4

Revenue trends and tax proposals

The 2005 Budget is designed to underpin the stronger economic growth performance of the South African economy, while maintaining consistency in approach and maximising certainty for taxpayers. Reforms to the tax structure and base-broadening initiatives implemented over the past decade have substantially strengthened Government's revenue-raising capacity. Favourable economic conditions enable Government to provide further tax relief, offset by unexpected buoyancy in revenue collections, primarily in consumption and personal income taxes.

This year's tax proposals include income tax relief for both individuals and companies, and significant changes aimed at reducing compliance costs and providing an enabling environment for small businesses. Key measures include:

- *Direct income tax relief of R1,4 billion for small business corporations and VAT cash flow relief of R275 million for small vendors*
- *Corporate income tax relief of R2,0 billion*
- *Repeal of the Regional Services Council and Joint Services Board Levies in 2006*
- *Personal income tax relief of R6,8 billion and a further R310 million in respect of investment income*
- *Tax relief relating to home ownership of R450 million and reducing the cost of banking by R350 million*
- *Tax administration and customs administration initiatives in the areas of service, trade facilitation, border control and anti-avoidance*
- *Net increases in excises and other taxes on goods and services of R2,3 billion.*

Overview

This Budget has as its foundation a decade of balanced base-broadening initiatives, lowered tax rates, and ongoing improvements in Government's revenue raising capacity. By 2004/05 total annual tax relief of close to R78 billion had been granted to individuals and companies. These measures contributed to buoyant consumption expenditure and a healthy growth in gross fixed capital formation.

Rationalising of tax instruments over period ahead

After the major tax reforms and administrative enhancements of the past decade, and the unexpected revenue overrun this year, the 2005 proposals initiate a three-year programme of structural changes aimed at promoting growth and equity, reducing complexity and compliance cost, and rationalising tax instruments.

Maintaining stable and predictable revenue mix

The maintenance of a stable and predictable revenue mix facilitates sound budgeting and confident business planning. The current revenue mix follows international norms by relying principally on the taxation of employment income, business income and income from capital (capital gain, dividends and interest) together with a moderate reliance on consumption taxes, duly recognising their regressive nature. Domestic revenue-raising strategies have been accompanied by a gradual elimination or reduction of financial transaction taxes (stamp and transfer duties) that increase the cost of doing business.

Tax policy to support growth and small business development

The tax framework for the medium term aims to reinforce the current upward momentum of growth in the South African economy while contributing to broader participation and small business development. Several further steps are taken to improve fairness and reduce economic distortions associated with the tax structure, and both social and environmental aspects of longer term tax reform are highlighted. Enhanced and streamlined tax administration remains clearly in focus in reform programmes of the SA Revenue Service (SARS) for the period ahead.

Main tax proposals

The 2005 Budget tax proposals include the following:

Tax relief

- Income tax on individuals is reduced by R6,8 billion
- The interest exemption is raised to R15 000 for taxpayers under the age of 65 and to R22 000 for taxpayers age 65 and over
- A competitive tonnage tax regime is proposed for the shipping industry to be implemented in 2006
- Stamp duties on banking debit entries are abolished, at a revenue cost of R350 million
- Property transfer duty thresholds are increased at a cost of R450 million
- *Ad valorem* excise duties on sun protection products and on professional digital cameras are abolished
- Provision is made for VAT payments every 4 months for small businesses
- Enterprises with a total annual payroll bill of less than R500 000 are exempted from the skills development levy
- Small businesses will be exempt from tax on the first R35 000 of income

- The tax compliance burden for small businesses will be reduced through both targeted fiscal stimulus measures and tax administration initiatives
- A simplified 50:30:20 tax depreciation regime is proposed for non-manufacturing assets of small businesses.

Tax increases

- Deemed business travel costs claimable against motor allowances are reduced
- Tobacco taxes are raised to maintain a tax incidence level of 52 per cent
- Taxes on alcoholic beverages are increased between 9,4 and 20 per cent
- The general fuel levy is increased by 5 cents a litre on petrol and diesel, together with an increase in the diesel fuel concession for primary producers
- The Road Accident Fund levy is increased by 5 cents a litre.

Proposals for overhauling and updating the general anti-avoidance rules in the revenue laws will also be tabled in a discussion document this year.

Consolidated national revenue estimates

Taking into account these tax proposals, main budget revenue is expected to stabilise at about 24,1 per cent of GDP over the MTEF period ahead. Table 4.1 sets out consolidated national revenue for 2003/04 to 2007/08, comprising main budget revenue, the receipts of social security funds and foreign technical assistance.

Main budget revenue 24,1 per cent of GDP

Table 4.1 Consolidated national revenue, 2003/04 – 2007/08

	2003/04	2004/05		2005/06	2006/07	2007/08
	Outcome	Budget	Revised	Medium-term estimates		
R million		estimate	estimate			
Total tax revenue	302 508	333 694	345 261	372 774	414 154	453 726
Less: SACU payments	-9 723	-13 328	-13 328	-12 053	-15 573	-16 151
Non-tax revenue[1]	6 646	6 590	6 027	9 148	6 846	7 068
Main budget revenue	**299 431**	**326 956**	**337 960**	**369 869**	**405 427**	**444 643**
Percentage of GDP	*23,4%*	*24,6%*	*24,1%*	*24,2%*	*24,2%*	*24,1%*
Social security funds						
Tax revenue	12 137	12 891	13 576	14 580	15 678	16 689
Non-tax revenue[2]	1 442	1 025	1 582	1 850	2 110	2 420
Total social security revenue	**13 579**	**13 916**	**15 158**	**16 430**	**17 788**	**19 110**
RDP fund receipts and technical co-operation	1 688	1 500	1 550	1 500	1 500	1 500
Consolidated national revenue[3]	**314 689**	**342 356**	**354 652**	**387 783**	**424 697**	**465 235**

1. Includes departmental revenue, transactions in assets and liabilities, and foreign grants received.
2. Includes own revenue, sale of capital assets and grants received.
3. Transfers between funds have been netted out.

Consolidated revenue of R355 billion in 2004/05

The consolidated revenue estimate is R354,7 billion in 2004/05, which is 3,6 per cent higher than projected at the time of the 2004 Budget. Between 2004/05 and 2007/08, consolidated national revenue is expected to increase at an annual average rate of 9,5 per cent.

National budget revenue – revised estimates

Table 4.2 highlights budget estimates and revenue outcomes of the major tax instruments for 2003/04 and projected revenue outcomes for 2004/05. Tables 2 and 3 in *Annexure B* set out these numbers in more detail.

Table 4.2 Main budget estimates and revenue outcome, 2003/04 and 2004/05

R million	2003/04 Budget estimate	2003/04 Outcome	2003/04 Deviation	2004/05 Budget estimate	2004/05 Revised estimate	2004/05 Deviation	2003/04–2004/05 % change
Taxes on income and profits	**177 864**	**171 963**	**-5 901**	**189 198**	**189 900**	**702**	**10,4%**
Personal income tax	96 714	98 495	1 781	105 938	110 950	5 012	12,6%
Company tax	65 820	60 881	-4 939	68 800	65 450	-3 350	7,5%
Secondary tax on companies	8 000	6 133	-1 867	6 760	7 600	840	23,9%
Tax on retirement funds	5 950	4 898	-1 052	6 000	4 500	-1 500	-8,1%
Other	1 380	1 556	176	1 700	1 400	-300	-10,0%
Taxes on payroll and workforce	**3 600**	**3 896**	**296**	**4 300**	**4 600**	**300**	**18,1%**
Taxes on property	**5 890**	**6 707**	**817**	**6 870**	**8 928**	**2 058**	**33,1%**
Domestic taxes on goods and services	**109 614**	**110 174**	**559**	**121 549**	**129 033**	**7 484**	**17,1%**
Value-added tax	81 000	80 682	-318	89 500	95 500	6 000	18,4%
Specific excise duties	11 364	11 365	1	13 112	12 975	-137	14,2%
Levies on fuel	16 342	16 652	310	17 409	18 800	1 391	12,9%
Other	908	1 475	567	1 529	1 758	230	19,2%
Taxes on international trade and transactions	**11 307**	**8 414**	**-2 893**	**10 476**	**11 650**	**1 174**	**38,5%**
Stamp duties and fees	**1 750**	**1 360**	**-390**	**1 300**	**1 150**	**-150**	**-15,4%**
State miscellaneous revenue[1]	**–**	**-7**	**-7**	**–**	**–**	**–**	**–**
Total tax revenue	**310 025**	**302 508**	**-7 518**	**333 694**	**345 261**	**11 568**	**14,1%**
Departmental revenue	4 031	5 931	1 900	5 944	5 493	-451	-7,4%
Transactions in assets and liabilities	125	715	590	646	533	-113	-25,4%
Less: SACU payments	-9 723	-9 723	–	-13 328	-13 328	–	37,1%
Main budget revenue	**304 459**	**299 431**	**-5 028**	**326 956**	**337 960**	**11 004**	**12,9%**

1. Revenue received by SARS in respect of taxation which could not be allocated to a specific tax instrument.

Revenue outcome – 2003/04

Revenue outcome R299,4 billion in 2003/04

Audited results show that actual receipts for 2003/04 were R299,4 billion, which is 1,7 per cent less than the original budget estimate of R304,5 billion. Significant deviations from the original estimates include:

- Personal income tax up by R1,8 billion
- Company tax down by R4,9 billion

- Secondary tax on companies down by R1,9 billion
- Tax on retirement funds down by R1,1 billion
- Trade taxes down by R2,9 billion.

