



REPUBLIC OF SOUTH AFRICA

**Eighth Interim Report
of the
Commission of Inquiry
into certain Aspects of the
Tax Structure of South Africa**

*The Implications of Introducing
a Land Tax in South Africa*

EIGHTH INTERIM REPORT OF THE COMMISSION OF INQUIRY
INTO CERTAIN ASPECTS OF THE TAX STRUCTURE OF
SOUTH AFRICA

TO THE PRESIDENT

MAY IT PLEASE YOU MR PRESIDENT:

WE HAVE THE HONOUR TO SUBMIT HEREWITH THE EIGHTH INTERIM
REPORT OF THE COMMISSION.

SIGNED AT JOHANNESBURG, THIS 25TH DAY OF SEPTEMBER 1998.

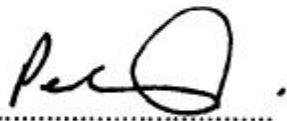
M M KATZ (CHAIRMAN)


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D M DAVIS

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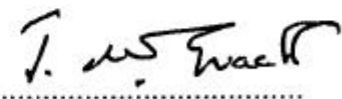
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THE IMPLICATIONS OF INTRODUCING A LAND TAX IN SOUTH AFRICA

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THE COMMISSION'S FINDINGS AND RECOMMENDATIONS WITH REGARD TO THE SUBCOMMITTEE'S FINAL REPORT

1. INTRODUCTION

1.1 At the request of the Minister of Land Affairs, the Commission was asked by the Minister of Finance in early 1995 to give attention to the question of the introduction of a land tax in South Africa.

1.2 It was decided in May 1995 to appoint a Subcommittee consisting of various experts under the Chairmanship of one of the Commission's members, Dennis Davis, to investigate this issue and report on its feasibility in the South African context.

1.3 The Subcommittee presented its report to the full Commission in November 1995. The Commission supported the recommendations in this first report and found that there was no reason in principle why a rural land tax should not be given serious consideration. The Commission found that there was sufficient international experience on the implementation and administration of such a tax. Moreover, the implementation of a land tax would not be a unique or novel experience for South Africa, as it had been levied previously by the former Cape Province on the divisional council level.

1.4 In view of these preliminary findings the Commission concluded that there was sufficient evidence to justify the possible imposition of such rural land tax at local government level for the following reasons:

- (i) A rural land tax has the potential to raise revenue for rural local authorities;
- (ii) A rural land tax levied at local government level will give greater fiscal autonomy to rural local authorities; and
- (iii) A local level rural land tax will seek to entrench the horizontal equity principle in taxation, as urban dwellers currently are liable for the municipal property tax on land.

1.5 Irrespective of the support of these broad principles, the Commission was nevertheless reluctant to give its full support to the immediate imposition of a rural land tax without having the benefit of a further detailed analysis that would, *inter alia*, seek to quantify the implications of a land tax on the agricultural sector, assess whether such a tax would create certain economic dislocations and perhaps even exceed the administrative capacity of many rural local governments. Thus, the Subcommittee was mandated to conduct this investigation.

1.6 Hence, the final report of the Subcommittee seeks to address these questions and to analyse, in particular, the following issues:

- (i) Whether the envisaged benefits of a local level rural land tax would actually arise;
- (ii) What the proper roles are of the national and provincial governments with regard to a rural land tax;

- (iii) The contents of the national framework legislation within which the proposed tax should be implemented;
- (iv) The factors that should be taken into account to ensure that, from an administrative point of view, the envisaged tax operates properly, including the definition of the tax base, the identification of the party liable for the tax, the assessment of taxable value, the tax rate, appropriate measures for tax exemption, tax relief proposals and relevant processes for determining such, tax administration and relevant collection capacity and tax enforcement issues;
- (v) The relationship between the proposed land tax and other revenue instruments, including, more particularly, RSC levies, as well as the relationship between the tax and fiscal transfers;
- (vi) Whether the envisaged tax should be treated as a net addition to the tax burden or whether it should replace other existing revenues; and
- (vii) The ways in which such a tax could be linked to urban local tax systems, including cooperation in the implementation of valuation methods and ways of using the tax to smooth the urban-rural interface in South Africa.

1.7 The Subcommittee, after the release of a detailed discussion document to the general public during September 1996 and two full days of public hearings, embarked on a thorough review. This included comprehensive quantitative and qualitative analyses of the aspects that need to be considered whether to introduce a rural land tax. The process was obviously quite protracted but this was for a very good reason, namely of working for a common view on these policy matters. Finally, the Subcommittee was able to submit its consensus report to the Commission early in September 1998.

1.8 As with the previous report, the Commission would again like to record its sincere appreciation for the quality of the research and the efforts that went into the compilation of such comprehensive review and analysis. The full report is annexed to this brief review of the Commission's main findings.

1.9 Subject to paragraph 2, the Commission supports the Subcommittee's report, titled – "*The Implications of Introducing a Land Tax in South Africa*".

2. FINDINGS AND RESPONSE

2.1 General

2.1.1 The findings of the Subcommittee are subsumed in 32 recommendations as summarised in Chapter 4 of the annexed report. Eleven recommendations deal with matters that the Subcommittee considers should be covered by national framework legislation if there is a decision to proceed with the levying of rates on rural land.

2.1.2 The Commission is of the opinion that some of the recommendations go beyond its terms of reference, especially where they may encroach upon aspects of the structure and governance of local government. Given its terms of reference, the Commission is not able to endorse these formally.

2.1.3 Furthermore, the Subcommittee has throughout its report made reference to a *rural land tax* and for purposes of consistency the Commission has maintained this terminology, but in effect, given the basis of

the Commission's recommendations, the subject of the recommendations is the possible introduction of a system of rural rates.

2.1.4 In essence, the recommendations of the Subcommittee from which the Commission differs, are:

- (i) The tax status of rural property rates, namely the Subcommittee's recommendation No. 26;
- (ii) The issue of the valuation cycle; and
- (iii) Whether *market value* or *use value* should be used as the basis of valuation.

2.2 Frequency of valuation

2.2.1 The Subcommittee is of the view (recommendations Nos. 13 and 23) that rural land should be revalued at least every five years. The Commission recognizes that equity requires revaluation whenever there have been significant changes in *relative* land values in a district. It also recognizes the disruption that a large shift in the burden of rates can create if too long a period is allowed to elapse between valuations.

2.2.2 The Commission is cognizant that international experience with property taxes suggests that without timely and regular adjustments to the property values, property valuations may deviate significantly from the market value (and this is especially relevant in the urban context) as market movements differ markedly among different properties and areas in the country. Experience also indicates that frequent valuations tend to minimise taxpayers' dissatisfaction and resistance that are normally associated with significant upward shifts in the burden of a property tax due to sudden increases of property valuations. Timely valuations with a relative short cycle (which are not too expensive if computer aided mass appraisal systems are employed) are therefore appropriate.

2.2.3 International experience also indicates that frequent valuations in the urban context are not that problematic and expensive if the correct techniques are utilized.

2.2.4 It is the Commission's understanding that the present research and review work on a more sound structuring of property taxes in South Africa on initiative of the Department of Constitutional Development is focusing on the need to clarify and formulate broad national level guidelines that in the final analysis will enable local governments to fully utilise their respective property tax bases. Moreover, the Commission is aware that legislation is planned that may preempt the method of valuation to be used for both urban and rural land. It is furthermore expected that draft national legislation will be prepared and submitted for discussion and subsequent enactment thereof by either the end of 1998 or the middle of 1999 if possible. This property tax legislation work is linked directly to work on the *Municipal Structure Law* and the *Local Government Systems Law* that are currently under preparation and discussion. The *Municipal Structure Bill* will determine the administrative structure of local authorities, including the introduction on the 'unicity' concept, which if adopted will have dramatic implications for the current two-tiered metropolitan government structure. The *Local Government Systems Bill* will clarify the basic responsibilities of local governments, including a specific section on revenue which will include references to the parameters for the property tax.

2.2.5 The Commission would prefer some consistency with regard to the valuation cycle between urban property taxes and the proposed rural land tax in order to respect the equality provision in the Constitution. Two different valuation cycles would therefore be entirely inconsistent with the constitutional requirement of equity.

2.2.6 In view of international best practice concerning valuation cycles, national framework legislation should require frequent valuations of properties and the Commission is aware that the Department of Constitutional Development was advised that the goal should be to undertake such valuations at least every

four years (this obviously applies to urban properties). Hence, the Commission is in agreement with the Subcommittee's recommendation No. 23 that states - *that national framework legislation should contain a provision for the reassessment of properties at intervals of no longer than 5 years*. The reason for this is patently clear as long valuation cycles tend to create taxpayer shock at the end of a given valuation period. Ideally, shorter revaluation cycles would be beneficial to local authorities' budget planning but too short cycles would lead to high administrative costs.

