirect benefits for the South African economy.

It is envisaged that the investment incentive will be introduced as follows:

- A 50 per cent or 100 per cent initial investment allowance will be granted to companies undertaking strategic projects. The allowance is an additional deduction against taxable income, calculated with reference to the cost of the investment undertaken. Once granted, the allowance will be valid for 3 years after the year in which the investment is made.
- The incentive will be allocated by an adjudication committee on the basis of quantitative and qualitative criteria defining strategic investment projects.
- R3 billion will be set aside for this incentive over a four-year period.

No revenue loss is anticipated in 2001/02, as the companies receiving the allowance in this fiscal year will only make lower tax payments in 2002/03.

Investment incentives for small business development

Small business vital for job creation and growth

In the 2000 Budget, a graduated corporate tax rate was introduced for qualifying small businesses. Active small businesses with gross income of R1 million or less are subject to a 15 per cent tax rate on the first R100 000 of taxable income.

Immediate expensing of investment for SMEs

Small businesses involved in manufacturing are subject to the same tax depreciation rules for investment as large corporations – the cost of investment may be written off over five years on a straight-line basis at 20 per cent a year. An accelerated depreciation regime is proposed for qualifying small businesses that invest in manufacturing assets. The full cost of investment may be deducted in the tax year in which the asset is brought into use by the taxpayer for the first time. This proposal will markedly improve the cash flow of growing small businesses and further enhance the potential for this sector to create jobs. It is anticipated that this will lead to a revenue loss of R40 million in 2001/02.

Depreciation of airport infrastructure

Historically, tax allowances have not been granted for the depreciation of permanent structures. There are two main reasons for this. Firstly, these assets generally have long economic lives. Secondly, investment in permanent structures, such as transmission lines, railway lines and airports, has traditionally been undertaken by Government.

2000 Budget allowances for permanent structures

The promotion of private investment in public infrastructure requires a different approach. South Africa has followed the international trend toward introducing tax allowances for depreciation of permanent structures. In the 2000 Budget, allowances were introduced for pipelines for transporting oil and gas, electricity transmission lines, telephone transmission lines and railway lines. It is now proposed that tax allowances of 5 per cent a year on a straight-line basis be introduced for investment in airport hangars and runways.

Table 4.7 details some of the airport depreciation regimes provided in other countries.

Table 4.7 Airport depreciation regimes in selected countries

	Runways	Hangars
Argentina	2% a year / 50 years straight line	2% a year / 50 years straight line
Australia	2,5% a year / 40 years straight line	5% a year / 20 years straight line
Canada	8% / 12,5 years double declining balance method	4% / 25 years double declining balance method
New Zealand	2% a year / 50 years straight line	2% a year / 50 years straight line
UK	4% a year / 25 years straight line (or 15 years accelerated depreciation)	4% a year / 25 years straight line
USA	5% a year / 20 years straight line	3,6% a year / 27,5 years straight line
SA proposal	***5% a year / 20 years straight line***	***5% a year / 20 years straight line***

Rules to limit unintended tax base erosion

As was the case with the current rules for depreciation of permanent structures, the allowances will be limited to assets owned directly by the taxpayer and used in his sole trade as an airport operator. The allowance will apply to assets contracted for, and the construction of which commences, on or after 1 April 2001.

Closing income tax loopholes

Closing loopholes improves efficiency and equity

As part of an ongoing effort to widen the income tax base, Government will intensify its efforts to identify loopholes in tax legislation.

Substantive reforms

To ensure potential loopholes are minimised, it is proposed to investigate:

- Section 24C of the Income Tax Act, which allows for the immediate deduction of future expenditure
- Provisions allowing deductions for contingency reserves of short-term insurers
- The taxation of intangibles
- The possibility of bringing all company directors into the Pay-As-You-Earn (PAYE) income tax system

Procedural reforms

Certain procedural reforms are also being considered, including:

- Limiting the potential for delaying the filing of corporate income tax returns.
- Streamlining the interest charges in various tax statutes and making all interest charges automatic.
- Streamlining the penalty provisions with respect to provisional tax payments and making these payments correlate more closely with the amounts ultimately owed.
- Reviewing the opportunity for taxpayers to reopen income tax assessments.
- Enhancing the scope for SARS to appoint expert outside counsel for important tax cases.
- Building capacity in SARS to issue advance rulings to specific taxpayers and for specific transactions, as well as the authority to charge user fees for any rulings or determinations issued. SARS will be required to report annually on the rulings issued.