Revised estimates for 2004/05

Strong consumer demand and job growth lead to higher PIT and VAT receipts

Based on revised macroeconomic projections set out in Chapter 2 and the in-year revenue trend, the main budget revenue estimate for 2004/05 is revised upwards to R338 billion. This is R11 billion higher than the original 2004 Budget estimate and R9,8 billion higher than the revised estimate published in the *2004 Medium Term Budget Policy Statement*. The main reasons for the strong revenue performance are the higher than projected receipts from personal income tax and value-added tax.

Taxes on income and profits

Personal income tax R5 billion over budget

Taxes on income and profits are expected to be R702 million more than the original budget estimate. Personal income tax is estimated to reach R111 billion, which is R5 billion more than the original budget estimate and 12,6 per cent more than the 2003/04 outcome. This increase is mainly due to higher wage settlements and an increase in employment numbers.

Company taxes 5 per cent under budget

The revised estimate for corporate income tax is R65,5 billion, which is almost 5 per cent less than originally budgeted due to lower than expected corporate profits, mainly in the mining sector. The tax on retirement funds is revised downwards by R1,5 billion, attributable to a switch by funds from interest bearing instruments to equities and because of a general reduction in market interest rates.

Taxes on payroll

The skills development levy is expected to raise R4,6 billion, R300 million higher than the budget estimate. This increase is mainly due to higher than estimated wage settlements.

Domestic taxes on goods and services

Strong consumer spending raises revenue take

Revenue from value-added tax is expected to raise R95,5 billion which is R6 billion higher than the 2004 Budget estimate, clearly reflecting the buoyancy in consumer demand. However, the revised estimated revenue from specific excise duties of R13 billion is in line with budget expectations. Fuel levies are expected to raise R18,8 billion, about R1,4 billion higher than originally budgeted.

Taxes on international trade and transactions

Customs duties revised upwards by R1,2 billion

Revenue from customs duties is largely driven by the composition of imports, import volumes and the exchange rate. Strong domestic demand translated into an upward revision in the receipts from customs duties of R1,2 billion.

Main budget revenue and progress with tax reform

Total tax to GDP ratio increased to 24,6 per cent in 2004/05

Total tax revenue as a percentage of GDP increased from 22,6 per cent in 1995/96 to an estimated 24,6 per cent in 2004/05. Over the decade, direct taxes increased as a percentage of total gross tax revenue from 54 per cent to almost 56 per cent.

Structural shift in revenue mix

Corporate income tax as a percentage of GDP remained at less than 3 per cent for the period 1994/95 to 1999/00 before increasing to the current 4,7 per cent. The share of personal income tax as a percentage of GDP has declined from 10,2 per cent in 1994/95 to an estimated 8 per cent in 2004/05, reflecting the significant tax relief of R66 billion granted over this period. Value-added tax increased from 5,8 per cent in 1995/96 to an estimated 6,8 per cent of GDP in 2004/05. The restructuring of the composition of tax revenue has targeted consumption tax exemptions to those items most likely to benefit the poor, while creating a more competitive direct tax regime capable of supporting investment and economic growth.

Table 4.3 sets out actual revenue collections for the period 2001/02 to 2003/04 and estimates for 2004/05 to 2007/08. More detail is provided in tables 2 and 3 of *Annexure B*.

Table 4.3 Main budget revenue, 2001/02 – 2007/08

	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
R million		Actual		Revised estimate		Medium-term estimates	
Taxes on income and profits	147 310	164 566	171 963	189 900	200 855	226 250	247 500
Taxes on payroll and workforce	2 717	3 352	3 896	4 600	4 908	5 600	6 000
Taxes on property	4 628	5 085	6 707	8 928	9 820	11 252	12 286
Domestic taxes on goods and services	86 888	97 582	110 174	129 033	143 091	155 232	170 500
Taxes on international trade	8 680	9 620	8 414	11 650	13 200	14 470	15 940
Stamp duties and fees	1 767	1 572	1 360	1 150	900	1 350	1 500
State miscellaneous revenue[1]	307	433	-7	–	–	–	–
Total tax revenue	**252 298**	**282 210**	**302 508**	**345 261**	**372 774**	**414 154**	**453 726**
Departmental revenue	4 088	4 192	5 931	5 493	8 502	6 167	6 378
Transactions in assets and liabilities	81	366	715	533	646	679	690
Less: SACU payments	-8 205	-8 259	-9 723	-13 328	-12 053	-15 573	-16 151
Main budget revenue	**248 262**	**278 508**	**299 431**	**337 960**	**369 869**	**405 427**	**444 643**
Percentage of GDP	*23,7%*	*23,3%*	*23,4%*	*24,1%*	*24,2%*	*24,2%*	*24,1%*
Gross domestic product	*1 047 992*	*1 193 771*	*1 277 029*	*1 403 851*	*1 528 633*	*1 674 016*	*1 847 290*

1. Revenue received by SARS in respect of taxation which could not be allocated to a specific tax instrument.

10,8 per cent growth in revenue since 2001/02

Between 2001/02 and 2004/05, main budget revenue grew at an annual average rate of 10,8 per cent. This strong growth is largely attributed to growth in the collection of taxes on goods and services that increased at an average annual rate of 14,1 per cent. Taxes on income and profits increased at an average annual rate of 8,8 per cent.

Taking account of revenue trends, tax policy changes and macroeconomic projections, main budget revenue is anticipated to grow at an annual average rate of 9,6 per cent over the medium term.

Revenue increases by 9,6 per cent annually over the MTEF

Progress on implementation of tax reform initiatives

Foreign exchange amnesty and adjudication process

In the 2003 Budget speech, the Minister of Finance announced an exchange control amnesty with accompanying tax measures to provide South African residents with an opportunity to regularise illegally held foreign assets and income. More than 42 000 amnesty applications were received by 29 February 2004, the deadline for the submission of amnesty applications, and over 43 000 applications have been submitted in total. Of these, more than 26 000 had been adjudicated by the end of January 2005. The total assets disclosed in amnesty applications are currently estimated at R65 billion, based on exchange rates prevailing on 28 February 2003.

R65 billion of declared foreign assets as result of amnesty programme

The Amnesty Unit expects to collect some R2,4 billion in amnesty levies, which will be allocated on budget for social and residential infrastructure. This comprises R250 million revenue collected from the 2 per cent tax levy for associated domestic tax law violations, R250 million raised by the 5 per cent levy in respect of foreign capital to be repatriated to South Africa, and R1,9 billion from the 10 per cent levy in respect of foreign-retained assets.

Amnesty levy proceeds to be utilised for community infrastrucutre

Progress with retirement fund reform

During 2004 the National Treasury and the Financial Services Board (FSB) embarked upon a thorough regulatory and policy review of the South African retirement industry. This investigation, drawing in part on several earlier inquiries, takes as point of departure the need to ensure protection of the interests of members of retirement funds and increase the proportion of people who are able to make adequate provision for retirement income through their working lives.

Review of pension fund industry to protect rights of members

As part of this process, the National Treasury published a Retirement Fund Reform Discussion Paper outlining regulatory policy objectives and reform proposals in order to address the current institutional weaknesses of the industry, excessive fee and cost structures and accompanying investment risk exposure of members. Work on the tax aspects of the pension fund industry is ongoing, and a discussion paper on these issues will be released in due course. This approach is adopted to ensure that the regulatory and prudential investment framework provides a workable foundation for future tax reforms.