Recommendation:

2.2.7 The Commission is sympathetic to the recommendation that the decision on the valuation cycle be mandated through the enactment of appropriate national framework legislation and that the suggestion of intervals not longer than 5 years be accepted as an appropriate benchmark, for both urban and rural properties. However, the Commission is aware that there may be certain areas which do not warrant such regular valuations as the property values remain relatively static and, hence, a measure of discretion by the appropriate local authority should be provided as to the most cost-efficient valuation cycle.

2.3 Tax status of rural rates

2.3.1 The Subcommittee's view, as stated in its recommendation No. 26, is that rural property rates should be treated as provisional taxes for income tax purposes. There are several reasons why the Commission is unable to support the suggestion of the Subcommittee which would like to *'treat the rural land tax as a provisional tax payment in terms of the Fourth Schedule of the Income Tax Act, No. 58 of 1962*.

2.3.2 One of the aspects that the Subcommittee was required to address in its final report was whether the envisaged tax should be regarded as a net addition to the country's overall tax burden or whether it should replace other existing revenues or revenue sources.

2.3.3 In essence, there are three options available to address this question:

2.3.3.1 The rural land tax could be deductible from income for income tax purposes to the extent that the land tax liability ranks as expenditure in the production of income. This would have the advantage that Central Government would not need to decide and specify how it would give up tax room at the centre in order to maintain its policy benchmark of a certain tax to GDP ratio (total tax burden). It is clear that income tax payments from the agricultural sector would be reduced by the rural land tax that would be assigned to the third tier of sub-national government. It would also mean that Central Government would forego income tax revenue in favour of the third level of government. Consequently, the only benefit from this tax assignment step would be to give the sub-national level of government a new revenue source that could possibly enhance accountability and good governance at that sphere of government.

2.3.3.2 The land tax becomes a provisional tax payment for income tax purposes. That would mean that those landowners whose income tax liabilities exceed their rural rates would receive a full credit for the latter. The result would be a transfer of revenue from Central Government to the municipality, with no net gain to compensate for the time and trouble involved in assessing and collecting the rates.

2.3.3.3 The tax can be treated as a non-refundable provisional tax payment or set-off against an assessed income tax liability and this would constitute a distinct policy movement toward a *minimum tax* approach.

2.3.4 A minimum tax is defined as a levy imposed on taxpayers with large incomes to assure that all pay a fair share of the total tax burden. This is of particular relevance in the tax treatment of farming income and its specific incentives as set out in the *First Schedule* of the Income Tax Act, No. 58 of 1962. These specific provisions grant farmers certain tax preference items, such as accelerated depreciation provisions and

certain specific deduction items which tend to minimise the income tax liability even in cases of large farming income. A land tax payment that would not be allowed as a deductible expense in the production of income would therefore serve as an approximation for a minimum tax. It would thus ensure that a taxpayer with large farming income - but who could escape any income tax liability due to the existing tax preferences in the income tax system - would at least pay some annual tax. This could be used as a powerful justification for introducing a land tax as a minimum tax instrument.

2.3.5 However, the Commission considers that a more satisfactory approach for limiting or minimising tax deferrals through the use of overly excessive tax incentives in the tax treatment of farming income would be to reform the system through the principle of tax base broadening and rate reductions. This could only be achieved by eliminating the existing tax incentives. In sum, addressing inadequacies in the income tax system should not be pursued through the introduction of yet another tax instrument that would only add to the administrative burden of the South African Revenue Service. In short, the land tax cannot be structured in such a way that would address the inadequacies of the income tax provisions that deal with farming income.

2.3.6 An additional reason against the Subcommittee's recommendation No. 26 would be that urban and rural property rates do not differ in principle. Neutrality and the principle of horizontal equity require that their tax treatment be similar. Urban rates are deductible from income for income tax purposes to the extent that they rank as expenditure in the production of income. Hence, given the existence of the deductibility of urban rates, the equality provision of the Constitution could be breached if the urban and rural property rating system were to be treated differently in this respect.

Recommendation:

2.3.7 The Commission recommends that the proposed rural property tax should be treated similarly to urban property rates and constitute a deduction from income for income tax purposes.

2.4 Concluding remarks

2.4.1 The levying of rates on land, whether urban or rural, for local authority purposes is not a revolutionary departure from accepted practice. An added advantage for assigning the authority to collect rural rates to local authorities is that this level of government has generally indicated a proven capacity and experience to impose and certainly administer such an impost.

2.4.2 The Commission has carefully considered the recommendation that the tax should be based upon property valued at *use value* rather than *market value*. The Commission has noted that there is no international consensus in this regard and that, while not unproblematic, the employment of market value as the basis for assessing the value of property is arguably a more certain and equitable method. The Commission therefore recommends that in drafting the framework legislation the *use value* be accepted, but in the case of local authorities which can justify the use of *market value*, consideration should be given to empower them to proceed on this basis.

2.4.3 The Subcommittee suggested national framework legislation for the regulation of the required equitable administration of urban and rural rates across South Africa. The Commission fully subscribes to this and endorses the need for clear framework legislation which will enable the constitutional empowerment of local government to impose tax on property in a coherent fashion, wherever it may be situated. The Commission suggests that the Subcommittee's recommendations in this regard can operate as a set of guidelines to government in drafting of such legislation, with the special *caveat* that all the recommendations as proposed by the Subcommittee (and with the exception of those that the Commission suggested need some

amendment) form a coherent whole. Hence, any selective acceptance of recommendations could impact adversely on the acceptability and equity of the recommended land tax.

2.4.4 In conclusion, the Commission would again like to express its gratitude to those who served on the Subcommittee and would like to thank them for their diligence in researching the subject and their individual contributions in reaching consensus decisions on what once appeared likely to become a controversial subject.

**REPORT OF THE LAND TAX SUBCOMMITTEE OF
THE COMMISSION OF INQUIRY INTO CERTAIN
ASPECTS OF THE TAX STRUCTURE
OF SOUTH AFRICA**

(KATZ COMMISSION)

*The Implications of Introducing
a Land Tax in South Africa*

AUGUST 1998

FOREWORD

To: Prof. M.M. Katz

Chairman of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa.

We, the undersigned, appointed by you as members of the Land Tax Subcommittee of the Katz Commission (hereafter called the Subcommittee), have the honour of submitting our Final Report.

Status of the report and investigative procedures

The Subcommittee began its deliberations at its first meeting on 24 May 1995, and released an Interim Report at end of 1995. The arguments contained therein were based on published and unpublished material on the subject of land taxes as they relate to South Africa; the input of two prominent international scholars; and numerous submissions to the Subcommittee following a public call for evidence on the matter. The recommendations contained in the Interim Report were substantially accepted by the government, and taken up in the White Paper on Land Reform.

In its Interim Report, however, the Subcommittee presented reasons why a final report was not feasible at that time. The Interim Report also stated that:

“The Subcommittee believes further investigation is required to ascertain the merits of a land tax in the local sphere, and to ensure that it is implemented in a non-distortionary manner if it is agreed that it should be implemented. The Subcommittee therefore recommends that the following issues be investigated further:

- **Whether these benefits of a local rural land tax will actually arise.** This will be partly contingent on the form of rural local government, and partly on consultations with all the relevant stakeholders, including the participants in the land reform programme.
- **The proper role of the national and provincial governments.** The Subcommittee has not been able to give proper consideration to the relative roles of Provincial governments, the national government and the Financial and Fiscal Commission. A further complicating factor is the shape of the final Constitution, especially with respect to the powers and functions of the various tiers of government and the intergovernmental fiscal relations. While it seems evident that municipalities should be provided with a framework within which the tax could be implemented, it is not clear whether this should be a provincial or national responsibility. It is also not clear what the relative roles of the Financial and Fiscal Commission, the Departments of Land Affairs and Agriculture, etc. will be.
- **The contents of the framework within which the tax should be implemented.** The relevant issue to address is the degree of freedom that rural municipalities will have in defining the tax base, identifying the taxpayer, measuring the taxable value and setting the tax rate. In addition, decisions will have to be made on whether matters such as exemptions and relief are to be set in the national, provincial or local sphere, as well as the latitude allowed for the administration, collection and enforcement of the tax.
- **The optimal administration of a rural land tax in the local sphere,** where the administrative processes raised above relating to the definitions of the tax base, the taxpayer, the taxable value and the tax rate, as well as exemptions, tax relief, administration, collection and enforcement should be investigated in more detail. This will also include preparation of required legislation.

- **The relationship between the tax and other revenues**, including whether the tax should replace or supplement RSC levies, and the relationship between the tax and fiscal transfers. A further issue is whether the tax should be regarded as a net addition to the tax burden or whether it should replace other existing revenues.
- **The ways in which such a tax can be linked to urban local tax systems**, including cooperation in the implementation of valuation methods and ways of using the tax to smoothen the urban-rural interface in South Africa.”