Unbundling transactions

Unbundling rules to help companies to flatten group structures

The unbundling provisions contained in the tax laws were introduced to facilitate groups of companies to flatten their corporate structures from a tax cost point of view. These provisions were aimed at assisting South African groups to restructure.

Non-resident companies now benefiting from provisions

With an increasing number of South African companies acquiring offshore listings, non-resident companies are also benefiting from these relief measures. This poses a risk to the South African tax base, particularly with respect to the secondary tax on companies. SARS and the National Treasury are reviewing these provisions to ensure they are appropriately adjusted to take account of the changing business environment.

Review of tax on banks

Low effective tax rate on banks

When one sector of the economy pays less than its fair share of tax, the burden on all other taxpayers is raised. For this reason, the low effective tax rate on the financial services sector is a matter of concern. Through a variety of tax-saving mechanisms, the industry, especially the banking sector, has increasingly been able to avoid or defer tax.

Intensified efforts to ensure equitable taxation of banks

This is an international phenomenon since banks are able to utilise sophisticated financial instruments and structured, asset-based transactions to minimise their tax liabilities. The introduction of a residence-based income tax system and the taxation of capital gains may reduce the scope for such tax-minimisation activities.

Continued efforts to reduce tax avoidance

Government will continue its efforts to ensure the banking sector pays an equitable share of tax. Further amendments to the Income Tax Act and intensified audit and enforcement are the next steps in this programme. Following detailed investigation, further amendments could include:

- Clarifying the distinction between capital and ordinary income for the sale of financial instruments
- Reviewing the tax rules regarding financial leases
- Ensuring the immediate accrual of certain income receipts that are postponed through artificial contingencies.

Treasury to investigate the need for alternative minimum taxes

Many countries have limited the potential for the banking sector to avoid taxes by imposing alternative minimum taxes on easily identifiable and audited bases, such as gross assets. Whether this would be appropriate for South Africa has yet to be considered. A thorough review of options for addressing the low effective tax rate of the banking sector has been initiated and consultation with the industry will be held in the course of 2001.

Tax status of Eskom

Eskom contributes to company tax

In the 2000 Budget, it was announced that Eskom's tax-exempt status would be withdrawn from 1 January 2000. Eskom and its subsidiaries will contribute to company income tax revenues in the future. In addition, Eskom will pay secondary tax on companies in respect of dividends it declares. As noted in Chapter 5, it is anticipated that Eskom will pay its first dividends in 2001/02.

Indirect tax proposals

VAT on illuminating paraffin

A primary source of energy for the poor

Illuminating paraffin is the primary source of energy for low-income households in South Africa, especially in non-electrified rural areas. Expenditure on illuminating paraffin constitutes a significant proportion of expenditure of poor households. Given the steep increases in the cost of fuel over the past year, the proportion of income spent on fuel is likely to have risen further.

VAT zero-rate illuminating paraffin

Illuminating paraffin is currently exempt from all fuel levies and is subject only to VAT. In a recent incidence study undertaken for the National Treasury, it was estimated that the removal of tax on illuminating paraffin would provide a significantly larger distributive gain to the poor, given the revenue cost to Government, than for any other expenditure item. It is proposed that illuminating paraffin be zero-rated for VAT purposes, with effect from 1April 2001. It is estimated that this will result in a revenue loss of R400 million.