Retirement Fund Reform Discussion Paper released

Retirement fund tax reform seeks to enhance and facilitate adequate retirement savings. In order to take account of the outcome of consultations on wider retirement reform issues, no changes to the tax treatment of retirement savings are proposed at this stage. However, a material adjustment to the tax-exempt threshold for persons age 65 and over is announced this year.

Mineral taxation

Draft Mineral and Petroleum Royalty Bill available by mid-2005

The redrafting of the Mineral and Petroleum Royalty Bill is in progress. While Government remains committed to an *ad valorem* royalty on gross sales, the Bill is undergoing substantial refinements in view of the comments received, industry financial data analysis and new cross-country royalty comparisons. Simultaneously, the redrafting process seeks to accommodate key concerns relating to mineral beneficiation and small-scale mining. It is anticipated that the second draft of the Bill should be available for public comment during the first half of 2005 with submission to Parliament before the close of the year.

A new mining tax regime under review

Government's holistic review of the mining income tax dispensation as announced in the *2004 Budget Review* is ongoing. Among the options under consideration is the appropriateness of the current tax allowance schemes, and the resultant tax deferral benefit enjoyed by mining companies. Government is mindful of both the high capital requirements and the risks attaching to mining investment, and accordingly recognises the need for careful consideration of possible tax changes.

Accelerated tax depreciation for urban development zones

Nine urban development zones approved

In the 2003 Budget, the Minister of Finance announced a tax incentive in support of inner city development projects. This incentive allows taxpayers to receive accelerated depreciation allowances for investment in under-utilised urban development zones. Demarcations of qualifying inner city areas have since been approved and gazetted for nine municipalities (Johannesburg, Cape Town, Tshwane, eThekwini, Emfuleni, Buffalo City, Mangaung, Mbombela and Sol Plaatje). The demarcations for a further seven municipalities are under review and should be concluded during 2005. Early indications are that the tax incentive will assist significantly in boosting development of the country's inner cities.

FIFA World Cup 2010

Legislation to accommodate FIFA World Cup commitments

As stated in the *2004 Medium Term Budget Policy Statement*, South Africa's hosting of the Soccer World Cup in 2010 will require a number of tax exemptions for the international football association's operations and activities. These refinements stem from Government's obligation to satisfy the guarantees required by FIFA to host the event. Discussion of this topic has been ongoing for the past several months in anticipation of possible legislative tax amendments during the latter half of 2005.

Revenue estimates and tax proposals – 2005/06

Table 4.4 sets out the estimates of revenue before tax proposals for 2005/06, based on the macroeconomic assumptions set out in Chapter 2 and the existing tax structure. These are set out in more detail in the *Estimate of National Revenue.*

Table 4.4 Estimates of revenue before tax proposals, 2005/06

R million	2004/05 Revised estimate	2005/06 Before tax proposals	% change
Taxes on income and profits	**189,900**	**211,350**	**11.3%**
Personal income tax	110,950	124,000	11.8%
Company tax	65,450	72,100	10.2%
Secondary tax on companies	7,600	8,700	14.5%
Tax on retirement funds	4,500	4,900	8.9%
Other	1,400	1,650	17.9%
Taxes on payroll and workforce	**4,600**	**5,000**	**8.7%**
Taxes on property	**8,928**	**10,270**	**15.0%**
Domestic taxes on goods and services	**129,033**	**141,085**	**9.3%**
Value-added tax	95,500	106,250	11.3%
Excise duties	14,075	14,400	2.3%
Levies on fuel	18,800	19,700	4.8%
Other	658	735	11.7%
Taxes on international trade and transactions	**11,650**	**13,200**	**13.3%**
Stamp duties and fees	**1,150**	**1,250**	**8.7%**
Total tax revenue	**345,261**	**382,155**	**10.7%**
Departmental revenue	5,493	8,502	54.8%
Transactions in assets and liabilities	533	646	21.1%
Less: SACU payments	-13,328	-12,053	-9.6%
Main budget revenue	**337,960**	**379,250**	**12.2%**

Main budget revenue estimated at R379,3 billion before tax changes

Main budget revenue is estimated to be R379,3 billion before tax changes are proposed. Personal income tax is estimated to increase by 11,8 per cent to R124 billion after accounting for projected increases in remuneration. Corporate income tax and value-added tax are projected to raise R72,1 billion and R106,3 billion respectively.

2005 tax proposals – overview

The 2005 tax proposals are designed to support sustained investment and economic growth, contribute to social equity and promote job creation in the small business sector.

Tax proposals provide net relief of R9,4 billion

Table 4.5 provides the anticipated revenue effects of the tax proposals set out in this Budget. The net effect is to reduce total tax revenue by R9,4 billion. Income tax relief for employment and business income totals R10,9 billion.

Table 4.5 Summary effects of tax proposals, 2005/06

R million	Effect of tax proposals	
Tax revenue		382 155
Non-tax revenue		9 148
Less: SACU payments		-12 053
Main budget revenue, before tax proposals		**379 250**
Budget 2004/05 proposals:		**-9 381**
- Taxes on individuals and companies	**-10 862**	
Personal income tax:	**-7 110**	
Adjust personal income tax rate structure for inflation	-6 800	
Increase in interest and dividend exemption under 65 years	-170	
Increase in interest and dividend exemption 65 years and over	-140	
Corporate income tax	**-2 000**	
Reduction in corporate tax rate	-2 000	
Small business incentives	**-1 752**	
Introduce VAT payments from every 2 months to every 4 months	-275	
Exemption from Skills Development Levy	-92	
Graduated rate structure	-900	
Accelerated depreciation for all assets	-485	
- Financial transaction taxes:	**-800**	
Adjust table for transfer duties	-450	
Elimination of stamp duties on debit entries	-350	
- Taxes on goods and services	**2 281**	
Increase in duties on alcohol	690	
Increase in duties on tobacco products (52% incidence)	620	
Abolish *ad valorem* excise duties on sun protection products	-10	
Abolish duty on base oils for lubricating	-1	
Increase in Air Passenger Departure Tax	32	
Increase in fuel levy	950	
Main budget revenue (after tax proposals)		**369 869**

Taxes on income and profits

Personal income tax – rate and threshold adjustments

Personal income tax relief of R6,8 billion

Since 1996 South Africans have benefited from more than R66 billion in personal income tax relief, primarily alleviating the tax burden on low-income earners. In 2005/06, further personal income tax relief of R6,8 billion is proposed. The adjustments benefit all taxpayers, and take into account that the proposed revision to the tax treatment of vehicle travel allowances will increase the tax payable by predominantly higher income earners. Reduced tax on employment income will favour economic growth and job creation while assisting in containing cost and price trends across the economy.

The tax burden reduction in respect of employment income will not only benefit wage earners but also individual entrepreneurs, who constitute a sizeable proportion of all personal income taxpayers. The increased tax-exempt threshold proposed (see below) will also benefit small businesses. The proposed rate schedule is set out in Table 4.6.

Table 4.6 Personal income tax rate and bracket adjustments, 2004/05 and 2005/06

	2004/05		2005/06
Taxable income (R)	**Rates of tax**	**Taxable income (R)**	**Rates of tax**
0 – 74 000	18% of each R1	0 – 80 000	18% of each R1
74 001 – 115 000	R13 320 + 25% of the amount above R74 000	80 001 – 130 000	R14 400 + 25% of the amount above R80 000
115 001 – 155 000	R23 570 + 30% of the amount above R115 000	130 001 – 180 000	R26 900 + 30% of the amount above R130 000
155 001 – 195 000	R35 570 + 35% of the amount above R155 000	180 001 – 230 000	R41 900 + 35% of the amount above R180 000
195 001 – 270 000	R49 570 + 38% of the amount above R195 000	230 001 – 300 000	R59 400 + 38% of the amount above R230 000
270 001 and above	R78 070 + 40% of the amount above R270 000	300 001 and above	R86 000 + 40% of the amount above R300 000
Rebates		**Rebates**	
Primary	R5 800	Primary	R6 300
Secondary	R3 200	Secondary	R4 500
Tax threshold		**Tax threshold**	
Below age 65	R32 222	Below age 65	R35 000
Age 65 and over	R50 000	Age 65 and over	R60 000

The main adjustments are:

- The primary rebate is raised to R6 300, increasing the income tax threshold by 8,6 per cent to R35 000. This grants significant real tax relief to low-income earners.
- The tax threshold for taxpayers age 65 and over is raised from R50 000 to R60 000.
- Income brackets are broadened, extending relief through the income distribution and offsetting the effect of inflation on the real tax burden.