The Subcommittee was subsequently requested to continue with its deliberations, with the above-mentioned issues as its Terms of Reference.

As a first step, the Subcommittee released a media statement¹ in which it set out those issues that it believed should receive further attention, along with its own views on each of these issues. This media statement elicited a large reaction from various interest groups, both in support of, and critical towards, the views expressed by the Subcommittee. At one extreme, some held to the Georgist view that a site value tax on all land should be introduced, while all or most other taxes should be abolished. Alternatively, some respondents fiercely resisted the prospect of a land tax as an unjust impost on only one form of wealth that would discriminate against certain sectors of the economy (i.e. the agricultural sector).

To gain a better understanding of certain aspects of these submissions, the Subcommittee arranged for verbal submissions in substantiation of some of these written submissions. However, this exercise only served to highlight the lack of substantive evidence that existed in South Africa on the issues at hand.

For this reason, the Subcommittee recommended to the Commission that further primary research should be conducted to substantiate the recommendations it was expected to make. This Final Report summarises the Interim Report of the Subcommittee, reports on the deliberations of the Subcommittee subsequent to the release of the Interim Report, and reports in some detail the results of the research that was commissioned. Based on these data, the Subcommittee ends its report with recommendations on the manner in which this sensitive issue should be dealt with in future to the benefit of all the citizens of South Africa.

A matter of concern

At the time of drafting this report, the Subcommittee was awaiting the results of the White Paper on local government, which eventually appeared at the end of March. During the (long) course of its investigation, the Subcommittee has noted with appreciation the many efforts that are being made at the political and administrative level to provide order to this difficult arena of public policy. However, the Subcommittee was also often frustrated in its attempts to provide a sound and rational basis for its recommendations because of the lack of progress in some areas of local government affairs. The result, as will be seen below, is often counter-productive: provincial governments implementing overtly unconstitutional policies; municipalities taking the first steps in implementing (the wrong kind of) rural land taxes before the Subcommittee has reported its recommendations; and so forth.

The most damaging result, however, is the almost complete lack of progress in redeploying human, fiscal and material resources to those rural municipalities that need it the most. South Africa’s poor are largely rural dwellers, and they live in communities of poverty. Without a sound framework of policy to provide them with these resources in the local sphere, their chances of escaping poverty are so much smaller. For this reason, the Subcommittee urges national and provincial governments to renew their efforts to provide a policy framework within which much-needed resources can be deployed in the sphere closest to where it matters. For this reason,


¹ Media Statement No 15, published in Government Gazette No 17496, dated 11 October 1996.

too, the Subcommittee urges the authorities to consider its recommendations, not only on their own merits, but as part of the broader process of ordering of local government affairs.

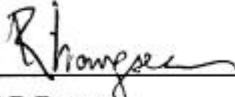
Acknowledgements

The Subcommittee wishes to thank all individuals and organisations that contributed to this process by means of written and oral evidence and to those respondents who participated in the research project. These include the various government agencies that provided the data required for the extensive modelling that was done, and those officials from the many District Councils that were visited or that responded to the questionnaire. A special word of thanks is due to the persons who acted over time as Secretaries to the Subcommittee of the Commission, Mr. D M Allwright, Mr. W Donachie and Ms A Smit, for the able logistical assistance provided.

SIGNED ON 15 AUGUST 1998, AT PRETORIA.




D Davis
Chairman



R C D Franzsen



M Grote



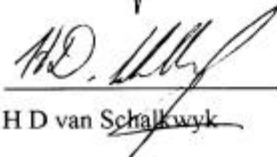
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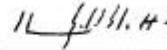
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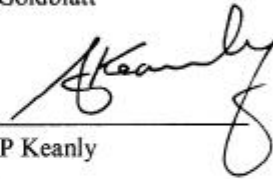
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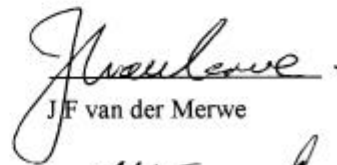
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CHAPTER 1

SURVEY OF THE WORK OF THE SUBCOMMITTEE

1.1 Background

1. The purpose of this Chapter is to summarise the processes the Subcommittee completed prior to reaching its recommendations. This is done in three sections. The first section provides an overview of the most important findings and recommendations of the Interim Report of the Subcommittee. Section two repeats the Media Statement (No. 15 of the Commission) released by the Subcommittee after the release of the Interim Report, while the final section contains a summary of the most important arguments presented in the submissions received from the general public.

1.2 Interim Report of the Subcommittee

2. The Subcommittee stated in its Interim Report that there is no reason in principle why a rural land tax should not be given serious consideration in the South African circumstances. The Subcommittee found that there was sufficient international experience with the implementation of such a tax, and that its imposition would not represent a new tax in South Africa.

3. However, the Subcommittee reached two further conclusions, namely that:

- A national land tax that has as its primary target the taxation of agricultural land was not a viable option for South Africa.
- The weight of the evidence from South Africa and abroad showed that a land tax would have at best a negligible effect on a land reform programme.

4. Nonetheless, the Subcommittee concluded that it had gathered sufficient evidence to suggest that a rural land tax levied in the local sphere of government might have merit in South Africa. In addition, the Subcommittee argued that these issues could not be resolved in isolation from a more comprehensive and transparent public debate. To this end the Subcommittee recommended, including that:

- The Interim Report be made publicly available as soon as possible;
- It be empowered to publicise the Interim Report and call for further public debate on the implementation of a rural land tax in the local sphere;
- It be empowered to engage with the principal groups responsible for the implementation of the tax, including the relevant ministries in the national sphere of government (Land Affairs, Agriculture, Finance, Provincial Affairs and Constitutional Development); Provincial governments; the Financial and Fiscal Commission; and rural municipalities with respect to issues such as the rules of the game for intergovernmental relations, the tax base for rural municipalities and the desirability and shape of a national or provincial framework for the implementation of the tax;
- It be empowered to further investigate and make recommendations on issues related to the implementation of a rural land tax in the local sphere of government;

- It be empowered to further engage in the investigations on RSC levies and the taxation of agriculture in general with whoever is given the responsibility to investigate these issues.

1.3 Media Statement No. 15

5. On 11 October 1996 the Land Tax Subcommittee released a media statement in Government Gazette No. 17496. The statement expressed their preliminary views concerning the introduction of a land tax in the local sphere of government. The media statement is included in Appendix 1.

6. Altogether, the Subcommittee received some 600 submissions, mostly as a result of this media statement. The most important arguments raised in these submissions are summarised in the next section. No attempt is made to justify the conclusions statistically, nor are any claims made concerning the representativeness of the views submitted.

1.4 An overview of submissions received by the Subcommittee

The tax authority

7. The majority of those who addressed this issue were of the opinion that, if such a tax should be introduced, it should be levied and collected in the local sphere of government. A popular argument was that local governments do not currently control adequate sources of income to afford necessary services such as improved local infrastructure, etc. The notion was that this tax, if levied locally, should be used locally and thus also benefit local taxpayers. Respondents also emphasised the importance of adequate representation on those agencies that disposed of the tax by the taxpayers. This would not only make the tax more palatable, but would also improve its efficiency and equity. Furthermore, respondents believed that local governments are better located to decide on matters such as exemptions and rebates.

8. Most of the submissions argued that primary rural municipalities should be empowered to levy the land tax. Many respondents argued that, in those cases where a municipality did not have the capacity to implement the tax (and most respondents doubted that rural municipalities had such capacity), they should make use of agency arrangements. Adequate training of staff to ensure the effectiveness of the process and to minimise corruption was also emphasised.

Definition of the tax base

9. Many submissions strongly emphasised that, if a land tax is introduced, the taxable base should include all land in the Republic of South Africa. Arguments were based on the principle of equity, and the Bill of Rights, as enshrined in the Constitution. In this respect, the majority of the respondents also felt that tribal land should not be exempted from the tax base, although they were aware that this raised practical problems, especially regarding the definition of the taxpayer.

10. Some respondents proposed that, where the formal owner of the land cannot easily be taxed (e.g. the owner is the state, the President in trust or the tribe collectively), the traditional authority should be held accountable for the tax. In this way subjects occupying the land could be made responsible for their share of the tax.

11. Respondents were also unsure of the implications of communal ownership for the valuation of such land. Mass valuation methods to appraise use values were suggested, since it was felt that market values could not be ascertained in the presence of an inactive land market. A prerequisite was that these valuations ought to take into account differences in land quality.