Specific excise duties

6,7 per cent growth between 1997/98 and 2000/01

Specific excise duties include duties on tobacco products, alcoholic and non-alcoholic beverages, and petroleum products. These have been a stable source of revenue, growing at an annual average rate of 6,7 per cent between 1997/98 and 2000/01. Specific excise duties on alcoholic beverages and cigarette products constitute about 87 per cent of total specific excise revenue.

Specific excise changes raise R779 million more revenue

Specific excise duties on alcoholic beverages and tobacco products are informed by Government's health policies and revenue needs. It is proposed to amend the specific excise duties as follows:

- Beer and cider raised by 6 per cent
- Sorghum beer and sorghum flour raised by 5 per cent
- All other alcoholic beverages raised by 10 per cent
- Tobacco products raised by between 11,8 and 20,2 per cent
- Soft drinks reduced by 25 per cent.

The net revenue effect of these changes is an increase in revenue of R779 million in 2001/02. The proposed adjustments, which take effect from 21 February 2001, are summarised in Table 4.8 and set out in more detail in Annexure C.

Tobacco taxes support health policies

Taxes on tobacco products are an efficient source of government revenue. These taxes have also contributed to the success of Government's tobacco control policy, as set out in the text box below. It is proposed to increase tobacco taxes again in this budget. The duty increases set out in Table 4.8 are estimated to generate additional R490 million in 2001/02.

Smoking trends in South Africa

A recent study on smoking trends in South Africa between 1993 and 1999 revealed that:

- Aggregate cigarette consumption has decreased by about 22 per cent between 1993 and 1999.
- Smoking prevalence among the adult population decreased by about 14 per cent over the period. However, the total number of smokers remained constant at approximately 8 million.
- Average cigarette consumption per smoker declined by about 21 per cent.
- Smoking among young adults is below the national average and falling.
- Real price increases, partly due to increased excise taxes, contributed to these decreases in prevalence and consumption.
- Real price increases appears to be effective at reducing smoking prevalence among lower income and young people.

Table 4.8 Changes in specific excise duties

Product	Current excise duty rate	Proposed change in duty	Estimated additional revenue R million	Nominal change in excise duty (%)	Real change in excise duty (%)
Malt beer	R22,39/ litre of absolute alcohol	R1,34/ litre of absolute alcohol	162,7	6,0	0
	(38c/ average 340ml can)	(2,28c/ average 340ml can)		6,0	0
Sorghum beer	7,45c/ litre	0,37c/ litre	0,5	5,0	-1,0
Sorghum flour	33c/ kg	1,65c/ kg	0,1	5,0	-1,0
Unfortified wine	67,9c/ litre	6,79c/ litre	20,4	10,0	4,0
Fortified wine	153,6c/ litre	15,36c/ litre	4,2	10,0	4,0
Sparkling wine	188,1c/ litre	18,81c/ litre	1,5	10,0	4,0
Mineral water and soft drinks	8,0c/ litre	-2c/ litre	-41,9	-25,0	-31,0
Ciders and alcoholic fruit beverages	113,98c/ litre	6,83c/ litre	12,5	6,0	0
Spirits	R30,34/ litre of absolute alcohol	R3,03/ litre of absolute alcohol	129,2	10,0	4,0
	R9,78/ average 750ml bottle	97,8c/ average 750ml bottle		10,0	4,0
Cigarettes	283,0 c/ 20 cigarettes	33,8c/ 20 cigarettes	417,9	12,0	6,0
Cigarette tobacco	320,6c/ 50g	37,74c/ 50g	0,1	11,8	5,7
Pipe tobacco	97,3c /25g	19,63c /25g	71,7	20,2	14,2
Cigars	1310,8c /23g	216,86c /23g	0,4	16,5	10,5

Alcohol taxes in line with international benchmarks

Government policy in respect of duties on alcoholic products is to maintain consistency with international benchmarks. The most recent estimates of the tax incidence (excise tax plus VAT as a percentage of retail price) in South Africa are:

- Spirits – 39,9 per cent
- Malt beer – 32,6 per cent
- Alcoholic fruit beverages – 25,6 per cent
- Fortified wine – 22,8 per cent
- Unfortified wine – 21,7 per cent.