The resulting distribution of the tax relief is as follows:

- Threshold to R60 000 12,0%
- R60 000 to R150 000 32,3%
- R150 000 to R250 000 22,4%
- R250 000 and above 33,4%.

Significant tax relief for pensioners

The proposed relief for taxpayers over 65, together with a further increase in the interest exemption thresholds, represent a significant alleviation of the tax burden on retired persons. This, in turn, enhances the return on savings for retirement and is a further fiscal encouragement to save. For a retired couple with income only from interest-bearing deposits, approximately R2 million can be invested tax-free in 2005/06. The maximum tax-free income of a couple who take full advantage of the interest exemptions rises from R132 000 to R164 000.

The revised personal income tax schedules are set out in more detail in *Annexure C*.

Interest and dividend income exemption

Interest income exemption thresholds increased

The domestic interest and dividend exemption is currently R11 000 for taxpayers under age 65 and R16 000 for taxpayers age 65 and over. This exemption is an important benefit for those who rely on interest as their main source of income. As from 1 March 2005, the interest exemption threshold is increased to R15 000 – 36,4 per cent higher – for taxpayers under 65, and to R22 000 – 37,5 per cent up – for taxpayers aged 65 and over. It is also proposed to increase the proportion of the exemption applicable to foreign interest income and dividends from R1 000 to R2 000 per annum. These changes will result in a revenue loss of R310 million.

Encouragement of medical scheme membership

The current tax treatment of medical scheme arrangements allows an employer to pay two-thirds of the member's contribution as a tax-free fringe benefit. This has the effect that the fiscal benefit, expressed as the tax-induced reduction in the price of medical scheme membership, rises from nil for individuals below the tax threshold to 26,7 per cent for those taxed at the maximum marginal rate of 40 per cent.

Reform of tax treatment of medical aid cover

With a view to encouraging broader medical scheme coverage, extending the tax benefit to self-employed individuals and achieving a more equitable tax treatment, it is proposed that the two-thirds tax-free provision should be replaced by a monthly monetary cap that takes into account the number of beneficiaries covered by medical scheme membership. This in effect provides complete tax relief for more affordable medical aid packages for low and middle-income families, while restricting benefits for more expensive packages.

The capping of medical aid contributions will have the further advantage of removing the tax-induced reduction in the marginal price of more expensive medical scheme options, which interferes with market discipline on medical scheme prices and costs. A discussion document will be released this year on the proposed reform. For administrative reasons, it will take effect on 1 March 2006.

Motor vehicle allowance

The deduction of deemed business expenses against a motor allowance has increased substantially over the years and has become a commonly used means of reducing tax liability, irrespective of actual business travel cost. The current formula creates a bias in the structuring of salary packages, particularly for higher income earners, encourages the purchase of higher value vehicles and unfairly influences household travel choices.

Residual value of vehicle to be taken into account

As from 1 March 2005, the deemed method for calculating fixed business travel cost will be adjusted by introducing a residual value element and by capping the car value at R360 000. The revision of the tables will recognise that five-year old vehicles commonly have a 30 per cent residual value. The deemed private kilometres will be increased from 14 000 to 16 000, and to 18 000 in 2006.

Simultaneously, the deemed maintenance and fuel costs are to be adjusted to reflect the latest applicable average running cost rates for motor vehicles, and will be annually reviewed in future. In line with these adjustments, the monthly taxable value of a company car is to be increased from the current 1,8 per cent to 2,5 per cent effective from 1 March 2006.

Travel allowance change to yield R1,7 billion

These structural changes will translate into additional revenue of approximately R1,7 billion, but it is recognised that this will accrue to Government only when 2006 tax assessments are finalized in 2006/07. Taxpayers would therefore be well-advised to exercise caution in their cash-flow management during 2005/06 and to anticipate higher top-up tax payments during the latter half of 2006.

Related VAT changes on deemed motor vehicle use

For VAT purposes, the value for the deemed supply of the right of use of a motor vehicle is determined by applying a percentage to the determined value of the vehicle. In light of the proposed changes to the motor use fringe benefit system, the percentages and amounts prescribed by the Minister for VAT purposes will also be adjusted, and will be published in the Government Gazette.

Curtailing subsistence allowances as a salary structuring

More stringent measures to arrest excessive claims for travel expenses

Many employers compensate their employees for work-related travel, including advances to cover travel subsistence. Currently, an exclusion from taxable income is available on a per diem basis, which obviates the need to maintain receipts for travel expenses incurred. Unfortunately, some employees and employers are relying on this mechanism in order to artificially reduce and postpone employees' tax obligations. Government will accordingly seek to eliminate this form of salary structuring by requiring a more direct and immediate link between a tax-free subsistence advance and anticipated travel. Tax-free advances for travel without fixed dates or for travel long after the advance is paid will no longer be condoned. The foreign travel per diem limits will also be revisited in order to align these more closely with prevailing foreign country costs.

Withholding tax on visiting entertainers and sportspeople

Like all visiting foreign workers, visiting entertainers and sportspeople are responsible for paying South African tax on their South African source income. However, tax compliance is poor. Problems in enforcement mainly stem from the short-term nature of the local events and the substantial quantum of the tax liability. It is therefore proposed, in line with international practice, to introduce a final withholding tax regime on the gross payments to visiting entertainers and sportspeople. These will be set at 5 per cent for visiting residents of African countries and 15 per cent for residents of other countries. The lower rate for African residents recognises the special nature of South Africa's relationship with other African countries.

Promoting visiting skilled expatriates

Alleviating the capital gains tax burden for visiting skilled expatriates

Government recognises the need to encourage visiting expatriates with scarce skills. Taking into account industry submissions in this regard, the introduction of the residence basis of taxation was therefore accompanied by a window period of three years for expatriates to reside in South Africa without being regarded as tax residents.

It has now become apparent that recent changes to the tax resident definition are imposing an undue burden on skilled expatriates, especially when considered in combination with the new capital gains tax. Subsequent experience and international benchmarking have indicated that this concession should be revisited. Consideration is therefore being given to possible changes to the tax resident definition to allow for extended South African visitation. As an alternative, tax amendments could seek to alleviate the capital gains tax burden on foreign assets acquired before entry into South Africa (as well as certain subsequently acquired foreign assets). These envisaged tax changes will be informed by international competitiveness concerns and the need for administrative simplicity.

Transfer duty

Transfer duty reduced

The purchase of fixed property is subject to transfer duty on a sliding scale when bought by natural persons and at a fixed rate of 10 per cent for properties acquired by juristic entities. In the case of fixed property bought by natural persons, the first R150 000 is not subject to transfer duty. Given the steep increases in property prices during the last few years, it is proposed to increase the exempt threshold from R150 000 to R190 000 and the second threshold from R320 000 to R330 000 with effect from 1 March 2005.

Table 4.7 Proposed rates of transfer duty, 2005/06

Property value	Rates of tax
R0 – R190 000	0%
R190 001 – R330 000	5% on the value above R190 000
R330 001 and above	R7 000 plus 8% on the value above R330 000

The proposed new duty rate structure will reduce the tax burden on a property transaction of R320 000 by R2 000. This proposal will result in a revenue loss of R450 million.

Table 4.8 Current and proposed transfer duty

Property value	Current duty	% of value	Proposed duty	% of value
R180 000	R1 500	0,8%	R0	–
R250 000	R5 000	2,0%	R3 000	1,2%
R320 000	R8 500	2,7%	R6 500	2,0%
R350 000	R10 900	3,1%	R8 600	2,5%
R500 000	R22 900	4,6%	R20 600	4,1%
R750 000	R42 900	5,7%	R40 600	5,4%
R1 000 000	R62 900	6,3%	R60 600	6,1%

Tax relief on business income

Reduction in corporate tax rate

Trend towards lower corporate tax rates rather than allowances

Internationally, a clear trend is emerging towards reduced taxation, or increased tax exemption levels, for business income. Corporate tax rate reductions have been implemented in many countries, motivated by the imperative of competing for scarce foreign direct investment, minimising incentives for tax avoidance and reducing distortions due to the imposition of high taxes. International practice is also informed by increasing evidence that a lower corporate rate together with a robust tax structure is fiscally more sustainable than the erosion of effective rates through a proliferation of special tax allowances.