12. Nonetheless, many interest groups vehemently opposed a tax on rural land. **Organised agriculture** reasoned that the equity principle should also be applied to the taxation of other assets. They argued that the taxation of land, which constituted two thirds of the assets of commercial farmers, was tantamount to the taxation of the working capital of agriculture. This form of a wealth tax would be unfair unless all other forms of capital were also taxed. By implication, therefore, the wealth of actors in other sectors of the economy should be taxed, otherwise property-owning farmers would be discriminated against.

13. Farmers also argued that the introduction of another tax would be damaging to the already low tax morale, leading to low compliance, as the agricultural sector is already heavily burdened by tax. They also argued that farmers do not enjoy most of the services that urban residents receive. Moreover, they often provide services for their own and their workers' use, therefore they should not be liable for property tax.

14. The **mining industry** objected to the imposition of a tax on land on similar grounds: Mines had traditionally also provided services to workers. A land tax should, therefore, not apply in their case. There was even a suggestion that they should receive a rebate for the services they provide in lieu of municipal services, or that mining towns should be certified as municipalities so that they could also benefit from the implementation of a land tax.

15. The **hospitality industry** also opposed the institution of a land tax. Their arguments included the view that such a tax would run counter to the spirit of the White Paper on the 'Development and promotion of tourism in South Africa'. Such a tax would undermine the competitiveness of the industry in the SADC region. They feel that any trade, which earns foreign exchange, should be stimulated rather than taxed. Furthermore, such a tax would undermine the equity principle, as many hotels are situated in rural areas, and thus do not enjoy urban services. In similar vein, they argued that national parks should be dealt with carefully. As there was a large demand for this land, its market value was very high. If, however, this land is exempted from the tax base, privately owned reserves should, for the sake of equity, be handled similarly in the interests of conservation and, ultimately, the economy.

16. The industry also argued that including government land in the tax base would be similar to a net transfer from the state to the concerned local government, except that administrative costs will impede effectiveness. Thus, they argue that should government land indeed be taxed, it must not advance through the entire system, but be paid by means of a net transfer.

The tax rate

17. The Subcommittee proposed in its media statement that the tax rate should fall somewhere between 1 and 2 per cent of the value of rural land. At one extreme, the Subcommittee felt that a rate of less than 1 per cent would not raise sufficient revenue to defray administrative expenses, while a rate of higher than 2 per cent would tax away the economic returns to holding land in agriculture, i.e. it would be tantamount to the nationalisation of land¹.

18. The general opinion of the respondents seemed to be that the tax rate should be capped nationally or at least at a provincial level. Some respondents believed that, if this were not done, rural municipalities could be tempted to implement higher rates to achieve other goals, with negative consequences for the agricultural sector. However, respondents shared the opinion that the rate should be high enough to cover the cost of administering the tax and to generate a reasonable income.

¹ Land rents for farmland are traditionally around 4-5 per cent. A tax rate at this level would, therefore, tax away the incentive to own land, which means that existing owners would not be able to sell their land.

19. Respondents also addressed the issue of differential rates for different categories of land and land use. While most seemed to support this notion, it is clear that it would increase the cost of administering the tax.

Methods of valuation of rural land

20. Many respondents were of the opinion that, if a land tax is introduced, market values should not be used to value the tax base, principally because market values do not reflect the real productive potential of the land. Where external factors such as the urban demand for land play a large role in determining market value, these farmers will be penalised to the detriment of the sector as a whole. In this vein, farmers and organised agriculture argued that market value results in the entrepreneur being taxed on unrealised capital profits. This could lead to serious liquidity problems, even if they were solvent. In addition, an unduly high tax rate could result in lower land values, which will eventually be reflected in solvency problems for farmers with high mortgage bonds². Furthermore, they argued that it is difficult to ascertain the value of the unimproved portion of land in an active market, since improvements cannot easily be excluded from the market value. A tax based on market value would also deter new investment, especially in less directly productive improvements such as housing for farm workers. It may even lead to disinvestment from such assets. The mining industry was similarly concerned about the possible disincentive effect of a land tax that was based on market values.

21. Many respondents also felt that the proposal that the land be valued every 3 to 5 years may be too long. They believe that the longer the period, the greater the probability that landowners will postpone investment until shortly after a valuation has been completed, in order to obtain the maximum tax benefit.

The economic impact of a land tax

22. Regarding the economic impact of land tax, most respondents warned against the potentially damaging effects of a land tax on the economy of South Africa, especially as the overall tax burden, by the admission of the fiscal authorities, was too high. In agreeing with the Subcommittee regarding the confiscatory nature of a high tax rate, some observers noted that this would effectively make the municipality a co-partner in the enterprise, albeit without being liable for any of the costs of investment, or having to carry any of the risks.

Administrative aspects of a land tax

23. Few respondents addressed the administrative aspects of the tax directly. The most common view on this matter was that the potentially high cost of implementation and subsequent running costs should serve as fair warning that the costs and benefits of the tax needed to be weighed more carefully. In fact, many respondents believed that the same amount of income could be obtained from within the existing tax structure, but more effectively and at a lower cost. There seemed to be a general feeling that it would make little sense to introduce a new tax while the collection of existing taxes was poorly administered.

Methods of enforcement

24. Respondents suggested that an enforcement mechanism similar to that used in the case of urban property taxes be used. This stipulates that land cannot be sold or transferred before all outstanding taxes are settled. Legislation should also stipulate that the land might be sold by means of an execution auction by the local government to pay off the outstanding land tax liability. Respondents did not, however, address the impossibility of applying these procedures to communally held land.

² In its Interim Report, the Subcommittee cited empirical evidence in support of this argument.

Alleviation measures

25. Respondents agreed that agriculture should be given special consideration because of the seasonal nature of production and its dependence on an uncertain climate. While most respondents opposed any exemptions, there was considerable support for mechanisms such as reductions and deferrals. These respondents supported the notion that local governments are best positioned to decide on such reductions and deferrals, as they were best placed to take local circumstances into account. Notwithstanding this view, some respondents also argued that national guidelines should be set to provide objective criteria for reductions and deferrals in order to minimise the potential distortionary effects of different tax treatment in contiguous jurisdictions. Respondents generally recognised the inflationary effect of such measures on the costs of administering the tax.

A rural land tax and income taxes

26. The majority of respondents argued in favour of classifying the land tax as a deductible expense against income tax, in the same manner as RSC levies and property rates in urban areas. Several respondents argued, however, that high costs of administering the tax together with this measure could diminish the net revenue to the extent where the net fiscal take from the tax was too low to justify its existence.

A rural land tax and other taxes

27. The most obvious overlap of a land tax is with the existing RSC levies on turnover and wages in rural businesses. Most of the respondents argued that a rural land tax would be palatable only if it served as a replacement for RSC levies.

1.5 Conclusion

28. The Subcommittee was able to refine its own views on the costs and benefits, and the advantages and disadvantages, of a rural land tax on the basis of the numerous submissions it received both prior to and after the release of its Interim Report. However, after careful analysis of the material at hand, the Subcommittee came to the conclusion that two critical issues required further investigation before it would be able to recommend further action. These issues are the potential economic impact of a land tax, and the capacity of rural authorities to implement such a tax. In order to give justice to these issues, the Subcommittee prepared a tender for further research. The results of this research are discussed in the next two chapters.

29. The purpose of the research was to allow the Subcommittee to test alternative recommendations regarding the introduction of a rural land tax within the particular circumstances of South Africa against the generally agreed principles of an efficient and coherent tax system. In this regard the Subcommittee identified the following important principles³:

- The tax structure should not interfere with the ability of the authorities to pursue economic goals through effective fiscal policy. In the South African circumstances, the Subcommittee has interpreted this to mean that 'new' taxes should not increase the total tax burden of the economy⁴.

³ Following Musgrave, R A and P B Musgrave. 'Public finance in theory and practice'. Fifth Ed. Singapore, McGraw-Hill: p 216

⁴ In the GEAR, this goal of fiscal policy is stated as: '... to avoid permanent increases in the overall burden of tax.' 'Growth, employment and redistribution: a macro-economic strategy.' Pretoria, Department of Finance, 1996: p 7.

- The revenue yield of a tax should be adequate, where the yield is measured as the ratio between the cost of administering the tax and the revenue it generates. In this respect, fair and non-arbitrary administration should be possible at the lowest compliance and administrative cost as is compatible with other objectives. Unfortunately, the Subcommittee was not able to ascertain the revenue yield of a rural land tax levied in the local sphere of government. First, the revenues accruing will depend on factors such as the method of assessment and the rate at which the tax is levied. These variables are dependent on decisions that will be taken by local authorities. Second, there was insufficient data available to the Subcommittee to estimate the cost of collecting a rural land tax. Nevertheless, the revenue yield should serve as an important guideline to decisions regarding the tax.
- The distribution of the tax burden should be equitable, in the sense that everyone should be made to pay his or her fair share of the tax. It is important to note that there can be a difference between the theoretical and the actual incidence of a tax, as economic actors try and shift the burden to others.
- The implementation of a tax should be designed to minimise interference in the working of the economy, i.e. it should as far as possible not detrimentally affect the normal economic decisions of land owners in rural areas.