R162,7 million more from beer duties

Inflation-related increases in the duties on beer will raise additional revenue of R162,7 million. The similar rates of increase in duties on ciders and alcoholic fruit beverages will raise a further R12,5 million.

10 per cent increase in excises on spirits and wine

The 10 per cent duty increase on spirits and wine will bring these taxes more in line with international benchmarks, raising R155,3 million.

Below inflation increase in tax on sorghum beer and sorghum flour

In the past two years, the duty on sorghum beer and sorghum flour has not been increased, although it has always been recognised that it is appropriate to tax these products. It is proposed to raise the duty on these items by 5 per cent, which is less than anticipated inflation. This will generate about R600 000 in additional revenue.

Further 2c/l reduction in tax on soft drinks

The excise tax on mineral water and soft drinks has been reduced in the past two budgets. It is proposed to reduce the duty by a further 2 cents a litre, bringing the tax on soft drinks to 6cents a litre. It is estimated that the revenue cost of the duty reduction will be R41,9 million.

Fuel levy

The total levy on fuel is made up of the general fuel levy, the Road Accident Fund levy, the Equalisation Fund contribution and the customs and excise charge. The current levies on fuel are set out in Table 4.9.

Table 4.9 Total combined fuel levy

	Leaded petrol Cents / litre	Unleaded petrol Cents / litre	Diesel Cents / litre
General fuel levy	95,6	89,4	79,1
Road Accident Fund	14,5	14,5	10,3
Equalisation Fund	0	3	0
Customs and Excise	4	4	4
Total	**114,1**	**110,9**	**93,4**

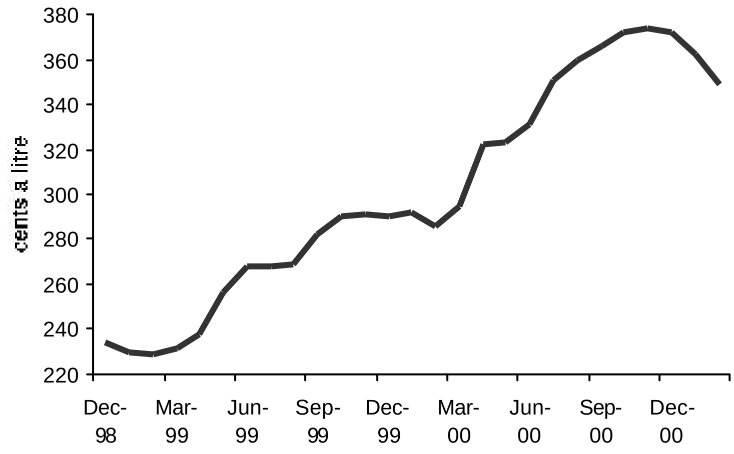
Rising petrol prices over the past 2 years

As a result of high international crude oil prices and the strength of the US dollar, between December 1998 and December 2000, the price of petrol rose by an annual average rate of 27,2 per cent. Figure 4.1 illustrates how the price of 93-Octane leaded petrol has changed since December 1998.

More stable oil prices expected

Recently, fuel prices have started to fall in line with the reductions in the oil price. Over the course of 2001/02, the oil price is anticipated to remain within the OPEC target of $22 - $28 a barrel. This, together with a more stable rand, will provide scope for domestic fuel prices to moderate over the course of the year.

Figure 4.1: 93- Octane prices Dec ’98 – Feb ’01



Levies on fuel serve a variety of purposes. First, they represent an important source of general government revenue. Second, to the extent that they limit fuel consumption, they have positive environmental effects. Third, the limitation of consumption has positive effects on the balance of payments.

Below inflation increases in fuel levy

In setting fuel tax policy for this Budget, Government is cognisant of the impact rising fuel prices have on the economy, but seeks to balance this against a need for consistent tax policy. It is proposed to raise the general fuel levy on leaded and unleaded petrol by 2,4 cents a litre and on diesel by 1,9 cents a litre, with effect from 4 April 2001. This will raise additional revenue of R363 million.