Reduction in headline corporate tax rate from 30 to 29 per cent

Globally, a general disillusionment in respect of tax incentives has set in, as governments seldom have a clear quantitative and qualitative understanding of their effectiveness or revenue impact. A moderate statutory rate structure, with a graduated lower rate regime for incorporated small businesses, from the perspectives of transparency, administrative simplicity and economic efficiency, is the preferred policy route. It is accordingly proposed that with effect from 1 April 2005, the South African corporate income tax rate will be reduced from 30 per cent to 29 per cent. This proposal is estimated to reduce total tax revenue by R2 billion.

The reduction in the general corporate tax rate necessitates corresponding changes to other rates linked to that rate:

- The tax rate for South African branches or agencies of a foreign company will be reduced from 35 per cent to 34 per cent.
- The rates for company policyholder funds and corporate funds of long-term insurers will be reduced from 30 to 29 per cent.
- In the case of gold mining companies not exempt from the STC, the new formula for gold mining income will be Y = 35-175/x (formerly, Y = 37-185/x); and in the case of gold mining companies opting to be exempt from the STC, the new formula will be Y = 45-225/x (formerly, Y = 46-230/x), with the rate for non-mining income reduced from 38 per cent to 37 per cent.
- The tax rate for an employment company will be reduced from 35 per cent to 34 per cent.

Lapsing of Strategic Industrial Projects Programme

Policy review of the SIP programme

South Africa has over the recent past implemented a strategic industrial investment incentive scheme, which provided R10 billion in special tax allowances for qualifying investments, subject to their implementation within a period of four years. The programme will lapse at the end of July 2005. It has served its purpose, and an interdepartmental task team will now review the lessons from this programme. This year’s business income tax proposals, together with the already enacted 40:20:20:20 tax depreciation regime for manufacturing assets, will provide significant impetus for fixed capital formation without the uncertainty of an adjudication process.

Introduction of tonnage tax regime to stimulate the South African shipping industry

Decline of ship registrations

South Africa primarily depends on maritime trade, with over 90 per cent of exports and imports conducted via international shipping routes. Unfortunately, foreign-registered vessels almost solely provide this service, as only one vessel remains on the South African Ships Register (down from 50 vessels in the 1970s). One of the reasons for the decline has been the rapidly changing international tax environment, which has rendered the South African system very unfavourable for ship owners.

Introduction of a tonnage tax with implementation in 2006

The introduction of a tonnage tax regime, which taxes shipping companies at fixed rates according to the size of their ships, and not according to the company's business income results, will lower the effective tax rate paid by such companies, making the South African tax environment for shipping more competitive. Tonnage tax regimes have been successfully implemented in other countries such as Belgium, India, Ireland, the UK and the Netherlands with almost immediate positive outcomes in terms of related business activities.

This proposal is part of a coordinated transport strategy led by the Department of Transport, which aims to revive the flagging maritime industry. South Africa hopes to signal to the rest of the world its seriousness in growing the South African ships register. It is proposed to draft legislation in 2005 with a view to introducing the regime in the following fiscal year. This should give ship owners enough time to adjust their view of the South African business environment before the new regime is actually implemented.

Facilitating company restructurings

Relaxation of provisions relating to company restructurings

A few years ago, Government revised the tax treatment of company restructurings in support of more efficiently realigned business structures. However, the regime is proving to be overly restrictive in practice. Of special concern are the various percentage requirements, such as 'the 75 per cent' shareholder threshold for intra-group tax-free transfers. It is proposed to reduce this threshold to 70 per cent as it accommodates other government regulations and guidelines. In addition, the 75 per cent look-through test for determining passive financial instrument company status may be too high in the case of domestic and foreign restructurings involving multi-tier company structures. The 'more than 25 per cent threshold' for tax-free formations is also unduly hindering company formations when multiple parties seek to form a company. Both thresholds will accordingly be reduced. Other lesser anomalies hindering restructurings and avoidance loopholes will be addressed as time permits.

Refining film incentives

Growing interest in the South African film industry is a welcome development. However, some film schemes involve complex and disguised 'sale/leaseback' or 'lease in/lease-out' arrangements that involve little or no commercial risk and may even carry no connection to the South African film industry. As a result, the tax incentives for films must be refined to achieve their intended goal. Alternative forms of targeted tax relief will be considered, such as exempting government film grants, to encourage this promising industry.

Government grants

Income tax exemption for Government's cash grants to private sector

Government has introduced a uniform system of dealing with the value-added tax in the context of government grants to public entities as well as in the context of government grants to private parties. It is appropriate to take a first step in this direction in terms of the Income Tax Act. The current system of exempting certain grants from income tax will be replaced with a more comprehensive system for exempting Government's cash grants.

Financial transaction tax relief for the new issue of company shares

Government has steadily removed transaction taxes on financial instruments. However, equity shares still remain fully within the tax net. While these tax charges per transaction are generally light, they can be substantial when a company issues new shares upon formation or upon raising capital via equity financing. The resulting tax non-neutrality between debt and equity capital makes little economic sense because equity financing offers companies better flexibility in terms of payments over the long-term than debt financing. In order to address these concerns, all financial transaction taxes will be eliminated on the issue of shares (while providing appropriate safeguards to ensure that this exemption is not used as a tool to eliminate financial transaction taxes imposed on sales between shareholders). This proposal will take effect from 1 January 2006.

Removal of financial transaction taxes on debit entries

Phased elimination of financial transaction taxes

Government and the public alike have become increasingly concerned about the high cost of banking charges in South Africa, often with a disproportionate impact on low-income individuals and small businesses. The introduction by the banking sector of low-cost Mzansi accounts, in keeping with Financial Sector Charter commitments, is a welcome step forward. Government is mindful of the fact that financial transaction taxes on debit entries add further costs on top of private banking charges. It has accordingly been decided that stamp duties on all debit entries should be eliminated with effect from 1 March 2005, at a cost of R350 million.

Business activities of public benefit organisations

PBOs will be able to conduct taxable activities

The income tax system provides exemption for public benefit organisations (PBOs) engaged in various forms of non-profit activities. As part of these overall requirements for exemption, any business undertakings in excess of certain limits results in termination of PBO tax exempt status. Subsequent experience in this area reveals that this 'all-or-nothing' approach is impractical because PBOs must be self-sustaining in order to survive. Government has accordingly decided to allow for a system of partial taxation. Under this approach, business activities of a PBO in excess of the prescribed limits will become fully taxable without undermining the exemption for the underlying public benefit activities. Consideration will be given to reviewing the business limits as well as the application of this partial tax system to other exempt organisations, such as sport clubs, as well as the interaction of all these entities with trusts.

Tax stimulus in support of small businesses

Graduated tax rate structure and accelerated depreciation

Tax benefits for small businesses

As part of a broader initiative to encourage and support small business development, further income tax relief for this sector is proposed in the 2005 Budget. The proposed measures should significantly increase cash flow for small businesses, contributing to the surplus available for reinvestment, thereby supporting business growth and employment. The tax reform measures are designed to be accompanied by minimal administrative and compliance costs.

Small business tax relief extended to personal services

Firstly, the category of small business companies eligible for relief will be expanded to cover personal services, in recognition of their prominence as an engine of growth within the wider small business sector. Small businesses primarily engaged in the provision of personal services will now be fully eligible for relief as long as these businesses maintain at least four full-time employees for core operations. This employee requirement ensures that the new incentive will be directed toward businesses that are capable of enhancing employment.

Increased turnover limit

Secondly, the turnover limit for eligible companies will be increased from R5 million to R6 million.

Graduated company rate structure for small businesses

Thirdly, under the new regime, qualifying small businesses will be subject to the following rate structure:

- R0 – R35 000 of taxable income - 0%
- R35 001 to R250 000 of taxable income - 10%
- R250 001+ of taxable income - 29%

Three-year accelerated tax depreciation write-off period for all non-manufacturing assets

Finally, small businesses will also benefit from a simplified and enhanced depreciation regime to encourage fixed capital formation. These companies will now be eligible for a depreciation write-off at a 50:30:20 per cent rate over a three-year period for all depreciable assets, while manufacturing assets will retain their immediate 100 per cent write-off. The current R20 000 double deduction for start-ups will be removed, in view of the new improved tax rate structure. These rate adjustments, and the inclusion of personal services, will take effect from 1 April 2005 at a cost of R1,4 billion.