CHAPTER 2

THE ECONOMIC EFFECT OF A LAND TAX ON AGRICULTURE¹

2.1 Introduction

30. Measuring the economic effects of a policy intervention such as the levying of a land tax presents a measurement problem of the kind that economists conventionally model with the use of mathematical programming algorithms. While these models provide powerful and rigorous evidence of these kinds of policy effects, they also suffer from a number of weaknesses. **First**, the models are as contemporary as the data that are used to portray the real world. In this respect, the available data bases for the rural areas in South African are less than reliable. For this reason, for example, the commercial farming sector is modelled here, although one case study from the former homeland areas has been included. **Second**, while the development of computer technology allows models of a complexity that were impossible only a few years ago, the real world cannot be duplicated, only modelled. For this reason, the models presented here focus largely on farm production, and less on the off-farm rural economy. **Third**, while the strength of such models is derived from their mathematical rigour, their resolution depends largely on a set of somewhat restrictive assumptions about the way in which markets, and biological processes, work. In this respect, dynamic modelling is introduced in some of the cases presented below in an attempt to make the exercise more realistic.

31. Notwithstanding these *caveats*, the purpose of this Chapter is to report on the results of an analysis of the effects of a land tax. The focus will be on the effect of the following variables:

- Different levels of a land tax;
- The cost of the land tax to the owner of the land;
- Different tax bases (i.e. market value versus productive value); and
- Different ways in which the land tax is implemented (e.g. deductibility from income tax).

32. The purpose of this exercise is to present information to policy makers on the optimal way in which a land tax could be implemented.

2.2 Methodology and data used

33. Various tools and techniques exist to analyse the efficient use and allocation of scarce resources within the farm business. One of the most widely used of these, linear programming, is a technique for solving problems that share the characteristic of an objective function or goal that has to be maximised or minimised given certain resource limitations as well as numerous alternative means of using the resources. The typical product of a linear programming analysis of a farm situation, for example, is a plan of how much of a wide variety of commodities should be produced, and the quantities of different inputs to use in producing those commodities, in order to maximise profits.

34. Furthermore, the technique also provides information on the true or economic value of the resources used in the optimal solution. Thus, a computational by-product of the programming procedure is information concerning those resources that limit the income potential of the farm operation, which resources are in excess, and the cost of acquiring additional units of the limiting resources. For example, a typical linear programming model would indicate how much land is used and how much is unused in a whole-farm planning problem, and if land is limiting the potential for growing additional crops and

¹ This Chapter is based on H D Van Schalkwyk, D B Louw and A P Dannhauser. 'Research report on the introduction of a land tax in South Africa.' Department of Agricultural Economics, University of the Free State. Unpublished report, 1998.

increasing income, how much the operator could pay for an additional hectare of lands. The value of land created in this way is also called the **shadow price**, which represents the income foregone if a hectare of land is lost or withdrawn from production.

35. A further attribute of linear programming is that it can easily be used to evaluate the effect of a change in product prices or in technical efficiency, i.e. it can be used to measure the sensitivity or stability of the farm plan to external changes. For example, the linear programming procedure indicates how the whole-farm organisation will change if the overhead cost (e.g. a change in the land tax rate) of the farm increases or decreases. Other questions of the “what would happen if...?” variety, such as what would happen to income if a land tax is raised at 2 per cent on the market values of land, can also easily be evaluated.

36. Linear programming handles opportunity cost with ease. Opportunity cost reflects the income foregone in using a resource in an alternative enterprise. The process of pricing resources in the production of various products based on the income generation capacity or opportunity cost of that resource in alternative uses, is the heart of the programming procedure. This characteristic will be very useful to calculate the productive value of the land. The effect of a land tax raised at different levels on the productive value of the business can easily be determined by simply comparing the results before the introduction of the land tax with that after the introduction of the tax.

37. Linear programming can be done for a single year, in which case it would be a static model, or it can be done for a series of consecutive years (dynamic approach). Both these methods were used in the current investigation.

Dynamic linear programming

38. The time-dependant processes of a biological system, such as is characteristic of agricultural production, can typically be modelled using dynamic algorithms. As biological processes vary over time, it is difficult to achieve a realistic description without reference to the time dimension. The effect of short and long term liabilities can also be analysed when the time factor is brought into account.

39. In dynamic linear programming, plans are formulated for distinctive and consecutive production periods within the planning horizon. The periods are mutually combined and conjoined by transfers. This means that activities and resources for each year under consideration have to be defined, which places large demands on the data requirement and computational capacity. The activities, which are executed in each year, are constrained by the resources available in that specific year.

40. The model assumes management is of high quality and that the manager will react immediately to counter any activity that will cause the objective function to decrease. In reality this might not be the case. Usually even better than average farmers do not always react in the manner and as fast as the model assumes. The effect on a farming unit will, therefore, be larger than implied by the model. This is magnified because of the long production periods in agriculture, i.e. a farmer has to wait for the current crop to be harvested and sold before he/she can alter the cultivation activities. In the application reported below, the optimum farm plan without a land tax is used as a base scenario from which the effect of a land tax is determined.

41. Different land tax rates are introduced in the model. The different tax rates are raised on both conservative and optimistic market values, and on agricultural use values of the land under question. For the Southern Cape study the conservative market values were taken as being one standard deviation or 17 per cent lower than the going rate and the optimistic market value as 17 per cent higher than the going rate. With reference to the Olifants river study the conservative market values were taken as 20 per cent lower than the going rate and the optimistic market value as 20 per cent higher. The two market values were introduced in the model to capture the effect of possible subjectivity on the part of land assessors. The shadow value of land as obtained by the model was used to reflect agricultural use values.

42. Due to the implicit reference to the time factor that characterises the dynamic method, it was necessary to use a discount rate to change future values to present values. For this purposes an 8 per cent discount rate was used. The rate is based on a long term average interest rate of 17 per cent and an expected inflation rate of roughly 10 per cent. According to this the real rate amounts to 6,3 per cent. An increment of 1,7 per cent was added to incorporate risk, which brings the total rate to 8 per cent.

Static linear programming

43. As noted above, such dynamic models require relatively large time and computational resources. For this reason, the rest of the study areas were modelled using static deterministic linear programming models. Comparison with the results of the dynamic models, however, enables a rough consideration of the effect of the time factor. Static models work on the same principles as the dynamic models, except that the time factor is not incorporated.

2.3 Measuring the effect of a land tax

44. To calculate the cost of a land tax to the owner of land, both the direct and indirect costs had to be taken into account. Non-linear models were used to estimate the indirect effects, whilst linear programming models were used to calculate the direct effects.

45. The effect of a land tax on land prices was estimated by a structural model of land prices that provides a framework for analysing the relative importance of factors determining farmland prices. The model has previously been formulated for different agro-economic regions and for South Africa as a whole. The possible effect of a land tax was measured by imposing taxes on land market prices at different rates in a model whose objective function is to maximise farm profits, measured by net farm income (NFI).

46. A land tax rate of respectively 1, 2, 3, 4, 5 and 8 per cent was imposed on average land prices for South Africa as a whole as well as for Gauteng province, as if the tax had been in effect since 1970. Gauteng was selected as farmers in that province are expected to capitalise more non-farm factors into land values because of the larger number of alternative uses available. The gap between the market and agricultural value of land is therefore expected to be larger. New entrants in the market will thus find it difficult to gain entry unless they have sufficient equity to overcome the gap between the market and agricultural value of land. This problem will assume even larger proportions if a land tax is imposed in the province, as, theoretically, the tax should have a relatively smaller effect on market values than on net farm incomes, because of the high component of non-farm factors in expected land prices in Gauteng.

2.4 Data used for the analysis

47. Representative farms were modelled in a number of regions of South Africa. These differ from the areas identified in the original project proposal, partly to ensure that the areas represent as wide a variety of farming conditions in South Africa as possible, and partly because of data problems. The following case studies were included:

- **Western Cape:** A group of typical farms in the Heidelberg district, Olifants river basin, Beaufort West district;
- **Free State:** Bloemfontein magisterial district;
- **KwaZulu-Natal:** Cedara study group information;

- **Mpumalanga:** Nelspruit magisterial district, former Gazankulu area (case study of communal areas); and
- **North-West:** Potchefstroom magisterial district.

2.5 The effect on market values of land in Gauteng and South Africa

48. This section compares the results of the mathematical programming analysis of areas where average market values are hardly distorted by non-agricultural factors with areas where considerable distortion is found. This is followed by an analysis of the results of the dynamic linear programming in order to explain the longer-term effects of the tax, and then by an analysis and summary of the results of the static linear programming approach.