Equalisation Fund levy

During 2000, the octane-level of unleaded petrol was raised to bring it on par with leaded petrol. To ensure the oil industry was able adequately to meet the demand for the higher-octane fuel, it was recommended that the retail price on unleaded and leaded fuel be equalised. This was achieved by raising the equalisation levy on unleaded fuel to 3 cents a litre.

Establishing appropriate methods to encourage use of unleaded petrol

The Department of Mineral and Energy Affairs is currently undertaking research to establish the most appropriate method for encouraging the use of unleaded petrol, in line with prior commitments. Until this is complete, it has been recommended that the retail price of leaded and unleaded petrol remain equal. It is thus proposed that a 3c a litre levy remain on unleaded petrol, but that this form part of the general fuel levy, rather than the Equalisation Fund.

Diesel fuel concession for primary production sector

In the 2000 Budget, a diesel fuel concession was reintroduced for the fishing and coastal shipping sectors. Government undertook to explore the possibility of extending this to other primary production sectors. Since widespread fuel tax fraud led to the withdrawal of the previous diesel concession, this extension was conditional on:

- Developing an appropriate administrative regime to minimise the risk of fraud.
- Ensuring the concession is affordable within the broader fiscal framework.

Primary production sector is dependent on diesel fuel

Liquid fuels are a primary source of energy in the primary production sector. In agriculture, forestry and mining it is estimated that almost 80 per cent of energy consumption is diesel-based. Since the ability to use alternative energy sources, such as electricity, is constrained by the nature of the production processes, demand for diesel is relatively inelastic and its cost affects the competitive position of these industries.

Concession of 25,6c/l of general fuel levy on "qualifying consumption"

Recognising that the bulk of diesel consumed by primary producers is used "off-road" and in order to enhance the competitiveness of this sector, a 25,6 cent a litre concession of the general fuel levy on diesel fuel for the agriculture, forestry and mining sectors on qualifying consumption, is proposed. This concession amounts to 31,6 per cent of the general fuel levy on qualifying diesel consumption, which translates into an effective concession of 25,2 per cent on total consumption. These sectors will also be exempt from the full Road Accident Fund levy on diesel. Together, these concessions amount to 42,1 cents a litre or 41,5 per cent of the total tax burden on diesel fuel.

Efficient administration

The diesel concession will be administered as a refund through the VAT system. Implementation of the proposed diesel concessions will be effective from 4 July 2001 to allow for the development of proper regulatory and compliance procedures. SARS will audit the diesel refunds regularly and it is envisaged that suppliers of diesel will be required to confirm all diesel sales to those eligible for the refund electronically.

Total cost to fiscus of R416,6 million

Based on estimated consumption patterns, the anticipated cost to the fiscus of the proposed concession from the general fuel levy is R253,3 million in 2001/02. The revenue cost of allowing an exemption from the Road Accident Fund levy for qualifying consumption is estimated to be R163,3 million. The total cost of the concession is therefore R416,6 million.

Additional diesel concessions

100% concession for offshore mining and NSRI

The diesel fuel concession announced in the 2000 Budget was extended to the fishing and coastal shipping sectors. Offshore mining and the National Sea Rescue Institute (NSRI) operate under similar conditions as these sectors and it is, therefore proposed to extend the 100 per cent diesel fuel concession to these taxpayers. This will cost about R6,1 million a year in foregone revenue from the general fuel levy. The reduction in anticipated receipts of the Road Accident Fund levy will be a further R1,3 million. The total cost is therefore R7,4 million.

Road tax relief for Spoornet

Spoornet and other rail freight hauliers rely on diesel. As the rail freight sector competes directly against its road counterparts, the payment of road-related fuel levies implies an indirect subsidy to its competitors. It is therefore proposed that the rail-freight sector be exempted from the Road Accident Fund levy. This proposal will reduce estimated revenue from the Road Accident Fund levy by about R28,8 million.

These concessions will also be effective from 4 July 2001.