Administrative measures in support of small businesses

Tax compliance burden of the small business sector reviewed

In 2004, the SARS undertook to review the administrative and tax compliance concerns of small, medium and micro-sized enterprises. Stemming from this initiative, SARS held extensive workshops and consulted widely with various stakeholders, from Government and industry. Valuable inputs were received from all these stakeholders and SARS compiled a list of issues that ranged from those that related directly to tax administration and policy, to issues arising from other government departments' regulatory practices.

In line with successful economies' practices, Government believes that vibrant entrepreneurship constitutes a key ingredient for higher economic growth and wealth creation. A thriving and dynamic small business sector must be nurtured as it increases competition and challenges established businesses to provide goods and services at lower cost, and indirectly supporting consumers' rights.

Enabling small business

The 2005 Budget heralds the beginning of a process of structural change that is intended to reduce compliance costs and provide a more enabling environment for small business. Differentiated responses are proposed according to business size, which will permit a smooth transition between the different firm sizes and their commensurate increase in compliance obligations. A set of responses is also proposed to encourage informal businesses to migrate to the formal sector.

The proposals below represent a set of interventions that demonstrate Government's commitment to assisting small business while permitting space for a broader package of interventions to be fully understood, agreed, and prepared for implementation.

- <u>Community tax helpers</u>: SARS will be deploying staff freed by its restructuring and greater efficiency to visit small businesses to help them with and educate them about registration, return completion, and businesses' tax obligations.
- <u>Small businesses help desks</u>: SARS will make dedicated facilities available for small business in its call centre and offices. This will be coupled with extended hours for the call centre and selected offices.
- <u>Accounting and payroll packages for small businesses</u>: SARS will make accounting and payroll packages available to small businesses both in the form of software that can be installed on the small businesses' existing computer equipment and web based systems running on SARS web servers that will be accessible over the internet or kiosks that SARS will set up.
- <u>Small retailers VAT package (VAT retail scheme):</u> The small retailers VAT package, which was announced as the VAT retail scheme in the 2004 Budget Review, will be ready for implementation on 1 April 2005. This package provides for a simplified method of accounting for VAT for businesses with a turnover of less than R1 million - mainly in the retail sector - that do not have access to cash registers that can distinguish between zero rated and standard rated sales.
- <u>Focus on VAT education:</u> In order to assist small businesses that have difficulty in understanding the VAT process and rules, a specific initiative on VAT education will be undertaken.

Three year programme to support small business

Establishing and growing a small business brings with it many responsibilities for the entrepreneur, of which tax compliance is one. But small businesses should not be obliged to spend an inordinate amount of time and energy in understanding and complying with the tax rules. Government therefore seeks to introduce for small businesses a simple, modern and fair tax system which is also adaptable to changes in the business environment and enables the revenue authorities to collect taxes that are due efficiently. A wide-ranging programme of administrative measures to support small businesses will be implemented over the next three years.

VAT return filing every four months

Small businesses regard the filing of VAT returns as a substantial part of their compliance costs. This is partially due to the requirement to file itself and partially due to the need to maintain accurate and up-to-date accounting records in order to complete the return.

Fewer VAT filings

As a further measure to keep the VAT compliance costs of small businesses to a minimum while providing a more gradual entry into the VAT system and to assist with the cash flow, a VAT return every four months is proposed, instead of the current two-monthly filing, for small businesses with an annual turnover of less than R1 million. Registered VAT vendors may elect to remain on the two-monthly return cycle if so desired. This cash flow relief comes into effect from 1 August 2005 at an estimated cost of R275 million.

Skills development levy

The threshold for skills levy obligations to be raised to R500 000

The skills development levy was introduced in 2001 to provide funding for the training and upgrading of skills levels of the workforce. Currently, businesses with a payroll of more than R250 000 per annum or with at least one employee registered for PAYE are required to account for the skills development levy. As part of the initiative to provide relief for small businesses and to reduce the compliance costs of small businesses it is proposed to increase this threshold to R500 000 and to drop the requirement that businesses must account for the skills development levy if at least one of their employees are registered for PAYE. This additional tax relief measure comes into effect from 1 August 2005 at an estimated cost of R92 million.

Small public benefit organisations

Public benefit organisations must complete a comprehensive application form, provide extensive supporting documentation, and submit detailed annual returns for their tax-exempt status. These standards operate as an important safeguard for the tax system but can be overly burdensome for small organisations. Government will introduce a simplified registration process and annual tax return procedure for small public benefits organisations in order to reduce their initial and ongoing compliance burden.

Tax measures to facilitate environmental sustainability

Government's policies aim to ensure environmental sustainability

In line with the policy objectives underlying the Millennium Development Goals, South Africa seeks to integrate the principles of sustainable development into government policies and programmes, including responsible stewardship of environmental resources. Government is keen to make a serious beginning during 2005 by engaging with a wide spectrum of stakeholders on drafting legislation for the imposition of environmental charges. These structural changes could firstly make resources available for the introduction of clean technologies in support of the environment, as required by our Constitution, and secondly, alleviate fiscal pressures on employment income.

Encouraging investments in renewable energy

3-year write-off for renewable energy technology

In 2004, Government provided accelerated depreciation for investments in bio-diesel and bio-fuels. Building on this initiative, it is now proposed to extend accelerated depreciation to other forms of environmentally friendly energy sources. Renewable energy investments, such as solar energy and windmill technology, will benefit from a tax-depreciation write-off of 50:30:20 per cent over three years.

Rehabilitation reserve funds

Government has long recognised the need for providing tax relief in the case of mining rehabilitation funds required by the Department of Minerals and Energy. Other sectors, such as the chemical and electricity generation industries, are subject to similar reserve requirements in terms of regulatory policies of the Department of Environmental Affairs and Tourism. Government is therefore planning to extend comparable tax relief for these forms of contingency reserves in 2005 or 2006 (depending on the outcome of consultations with the Department of Environmental Affairs and Tourism). Simultaneously, the tax treatment of mining rehabilitation funds will be re-examined in order to address certain anomalies as well as to consider extending relief for other forms of mining rehabilitation fund set-asides.

Anti-avoidance measures

Overhaul of the general anti-avoidance rule ("GAAR")

Aggressive tax planning practices undermine legislative intent

A review of schemes giving rise to many of the tax amendments of recent years indicates the myriad of ways in which taxpayers seek to undermine tax principles. Many of these contrivances demonstrate disparities between legal form and economic substance. Some of these contrivances (such as hybrid instruments) illustrate how taxpayers attempt to distort the law by calling an instrument one thing for legal and tax purposes while that same instrument provides economic features yielding the opposite effect. Other contrivances involve circular cash flows, multiple and temporary structures as well as extraneous steps added to an otherwise valid transaction.

Many countries have general anti-avoidance rules (GAARs). These provisions seek to overturn tax-motivated transactions violating economic substance despite the legal form. Section 103 of the Income Tax Act, the South African GAAR is based on antiquated notions of legal form and intent. The problem is exacerbated by formalistic judicial interpretations that undermine the legislation's ultimate goal of curtailing tax avoidance schemes that undermine the Income Tax

Act's underlying policy, which is to tax in full the enhancement of net economic wealth. A discussion paper regarding the proposed new format of section 103 is to be circulated for comment this year.

Offshore banking centres

Residence-based income tax system must balance international competitiveness with effective tax measures arresting undue tax deferral

When South Africa shifted to a worldwide tax system, one key concern involved the treatment of South African controlled foreign subsidiaries. The overall treatment of these subsidiaries represents a difficult balance between preventing artificial outflows (requiring immediate taxation), and maintaining international competitiveness (requiring exemption). Offshore banking and other forms of financing only serve to highlight this dilemma. In order to achieve this balance, the tax system contains requirements specifically tailored for South African controlled foreign banks. For instance, tax-free treatment applies only to banks, insurers, dealers or brokers having a license or registration that allows for foreign subsidiary operations to be conducted with local country clients to the same extent as locally controlled operations. The purpose of these rules is to ensure that the above operations are stand-alone active businesses (as opposed to company treasury activities) and to ensure that these operations are located outside countries that utilise harmful tax practices in an attempt to poach South African tax base. Recent experience with the South African controlled foreign company rules requires that the residence-based income tax system be improved.