49. One explanation for opposition to an agricultural land tax by farmers is that current landowners believe that the cost to them may end up being considerably more than the cost of tax alone. Farmers will not only have to pay the tax, but may also incur a loss in land values, since the prospect of future tax payments depresses current land prices. In this section an attempt is made to quantify the extent of this capital loss.

50. In the model, a land tax at different rates is raised on the market value of land. The area covered includes South Africa as a whole to determine what the average effect of a land tax will be, and Gauteng to determine the effect in an area where market values are distorted by non-farm factors. The results are shown in Table 2.1 below.

51. According to Table 2.1 a land tax of 1 per cent, if an additional tax, will have an average negative effect of 5,3 per cent on predicted real land prices in South Africa as a whole. It should be noted that these results represent a worst case scenario, as it is assumed that landowners cannot shift the tax burden to consumers or tenants through higher prices or rentals, etc. However, it is entirely possible for the latter to occur, namely that the burden of the tax may be shifted down to tenants by the landowners.

52. It is often argued that the tax-induced decline in land prices encourages access to land for new farmers such as participants in a land reform programme, young people or tenants wishing to own land. However, if the tax is fully capitalised into reduced land values, this implies that land values fall by the same proportion as the fall in profits. If the ratio of after tax profits to land values remains the same, there is no additional incentive to buy land.

53. Table 2.1 shows further that a 2 per cent tax rate, if an additional tax, would have resulted in a decline of 12,32 per cent in land prices in 1991. Thus the average real value of a hectare of farm land in South Africa would have declined from R297,75 to R218,40. The land tax payable on R218,40 per hectare at 2 per cent would have been R4,37 per hectare, which would have resulted in a decline of 11,28 per cent in net returns, i.e. from R38,72 to R34,35. This differential in the reduction of land values and net returns is mainly caused by variable weather conditions. Therefore, these results support the argument that although land will be cheaper, farmers will not necessarily be better off with the tax, and the land market will not favour new entrants.

54. Another interesting observation is shown in the final column, which shows that land must be taxed at more than 8 per cent before its value falls to zero, in contrast with the theoretical argument of a 4 – 5 per cent rate. The difference in these two rates can be explained by the reaction of farmers, who discount the negative effect of a land tax into lower land market values, resulting in a declining base from which the tax is calculated.

55. A 1 per cent land tax rate in Gauteng, if an additional tax, will have an average negative effect of 2,5 per cent on predicted real land prices, which is about half the extent of the effect for the country as a whole. This result is to be expected, as landowners there will discount the probability of their land becoming rezoned for urban use, and therefore of much higher value. Furthermore, the demand for agricultural land near urban areas is higher because of its potential recreational value. Thus, even if it remains zoned as farmland, it has a higher value. Average returns per hectare in Gauteng might also be higher because of a higher degree of intensification, which is a direct result of the proximity to the market.

56. A 2 per cent land tax rate on land in Gauteng, if an additional tax, would have resulted in a decline of 2,88 per cent in land prices in 1991, implying that the average real land value would have fallen from R1 526,77 to R1 482,44. At a tax rate of 2 per cent, this would have amounted to R29,65 per hectare, or a 20,38 per cent decline in net returns, i.e. from R145,43 to R115,78. This higher than expected fall in profits is again the result of the capitalisation of non-farm factors in land values. The result is that farmers who are dependent on the land are, therefore, in a highly vulnerable position in such areas.

Table 2.1: The effect of a land tax on real land prices in Gauteng and South Africa (%)

Year	Predicted land prices (R/ha) before a land tax	Effect of different land tax rates on real South African and Gauteng land prices (%)					
		1%	2%	3%	4%	5%	8%
South Africa							
1988	341,24	-4,52	-9,06	-13,60	-18,03	-22,11	-91,62
1989	370,52	-4,28	-8,59	-12,88	-17,05	-20,84	-86,91
1990	267,21	-6,00	-12,06	-18,10	-24,00	-29,40	-120,88
1991	297,75	-6,17	-12,32	-18,61	-24,69	-30,31	-114,72
Average (1970-1991)		-5,30	-10,57	-15,73	-20,65	-24,75	-93,00
Gauteng Province							
1988	2338,76	-1,78	-3,45	-4,99	-6,73	-7,59	-10,06
1989	1982,74	-2,69	-5,41	-8,15	-10,89	-13,65	-22,13
1990	1412,62	-2,64	-5,26	-7,81	-10,27	-12,61	-18,63
1991	1526,77	-1,41	-2,88	-4,38	-5,89	-7,41	-12,04
Average (1970-1991)		-2,51	-4,99	-7,44	-9,84	-12,19	-19,00
South Africa (land tax replaces income tax)							
Tax rate		0,5%	1%	2%	3%	4%	5%
1988	341,24	-1,56	-3,11	-6,24	-9,40	-12,63	-15,95
1989	370,52	-1,56	-3,02	-5,98	-9,02	-12,14	-15,39
1990	267,21	-2,28	-4,41	-8,76	-13,22	-17,83	-22,60
1991	297,75	-2,20	-4,53	-9,27	-14,10	-19,05	-24,15
Average (1970-1991)		-1,37	-3,37	-7,36	-11,36	-15,39	-19,46

57. It is often argued that the prospects of future income or commodity taxes will have the same effect on land prices. However, Table 2.1 shows that even at a rate of 0,5 per cent, if the land tax is substituted for income tax, average farmland prices in South Africa will decline. The land tax will exceed income tax in most years. The reasons for this might be:

- (i) a lower rate of return on South African farmland;
- (ii) widespread evasion of income tax in South Africa; and/or
- (iii) a low average income tax rate applicable to farmers.

2.6 The results of the Heidelberg case study

58. The underlying reason for the use of the dynamic linear programming model is to illustrate the long-term effects of a land tax. Tables 2.2 and 2.3 show the direct and indirect effects of a land tax in the Heidelberg district of the Western Cape province. In all the scenarios the model has chosen only wheat and barley as cash crops as a result of the limited alternatives available to farmers. When a land tax is introduced on the shadow value of the land, no changes occur to the farming structure. However, the net present value of the income stream for the six-year period declines at 1,1; 1,7 and 2,3 per cent when a land tax of 1; 1,5 and 2 per cent respectively is raised. Labour hours remain constant because of the static cost structure. The largest impact of the tax is on the liabilities of the farmer. Farmers will require more debt to operate their farms at an optimal level.

Table 2.2: Effects of different land tax rates if levied on shadow prices of land (R/ha)

Item	Base value	Land tax rate		
		1%	1,5%	2%
Wheat (ha)	1284	1284	1284	1284
% change		-	-	-
Barley (ha)	2483	2483	2483	2483
% change		-	-	-
Established pastures (ha)	2974	2974	2974	2974
% change		-	-	-
LSU	647	647	647	647
% change		-	-	-
NPV (R) of net farm income	303707	300339	298656	296972
% change		(-1,1%)	(-1,7%)	(-2,3%)
Short-term liabilities Year 1	581087	602727	613547	624387
% change		(3,7%)	(5,6%)	(7,4%)
Short-term liabilities Year 2	-	-	-	-
Short-term liabilities Year 3	51440	119065	152878	186691
% change		(131,5%)	(197,2%)	(262,9%)
Short-term liabilities Year 4	-	-	-	-
Short-term liabilities Year 5	-	-	-	-
Short-term liabilities Year 6	-	-	-	-
Total labour hours over six years	34891	34891	34891	34891
Change in hours	-	-	-	-

Notes: LSU = large stock unit
NPV = net present value

Table 2.3: Effects of different land tax rates if levied on market values of land (R/ha)¹

Item	Conservative market value			Optimistic market value		
	1%	1,5%	2%	1%	1,5%	2%
Wheat (ha)	1284	1275	1245	1275	1245	1356
% change	-	(-0,7%)	(-3,0%)	(-0,7%)	(-3,0%)	(5,6%)
Barley (ha)	2483	2492	2503	2492	2503	2417
% change	-	(0,3%)	(0,8%)	(0,3%)	(0,8%)	(-2,7%)
Established pastures (ha)	2974	2971	2998	2971	2998	2927
% change	-	(-0,1%)	(0,7%)	(-0,1%)	(0,7%)	(-1,4%)
LSU	647	647	647	647	647	647
% change	-	-	-	-	-	-
NPV (R) of net farm income	295288	291020	281480	291861	280602	261875
% change	(-2,8%)	(-4,2%)	(-7,3%)	(-3,9%)	(-7,6%)	(-13,8%)
Short-term liabilities Year 1	635187	661237	690863	655837	696265	700000
% change	(9,3%)	(13,8%)	(18,9%)	(12,9%)	(19,8%)	(20,5%)
Short-term liabilities Year 2	-	-	-s	-	-	-
% change	-	-	-	-	-	-
Short-term liabilities Year 3	220504	304871	386934	287976	403809	516391
% change	(328,7%)	(492,7%)	(652,2%)	(459,8%)	(685%)	(903,9%)
Short-term liabilities Year 4	-	-	-	-	-	-
% change	-	-	-	-	-	-
Short-term liabilities Year 5	-	-	44264	-	71664	302365
% change	-	-	(NA)	-	(NA)	(NA)
Short-term liabilities Year 6	-	-	-	-	-	-
% change	-	-	-	-	-	-
Total labour hours over six years	34891	34897	34919	34897	34919	35167
Change in hours	-	6	22	6	22	276
% change in hours	-	(0,02%)	(0,06%)	(0,06%)	(0,06%)	(0,8%)

Notes: ¹Base year values the same as in Table 2.2

LSU = large stock unit

NPV = net present value

Modelling for *conservative* and *optimistic market values* is for purposes of accommodating valuers' possible bias in a comparable sales method environment.