Restructuring *ad valorem* customs and excise duties

Current system in place since 1969

The system of *ad valorem* customs and excise duties has been in place since 1969. These duties apply to a range of "up-market" consumer goods, which are either imported (customs duties) or produced in South Africa (excise duties). The current statutory rate is 10 per cent on most products, except printing machines, computers, automatic data processing machines, modems, photocopying apparatus and motor cycles, on which the duty is 5 per cent. These rates were reduced from 37,5 and 32,5 per cent in 1996/97, to 15 and 10 per cent in 1997/98, and further to 10 and 5 per cent in 1998/99.

Duties contribute to revenue and equity

Ad valorem duties are an important source of revenue. In 1999/00, R2 billion in duties was collected, R1,8 billion in 1998/99 and R1,6 billion in 1997/98. Over 70 per cent of this revenue is from the *ad valorem* customs duties. In addition, the duties contribute to the overall equity of the tax system to the extent that they apply to items that are consumed disproportionately by higher-income groups.

Complex administration

The National Treasury and SARS have reviewed the *ad valorem* tax system to consider ways to simplify the cumbersome administrative arrangements, particularly with respect to goods produced domestically. This complex administration not only leads to high compliance costs, but also provides scope for tax evasion that undermines the integrity of the tax system.

Simplification of administration and reduction of maximum duty

It is evident that significant savings could be realised if the administrative system were simplified. It is proposed, therefore, that the value determination process for domestically produced goods be abolished for all items, except motor vehicles. In future, the *ad valorem* duty on domestically produced goods will be calculated on the invoice price of the product. It is also proposed to reduce the maximum *ad valorem* rate from 10 per cent to 7 per cent. The 5 per cent duty on the items listed above remains. A schedule of the *ad valorem* duties is contained in Annexure C.

Reduced duty on cosmetics

Based on an analysis of the latest available data on household consumption patterns, it is proposed that the duty rate on cosmetics be reduced from 10 per cent to 5 per cent.

Net revenue loss of R210 million

Taken together, the proposed administrative restructuring and the duty reductions will result in a revenue loss of R210 million.

Tariff reform to promote trade and development

Most of GATT and WTO obligations met

South Africa has met most of its tariff obligations under GATT and the WTO, although minor tariff reductions will continue up to 2004 in some sectors. The average import-weighted tariff on industrial goods has fallen sharply from 14 per cent in 1994 to around 5 per cent in

2000. On agricultural goods, liberalisation has been even faster, with the average import weighted tariff calculated at 2,5 per cent in 1998.

Unless a new round of WTO negotiations is launched and concluded, further tariff liberalisation is likely to proceed on a regional and bilateral basis.

Regional and bilateral trade reform

The South Africa-European Union Agreement on Trade, Development and Co-operation was initiated last year and will see tariffs on around 85 per cent of imports from the EU fall to zero by 2012. Given that the EU accounts for more than 40 per cent of South Africa's total imports and custom's revenue, this agreement should contribute to a steady decline in duties collected as a share of total imports.

Supporting SADC trade development

South Africa also signed a Free Trade Area (FTA) agreement with SADC in 2000. Harnessing the potential of the combined regional market enhances the region's attractiveness as a trade and investment destination. SADC countries account for 3 per cent of South Africa's total imports and almost all customs revenue on imports from SADC will be lost immediately as a direct result of this FTA.

Duty revenue to rise moderately

Despite the negative effect regional and bilateral trade agreements will have on the average import tariff rate, duties collected are expected to rise moderately over the next few years in line with stronger import growth.

Stamp duties

Freeing up administrative resources

Stamp duties are levied on a range of legal instruments. In total, stamp duties are estimated to raise R1,6 billion in 2001/02. Duties on some instruments generate insignificant revenue for Government, yet require administrative resources. Given this, it is proposed to remove the stamp duties on bills of exchange, bills of entry and securities and suretyships, which will result in a revenue loss of R15 million. This change will be effective from 1 April 2001.