Rules related to harmful tax practices by tax havens to be reconsidered

New offshore legislation of certain tax havens reveals that certain tests (i.e., the banking license/registration rule for finance operations) are no longer effective to prevent the impact of harmful tax practices by tax havens. It has also been discovered that current tax legislation may inadvertently inhibit legitimate offshore financing operations by South African banks (such as vehicle financing). In view of these circumstances, Government will reconsider the rules in this area.

Bribes, penalties and other illegal activities

South African tax law does not specifically address bribes, penalties and other forms of illegal activity. This leaves open the possibility that a business might seek to deduct a bribe purportedly incurred in the production of income. Deductions of penalties and fines might be subject to similar reasoning. Arguments have also been advanced to the effect that amounts generated from criminal activity do not qualify as taxable income. These matters need to be addressed both as a matter of good governance and to clarify the tax law. The proposed changes will reinforce South Africa's anti-corruption drive.

Taxes on goods and services and international trade

Value-added tax place of supply rules

VAT place of supply rules will be clarified this year to provide certainty with regard to the responsibility and accountability for VAT in the case of certain international transactions, including service related transactions and purchases via the internet (e-commerce).

Excise duties on alcoholic beverages

This is the second year of the phasing-in of agreed tax burdens (excise duties plus VAT) on alcoholic beverages, set at 23 per cent on natural wine, 33 per cent on clear beer and 43 per cent on spirits.

The proposed increases in the respective excise duties range from 9,4 per cent to 20 per cent and come into effect on 23 February. These adjustments are expected to raise about R690 million in additional revenue. In addition, the SARS has issued a revised structure of rebates for excise duties. This step will simplify the administration of such rebates and will ensure that such rebates are fairly made available within a clear policy framework.

Excise duties on tobacco products

Tobacco tax increases ranging from 7,5 to 15 per cent

The 52 per cent total tax burden (excise duties plus VAT) is to be maintained. Excise duties on tobacco products will increase between 7,5 per cent and 14,9 per cent with effect from 23 February and are expected to raise about R620 million in additional revenue.

Table 4.9 Changes in specific excise duties, 2005/06

Product	Current excise duty rate	Proposed excise duty rate	Estimated additional revenue R million	Change in excise duty Nominal	Real
Malt beer	R30,73c / litre of absolute alcohol (52,24c / average 340ml can)	R33,65 / litre of absolute alcohol (57,20c / average 340ml can)	390,0	9,5%	5,3%
Traditional African beer	7,82c / litre	7,82c / litre	–	0,0%	-4,2%
Traditional African beer powder	34,7c / kg	34,70c / kg	–	0,0%	-4,2%
Unfortified wine	117,1c / litre	140,52c / litre	65,5	20,0%	15,8%
Fortified wine	232,87c / litre	263,14c/ litre	10,4	13,0%	8,8%
Sparkling wine	323,32c / litre	387,99c / litre	5,1	20,0%	15,8%
Ciders and alcoholic fruit beverages	153,74c / litre (52,27c / average 340 ml can)	168,24c / litre (57,20c / average 340 ml can)	29,0	9,4%	5,2%
Spirits	R45,84c / litre of absolute alcohol (R14,78 / average 750 ml bottle)	R50,42 / litre of absolute alcohol (R16,26 / 750 ml bottle)	190,0	10,0%	5,8%
Cigarettes	452,8c / 20 cigarettes	504,87c / 20 cigarettes	577,6	11,5%	7,3%
Cigarette tobacco	695,17c / 50g	747,30c / 50g	0,2	7,5%	3,3%
Pipe tobacco	170,79c / 25g	190,60c / 25g	41,3	11,6%	7,4%
Cigars	R28,36 / 23g	R32,59/ 23g	0,9	14,9%	10,7%

General fuel levy

5 cents/litre general fuel levy increase for petrol and diesel

It is proposed that the general fuel levy on petrol and diesel be increased by 5 cents per litre to 116 cents and 100 cents per litre respectively with effect from 6 April 2005. For petrol this constitutes an increase of 4,5 per cent and for diesel a 5,3 per cent increase. These adjustments are broadly in line with inflation and will result in a marginal reduction in the fuel tax differential between petrol and diesel. The proposed increase in the fuel levy will raise approximately R950 million in additional revenue for 2005/06.

Diesel rebate for primary producers increased by 3,14 c/litre

At the same time, it is proposed to increase the diesel fuel concession refund percentage to producers in agriculture, mining and forestry from the current 38,8 per cent of the general fuel levy to 40 per cent. The actual concession will increase from 36,86 to 40 cents per litre. This adjustment comes into effect on 6 April 2005.

Introduction of new rules in respect of sub-contractors making use of the diesel refund system

The SARS and the National Treasury will during the course of 2005 undertake a review of the diesel refund system with the aim of identifying and eliminating potential abuse. Problems relating to sub-contractors that may not claim the diesel fuel refund and wet versus dry contracts will also be addressed.

LPG will not attract general fuel levy

After further consultation with stakeholders during 2004, liquid petroleum gas used for road transport purposes (Autogas) will not attract the general fuel levy due to administrative considerations. Given that individuals injured in motor vehicle accidents, where one or more such vehicles were powered by Autogas, may claim from the

Road Accident Fund it is suggested that the LPG Association and the Road Accident Fund come to an understanding in respect of a fair contribution towards the Road Accident Fund.

Table 4.10 Total combined fuel levy on leaded petrol and diesel, 2003/04 – 2005/06

	2003/04		2004/05		2005/06	
	93 Octane petrol	Diesel	93 Octane petrol	Diesel	93 Octane petrol	Diesel
General fuel levy	101,0	85,0	111,0	95,0	116,0	100,0
Road Accident Fund levy	21,5	21,5	26,5	26,5	31,5	31,5
Customs and Excise levy	4,0	4,0	4,0	4,0	4,0	4,0
Equalization Fund levy	–	–	–	–	–	–
Illuminating Paraffin marker	–	0,2	–	0,2	–	0,2
Total	**126,5**	**110,7**	**141,5**	**125,7**	**151,5**	**135,7**
Pump price: Gauteng (as in February)[1]	392,0	355,1	408,0	347,5	420,0	384,5
Taxes as % of pump price	*32,3%*	*31,2%*	*34,7%*	*36,2%*	*36,1%*	*35,3%*

1. Diesel (0,3% sulphur) wholesale price (retail price not regulated).

Octane differential

Following discussions between the Department of Minerals and Energy, the petroleum industry, motor vehicle manufacturers and other stakeholders, it was decided that the domestic octane structure of petrol will be changed as of January 2006 when 91, 93 and 95 octane will be made available inland as opposed to 93 and 95 octane at the coast. For purposes of fuel efficiency, only some of the newer vehicles require 95 octane petrol in the inland. Therefore, given limited fuel refining capacity as well as the need to limit octane wastage in inland areas, it will be necessary to manage the inland uptake of 95 octane petrol. It is therefore proposed to introduce a demand management levy on 95 octane petrol from 1 January 2006 for inland areas only.

Road Accident Fund levy

Increase Road Accident Fund levy by 5c/litre

It is proposed to increase the Road Accident Fund levy on petrol and diesel by 5 cents per litre, from 26,5 to 31,5 cents per litre. This higher than inflation adjustment of 18,9 per cent will seek to stabilise the financial position of the Road Accident Fund. The increase comes into effect on 6 April 2005.

Base oils for lubricating

Scrapping of excise duty on lubrication base oils

After consultation with all the relevant stakeholders, it was decided to abolish the excise duty on base oils for lubrication with effect from 1 April 2005. The duty of 20 cents per 100 litres has been at this level for many years. The revenue potential of this duty is very limited (R700 000 per annum) and industry has put in place adequate financial measures to address the environmental consequences of disposing of such oils.

Air departure tax

The air passenger departure tax will be increased to take account of inflation. The tax on international departing passengers within the SACU region will be increased from R55 to R60. For international departing passengers travelling to destinations outside the SACU region the tax will be increased from R110 to R120. These increases come into effect 1 August 2005 and will raise approximately R32 million in additional revenue.

Regional Service Council (RSC) levies and Joint Services Board levies

RSC levies to be replaced

It is proposed to abolish the RSC levies on 30 June 2006, to be replaced with alternative tax instruments or funding arrangements to ensure the continued independence and financial viability of municipalities. The alternative tax instruments and or funding arrangements will be finalised in consultation with all stakeholders by the end of September 2005 in order to enable draft legislation to be tabled before the end of 2005.