59. For the first year short-term liabilities increase by 3,7 per cent when a tax of 1 per cent is raised, and by 7,4 per cent when a 2 per cent tax rate is levied. In year 3 the increase in short-term debt, when compared to the base, rises to 131,5 per cent when a tax of 1 per cent is raised, and 262,9 per cent when a tax of 2 per cent is raised. Here it is important to note that R50 000 of short-term credit is used in the base year. An increase of 131,5 per cent thus implies an amount of about R119 000 credit needed to operate the farm at an optimum level. The situation is worse when the land tax is levied on market values. The year 1 short-term liabilities

increase by 9,3 per cent when a 1 per cent land tax is levied, and by 18,9 per cent with a 2 per cent land tax rate. In year 3 short-term liabilities increase by 328,7 per cent and 652,2 per cent respectively with a 1 per cent and 2 per cent land tax rate. When land tax is levied at a 2 per cent rate, financial assistance is also needed in the fifth year. Farmers exposed to this situation may incur liquidity problems and eventually face insolvency. Tables 2.2 and 2.3 clearly show that the impact of a land tax raised on shadow values differs considerably from the scenario where it is raised on market values.

2.7 The Olifants river basin results

60. While models have been constructed for all the case studies under consideration, only the case study of the Olifants river basin in the Western Cape province is discussed in full because the results of the other case studies show the same trends. A comparison between the different areas is, however, made, and this presents significant insight on the effect of different tax rates and tax bases. Summary results of this case study are given in Table 2.4, while complete results for the separate areas can be found in the original research report.

61. Table 2.4 shows that when a non-deductible land tax of 0,5; 1; 1,5 and 2 per cent is levied on the shadow prices of land, the land tax per hectare amounts to R33, R65, R98 and R130 per hectare respectively. The objective function (profit) falls by 0,59; 1,19; 1,80 and 2,42 per cent respectively.

62. When a land tax is raised on the market value of land the taxed amount per hectare increases sharply as the tax rate increases. The land tax per hectare at the various rates is R200, R400, R600 and R800 per hectare respectively, resulting in a proportionate change in the net farm income of 3,77; 7,84; 12,23 and 17,00 per cent respectively. When the tax is made deductible from income tax (i.e. at a marginal rate of 43 per cent), the situation alters significantly. Using the productive value as base, and rates of 0,5; 1,0; 1,5 and 2,00 per cent, the amount of tax payable reduces to R19, R37, R56 and R74 per hectare, accounting for 0,34; 0,68; 1,02 and 1,36 per cent of the respective net farm income values per hectare. When market values are used as base, the magnitude of these changes is much higher.

63. When the land tax is levied on market values, the effect on net farm income is much larger than the tax rate, for example when a non-deductible rate of 2 per cent is levied on market values, the land tax consumes 17 per cent of the net farm income per hectare. Therefore, a land tax raised on market values does not account for the ability to pay principle, unlike a tax on the shadow value of land. The small differences between the effect of the latter on the net farm income and the tax rate can be attributed to data problems.

Table 2.4: Summary of the Olifants river case study

Item	Optimal Solution	Land tax (shadow price of land)				Land tax (market value of land)			
		0.5%	1.0%	1.5%	2.0%	0.5%	1.0%	1.5%	2.0%
Land tax per ha (not deductible from income tax) – i.e. land tax as additional tax	0	33	65	98	130	200	400	600	800
Net farm income per ha (not deductible from income tax)	5505	5472	5440	5407	5375	5305	5105	4905	4705
Land tax as a percentage of the net farm income per hectare	0.00	0.59	1.19	1.80	2.42	3.77	7.84	12.23	17.00
Land tax per ha (20% deductible from income tax)	0	26	52	78	104	160	320	480	640
Net farm income per ha (20% deductible from income tax)	5505	5479	5453	5427	5401	5345	5185	5025	4865
Land tax as a percentage of the net farm income per hectare	0.00	0.47	0.95	1.44	1.93	2.99	6.17	9.55	13.16
Land tax per ha (43% deductible from income tax)	0	19	37	56	74	114	228	342	456
Net farm income per ha (43% deductible from income tax)	5505	5486	5468	5449	5431	5391	5277	5163	5049
Land tax as a percentage of the net farm income per hectare	0.00	0.34	0.68	1.02	1.36	2.11	4.32	6.62	9.03
Shadow prices of land (irrigation land)									
Not deductible from income tax	6504.5	6472.0	6439.5	6407.0	6374.5	6304.5	6104.5	5904.5	5704.5
Deductible at 20% from income tax	6504.5	6478.5	6452.5	6426.5	6400.5	6344.5	6184.5	6024.5	5864.5
Deductible at 43% from income tax	6504.5	6485.0	6478.5	6445.5	6451.5	6426.5	6354.5	6254.5	6184.5

Note: A marginal tax rate of 43 per cent was used for illustrative purposes.

64. In theory the effect on net farm income should equal the tax rate, since the shadow price represents the opportunity cost of the land, which should be equal to its net income raising capability. It should be noted, however, that the productive value of land can be measured in many different ways. In this study the shadow price of land was used, which represents the opportunity cost of land. Productive values calculated in the conventional way (i.e. net farm income / discount rate) will yield higher effects. In this case the land tax rate should be divided by the same denominator to establish the effect of the land tax on the net farm income.

65. It is also clear that these impacts tell only a part of the story. The forward and backward linkages between agriculture and the rest of the economy also have to be accounted for in assessing the total impact of the imposition of a land tax. These multiplier effects include the effect of reduced income for farmers and farm workers on important variables such as total value added in the region and job creation. The multiplier effects of a land tax in terms of the different land tax regimes are shown in Table 2.5 below. For example, when a tax of 2 per cent is levied on the productive value of land in the Olifants river basin, GDP will decline by R3,7 million at a loss of 212 job opportunities, and a loss of R0.8m in revenue from income tax foregone, as shown in the second last row. Alternatively, if a tax of the same magnitude is levied on the market value of land, its GDP contribution will decline by R22,7 million, government revenue will decrease by R4,7 million, and 1 305 jobs will be lost in exchange for a revenue of R12,6 million from the land tax.

66. It is however important to remember that the money removed from agriculture through the tax will be re-invested into the community by the local government, with the result that these figures represent the gross losses. In addition, local authority spending may have a redistributive effect that is beneficial to the community as a whole. On the other hand, the multipliers for agriculture are larger than for the other sectors in the economy.