Social security tax changes

Road Accident Fund levies

Cash-flow deficit at the Fund

The Road Accident Fund is funded on a cash flow basis from a dedicated fuel levy. Over the past year, there has been a marked increase in the outflows from the Fund, following a concerted effort to reduce the claims backlog. This has resulted in a cash-flow deficit at the Fund. In addition, the diesel fuel concessions proposed in this budget will result in a revenue loss to the Road Accident Fund of R193,3 million.

Ensuring financial soundness

To ensure financial soundness of the Road Accident Fund and to accommodate the proposed diesel fuel levy concessions, the following levy adjustments are proposed:

- From 4 April 2001, the levy on petrol will be increased by 2 cents a litre to 16,5 cents a litre.

- From 4 July 2001, when the diesel concessions come into effect, the RAF levies on diesel and petrol will be equalised at 16,5 cents a litre.

These adjustments will result in additional revenue of R437 million in 2001/02 for the Road Accident Fund.

Regional tax co-operation

Southern African Customs Union

All customs and excise revenues collected in the Southern African Customs Union (SACU) are shared between the five SACU member countries according to an agreed formula. The current formula, which has been in place since 1969, no longer reflects the trading environment in which SACU operates. This has led to large and growing transfers from South Africa to the BLNS countries (Botswana, Lesotho, Namibia and Swaziland) over the past few years.

Principles for new formula agreed in 2000

In September 2000, SACU Ministers of Trade and Ministers of Finance agreed on the principles for a new formula for the distribution of SACU customs and excise revenues. According to this new formula, the total revenue accruing to each member state will be calculated as follows:

- Customs revenue will be distributed according to each country's share of intra-SACU imports.
- Excise revenues will be distributed according to the relative GDP of each SACU member country.
- A development fund will be created in relation to the level of development of each SACU member country.

Although the new formula still provides for large transfers from South Africa to the BLNS, it has many advantages over the current method. Unlike the existing formula, the new formula is bound to the actual amount of customs and excise revenue collected. This will ensure that South Africa's share of the total customs and excise pool remains relatively stable over time.

It is estimated that South Africa's payments in terms of the SACU agreement will be R8,2 billion in 2001/02. Historical and future shares of the total customs and excise pool, by both the existing and new formula are presented in Table 4.11.

Table 4.10 Distribution of SACU customs and excise revenues

Per cent	Existing formula (actual)		New formula (forecast)		
	1999/00	2000/01	2001/02	2002/03	2003/04
South Africa	53	50	53	54	52
BLNS	47	50	47	46	48

SADC Tax Sub-committee

Promoting growth in SADC

Socio-economic development in South Africa is inextricably linked to the fortunes of Africa and more immediately to the Southern African region. This is reflected in the Southern African Free Trade Protocol, which sets out to realise the development potential of the regional market. Tax co-operation will increase the attractiveness of the region as an investment destination and ensure full advantage from the free trade protocol.

Toward tax co-operation

In this respect, the SADC Tax Sub-committee was instituted on 5 July 2000, chaired by South Africa. Its primary objective is "the co-ordination of taxation policies to the extent necessary to improve efficiency in tax collection, safeguard regional tax bases and reduce obstacles to intra-SADC trade and investment". The sub-committee will seek to:

Key initiatives

- Compile a comprehensive SADC tax database.
- Determine a common policy in respect of tax incentives, especially those aimed to attract foreign direct investment into the region. This is vital to securing current tax bases and ensuring investment resources attracted to the region are efficiently allocated.
- Work steadily toward the elimination of barriers to intra-SACU trade. Removing such barriers increases the potential market in the region, stimulating further domestic and foreign direct investment.
- Estimate the compliance gap in respect of excise duties and introduce comprehensive programmes to minimise revenue loss from tax fraud.
- Identify and promote areas in which co-ordination of direct taxation would significantly enhance the attractiveness of SADC as an investment destination.
- Build institutional capacity in member states, with particular emphasis on tax policy-making and revenue collection. This will be advanced through training institutes and tax seminars, in close conjunction with key multilateral institutions.