A recent Supreme Court of Appeal decision has ruled that dividends paid to certain holding companies are subject to RSC levies. In order to create certainty and to limit the impact of this ruling on businesses, the RSC Act will be amended with a view to limiting the retrospective collection of RSC levies in these instances. A prescription period will be included in the RSC Act.

Taxes on international trade and transactions

Elimination of ad valorem excise duties on sun protection products and certain digital video cameras

It is proposed to eliminate the *ad valorem* excise duties on cosmetic sun protection products with a sun protection factor of 15 and more. This is to ensure that preventative products that could help to limit the incidence of skin cancer are available at reasonable prices. In addition, digital video cameras with a value in excess of R15 000 will not be subject to the *ad valorem* excise duty as such cameras are used almost exclusively for commercial purposes to produce films and TV programmes. These proposals take effect from 1 April 2005 at a cost of R10 million.

Measures to enhance tax and customs administration

Tax policy design and administration reforms are coordinated for the attainment of Government's fiscal objectives

It is well established internationally that tax and administrative policy must operate in an interactive way to achieve government's fiscal policy goals. Tax administration has underpinned tax policy in an environment characterised by substantial tax and trade policy changes over the past five years, matched by fundamental tax administration reforms. As an example, while the residence basis of taxation, the EU trade agreement, and other tax and trade policy changes were introduced, the SARS fundamentally reorganised its operations along process lines, with greater emphasis on risk assessment, enforcement for non-compliant taxpayers and enhanced service for compliant taxpayers.

Reducing compliance costs and enhancing service

A number of key service initiatives by SARS will be introduced in 2005/06, benefiting the broad taxpaying community and tax practitioners.

Single registration for all tax products per taxpayer

Taxpayers registering for the first time will be able to register for all taxes SARS administers using a single form and process.

e-Filing to be extended to a number of new tax instruments

Compulsory e-filing for large taxpayers

In order to streamline return processing, payments and refunds, compulsory e-filing for PAYE and VAT returns for large taxpayers with a turnover in excess of R30 million per annum will be introduced. Other e-filing initiatives include:

- The e-stamp initiative with effect from 1 April 2005
- Individual returns in respect of taxpayers only earning a salary and investment income below the exempt thresholds
- Transfer duty
- Tax on retirement funds
- Secondary tax on companies
- Air passenger tax
- Applications for tax clearance certificates for tenders.

In order to expedite the awarding of tenders and reduce the incidence of fraudulent certificates, the tax clearance system will allow government procurement officers access to the tax status of applicants that have given consent to such access.

Full view of account for taxpayers and tax practitioners

Electronic view of taxpayers' accounts

Taxpayers will be able to view their account information and balances in respect of their core taxes through the e-filing system. This facility will also be extended to tax practitioners representing taxpayers.

Single national call centre access number for tax and customs

Single national call centre will be created

At present different call centre numbers are used depending on the region in which a taxpayer is based. There is also no Customs call centre to handle traders' calls. A single national call centre access number will be created that will enable a single point of entry for both tax and customs enquiries.

Taxpayer relationship managers at the Large Business Centre

From the second half of this year, dedicated taxpayer relationship managers will be in place per sector at the Large Business Centre, allowing taxpayers a single point of entry to the centre.

Trade facilitation and economic security

Implementation of trans-national electronic corridors on NEPAD priority corridors

Increased customs cooperation between Namibia, Botswana and South Africa

The Trans-Kalahari Corridor pilot project was initiated as a tri-lateral initiative between the governments of Namibia, Botswana and South Africa. It has resulted in the successful implementation of *inter alia* a single administrative document as well as the introduction of simplified customs transit procedures and increased cooperation between the customs administrations of the three countries. The success of this seamless processing initiative will now be extended to the Maputo Development Corridor.

Single administrative document for all customs declarations

Introduction of single multi-purpose customs declaration

In order to significantly reduce red tape, minimise processing times and delays at borders for traders and transporters, a single multi-purpose customs declaration for the importation, exportation and transit movement of goods across borders will be introduced.

One stop border posts at selected border posts

Joint customs control instituted at major commercial ports of entry

At the core of the one-stop concept is the ability of border authorities to perform joint controls. Joint controls secure improved enforcement efficiencies in several ways and reduce long delays in processing commercial vehicles at border posts. It is envisaged that joint customs controls will be put in place at South Africa's major commercial ports of entry.

Implementation of a single window linking SA government departments and foreign customs administrations

Single document registration facility for importers and exporters

Traders currently have to interact with a number of government authorities when importing and exporting goods and, as a result, have to complete various documents. A single window linking government departments and foreign customs administrations will enable exporters to provide information on import and export transactions to one government authority that then shares the information with the other interested parties, hence reducing costs and saving time. SARS has already started to interact with some other government authorities, and it is expected that this initiative will further streamline import and export control processes and contribute to trade promotion.

Broadening the tax base and reducing non-compliance

Increasing the number of people in the tax system

Enforcing registration for income tax purposes

Legislation has been passed making it compulsory to register for income tax when liable. SARS intends to ensure that the legislation is applied by the cross-referencing of data and accessing of third party information.

Mobile X-ray scanners and high visibility roving anti-smuggling teams

New monitoring technology at ports of entry

Ten state-of-the-art mobile X-ray scanners will be acquired and will serve to inspect both imports and exports at selected ports of entry. Furthermore, high-visibility roving anti-smuggling teams, backed up by canine units, will also be introduced.

Identifying undisclosed income

Investigative unit for high net worth individuals

Two key risk areas have been identified for special focus in the coming year. Firstly, with the substantial increase in the value of property transactions in recent years, it has come to SARS' attention that there is an increase in under-declaration of income in respect of property transactions. Secondly, attention will be given to income diversion and aggressive tax planning by individuals with substantial wealth. A high net worth individuals sector will be established at the Large Business Centre during this year.

Voluntary disclosure dispensation

Introducing voluntary disclosure dispensation

One of the barriers to taxpayers coming forward voluntarily to correct their failures to meet their tax obligations is the fear of SARS and the tax burden that they will be assuming. In order to lower this barrier, it is proposed that a voluntary disclosure dispensation be made available to taxpayers who have failed to meet any of their tax obligations, for example, through non-registration, non-disclosure of income or deductions of fictitious expenditure. This dispensation will allow for the waiving of penalties or additional tax provided that the taxpayer wishing to participate in the dispensation approaches SARS voluntarily before an investigation of his or her affairs has commenced.

Aggressive tax avoidance

Voluntary approaches to resolve outstanding tax avoidance cases

The issue of aggressive tax avoidance remains a concern. Although good progress has been made in the financial services sector, a number of large schemes in this sector and others remain points of contention, which will receive attention during the coming year. In order to reduce uncertainty, limit legal costs, and expedite the resolution of the outstanding cases, SARS would welcome voluntary approaches by participants in such schemes to reach settlements on a mutually acceptable basis.

Countering abuse of incentive schemes

There are indications that some of the incentive schemes offered by Government are abused. Two specific focus areas have been identified for further action in the coming year. In respect of the Motor Industry Development Programme, fifty companies have been earmarked for audit during this fiscal year. Abuse in the area of Duty Credit Certificates has also been identified. Certificates are being falsified and traded in. To combat such practices, a register of all participants in these schemes will be consolidated.

Administrative issues requiring separate bills

Tax Practitioner Bill

Establishing Tax Practitioners' Board

The regulation of tax practitioners has been sub-divided into two phases. The first phase introduced in the Revenue Laws Amendment Act of October 2004 is an interim step in order to obtain sufficient data to assist in clearly establishing final registration requirements. The second phase will involve the establishment of an independent Tax Practitioners' Board, which will regulate tax practitioners.

Tax Administration Bill

Introduction of Tax Administration Bill to eradicate duplication of administrative provisions

SARS is in the process of drafting a Tax Administration Bill, which will be published later this year for comment. The purpose of this Bill is to incorporate into one piece of legislation certain generic administrative provisions, which are currently duplicated in the different tax Acts. These provisions include, for example, the objection and appeal procedures, search and seizure provisions, provisions relating to secrecy and collection processes. It may become necessary, prior to the introduction of the Administration Bill, to refine or adjust pressing administrative issues by legislative amendment during the current legislative cycle.