Table 2.5: Effect of different land tax rates and bases on the Western Cape economy

Land tax is not deductible from income tax								
Item	Shadow prices of land				Market value of land			
	0.5%	1.0%	1.5%	2.0%	0.5%	1.0%	1.5%	2.0%
Decrease in net farm income	-727558.0	-1455116.0	-2182674.0	-2910232.0	-4477280.0	-8954560.0	-13431840.0	-17909120.0
Employment multiplier	-53.0	-106.1	-159.1	-212.2	-326.4	-652.8	-979.2	-1305.6
GDP multiplier (Rm.)	-0.9	-1.8	-2.8	-3.7	-5.7	-11.4	-17.1	-22.7
Government revenue (mill)	-0.2	-0.4	-0.6	-0.8	-1.2	-2.3	-3.5	-4.7
Land tax revenue (Rm.)	0.5	1.0	1.5	2.0	3.1	6.3	9.4	12.6
Land tax is deductible at a 20% income tax rate								
Item	Shadow prices of land				Market value of land			
	0.5%	1.0%	1.5%	2.0%	0.5%	1.0%	1.5%	2.0%
Decrease in net farm income	-582046.4	-1164092.8	-1746139.2	-2328185.6	-3581824.0	-7163648.0	-10745472.0	-14327296.0
Employment multiplier	-42.4	-84.9	-127.3	-169.7	-261.1	-522.2	-783.3	-1044.5
GDP multiplier (Rm.)	-0.7	-1.5	-2.2	-3.0	-4.5	-9.1	-13.6	-18.2
Government revenue (mill)	-0.2	-0.3	-0.5	-0.6	-0.9	-1.9	-2.8	-3.7
Land tax revenue (Rm.)	0.4	0.8	1.2	1.6	2.5	5.0	7.6	10.1
Land tax is deductible at a 43% income tax rate								
Item	Shadow prices of land				Market value of land			
	0.5%	1.0%	1.5%	2.0%	0.5%	1.0%	1.5%	2.0%
Decrease in net farm income	-414708.1	-829416.1	-1244124.2	-1658832.2	-2552049.6	-5104099.2	-7656148.8	-10208198.4
Employment multiplier	-30.2	-60.5	-90.7	-120.9	-186.0	-372.1	-558.1	-744.2
GDP multiplier (Rm.)	-0.5	-1.1	-1.6	-2.1	-3.2	-6.5	-9.7	-13.0
Government revenue (mill)	-0.1	-0.2	-0.3	-0.4	-0.7	-1.3	-2.0	-2.7
Land tax revenue (Rm.)	0.3	0.6	0.9	1.2	1.8	3.6	5.4	7.2

2.8 Summary of the results from the other case studies

67. In this section the results of all the areas modelled are compared to ascertain the extent to which the patterns described above are repeated. The results are compared with regard to the effect of a land tax on the net farm income of different areas. This is followed by a brief comparison between land taxes and RSC levies.

68. Table 2.6 presents the effect of different land tax rates on the net farm income value when the tax is raised on market values. From the table it can be seen that the effect is dependent on the scenario followed. When a non-deductible land tax of 2 per cent is introduced, the effect differs significantly between the areas. In the Great Karoo, for instance, such a tax absorbs 7,80 per cent of the net farm income per hectare, while in Bloemfontein it is a mere 1,85 per cent. This may be because average market values per hectare in Bloemfontein are relatively low in comparison. In addition, the area is characterised by a wide variety of land uses, ranging from extensive grazing to irrigated production. Thus, average values are skewed in this case.

69. Nonetheless, when a land tax is raised on average market values the effect on net farm income differs considerably across different regions, negating the equity principle. It is also very difficult to quantify what the effect will be on the net farm income because one will first have to identify the non-farm factors that are capitalised in the market values. Raising a land tax on market values can therefore be seen as distortion, as the imposition of the tax makes certain areas more profitable relative to others.

70. When a land tax is levied on the shadow prices as tax base, the effect on the net farm income of different regions is more neutral, even though the actual tax per hectare paid differs considerably. Table 2.7 shows the results. When a non-deductible land tax is levied at a 2 per cent rate on the shadow price of land, the effect on net farm income falls in the narrow range of 1,84 per cent to 2,36 per cent. When the tax is made deductible at the marginal income tax rate of 43 per cent, the range narrows even further, to between 1,05 per cent and 1,35 per cent. Thus, the effect of the tax is more predictable, and more equitable.

71. If a land tax is raised as a provisional tax, i.e. if it is made fully deductible from income tax payable, it will not have any effect on the shadow price of land or on the income potential of the land. However, it might still have a negative effect on the short-term availability of credit, as the owner has to pay the land tax before it can be claimed against income tax payable.

Table 2.6: The effect of a land tax on net farm income per hectare: market valuation

Region	Great Karoo	Bloemfontein	Nelspruit	Potchefstroom	Cedara	Olifantsriver
1% land tax if not deductible from income tax						
% change in the net farm income (%/ha)	-7.80	-1.85	-2.51	-3.26	-2.54	-7.27
Land tax (R/ha)	R 1.37	R 7.00	R 27.80	R 11.30	R 5.60	R 400.00
1,5% land tax if not deductible from income tax						
% change in the net farm income (%/ha)	-11.70	-2.77	-3.76	-4.90	-3.82	-10.90
Land tax (R/ha)	R 2.05	R 10.50	R 41.70	R 17.00	R 8.40	R 600.00
2% land tax if not deductible from income tax						
% change in the net farm income (%/ha)	-15.60	-3.69	-5.02	-6.53	-5.09	-14.53
Land tax (R/ha)	R 2.74	R 14.00	R 55.50	R 22.70	R 11.20	R 800.00
1% land tax if deductible at 43% from income tax						
% change in the net farm income (%/ha)	-4.45	-1.05	-1.43	-1.86	-1.45	-4.14
Land tax (R/ha)	R 0.78	R 4.00	R 15.80	R 6.50	R 3.20	R 228.00
1,5% land tax if deductible at 43% from income tax						
% change in the net farm income (%/ha)	-6.67	-1.58	-2.15	-2.79	-2.18	-6.21
Land tax (R/ha)	R 1.17	R 6.00	R 23.70	R 9.70	R 4.80	R 342.00
2% land tax if deductible at 43% from income tax						
% change in the net farm income (%/ha)	-8.90	-2.11	-2.86	-3.72	-2.90	-8.28
Land tax (R/ha)	R 1.56	R 8.00	R 31.70	R 12.90	R 6.40	R 456.00

Table 2.7: The effect of a land tax on net farm income per hectare: shadow values

Region	Great Karoo	Bloemfontein	Nelspruit	Potchefstroom	Cedara	Olifantsriver
1% land tax if not deductible from income tax						
% change in the net farm income (%/ha)	-0.92	-0.87	-1.12	-1.34	-1.21	-1.18
Land tax (R/ha)	R 0.16	R 3.30	R 12.40	R 5.20	R 2.70	R 65.00
1,5% land tax if not deductible from income tax						
% change in the net farm income (%/ha)	-1.38	-1.31	-1.68	-2.00	-1.82	-1.77
Land tax (R/ha)	R 0.24	R 5.00	R 18.60	R 7.80	R 4.00	R 98.00
2% land tax if not deductible from income tax						
% change in the net farm income (%/ha)	-1.84	-1.75	-2.24	-2.67	-2.43	-2.36
Land tax (R/ha)	R 0.32	R 6.60	R 24.80	R 10.40	R 5.30	R 130.00
1% land tax if deductible at 43% from income tax						
% change in the net farm income (%/ha)	-0.52	-0.50	-0.64	-0.76	-0.69	-0.67
Land tax (R/ha)	R 0.09	R 1.89	R 7.10	R 3.00	R 1.50	R 37.00
1,5% land tax if deductible at 43% from income tax						
% change in the net farm income (%/ha)	-0.79	-0.75	-0.96	-1.14	-1.04	-1.01
Land tax (R/ha)	R 0.14	R 2.80	R 10.60	R 4.50	R 2.30	R 56.00
2% land tax if deductible at 43% from income tax						
% change in the net farm income (%/ha)	-1.05	-0.99	-1.28	-1.52	-1.38	-1.35
Land tax (R/ha)	R 0.18	R 3.80	R 14.10	R 5.90	R 3.00	R 74.00

2.9 Land taxes and RSC levies

72. Due to time constraints it was not possible to compare the effect of a land tax and of RSC levies for the whole of the South African agricultural sector. However, a case study was done of the Olifants river area that compares the potential revenue from these two sources. RSC levies are levied as a percentage of the turnover of a farm as well as a percentage of the wages paid out. According to the District Council, the establishment (turnover) levy amounts to 0.15504 per cent of the turnover (including VAT) in this area, whilst the service levy, which is charged on gross salaries, wages and drawings, amounts to 0,3876 per cent (including VAT) of these components. Administration costs account for 20 per cent of the revenue generated through these levies. Table 2.8 compares the expected revenue from these taxes with those from a non-deductible land tax. However, the amounts in Table 2.8 have been adjusted to exclude VAT.

Table 2.8 : RSC levies compared with different land tax regimes

Item	Land tax (shadow values)				Land tax (market values)			
	0,5%	1,0%	1,5%	2,0%	0,5%	1,0%	1,5%	2,0%
Olifants river case study								
Income from land tax per ha (R)	R32.50	R65.00	R97.50	R130.00	R200.00	R400.00	R600.00	R800.00
Income from RSC levies (R)	R50.00	R50.00	R50.00	R50.00	R50.00	R50.00	R50.00	R50.00

73. It is clear from Table 2.8 that if a land tax is levied on market values, the cost of the land tax to the landowner will far exceed that of RSC levies. However, when the land tax is raised on the shadow prices of the land the amount of the revenue is more comparable. As these RSC levies are deductible from income tax, the actual cost of the RSC levies to the landowner will be much smaller. However, it is clear that the revenue from RSC levies will be larger than the revenue from a land tax if the rate for the latter is closer to 0,5 per cent, both are deductible, and the land tax is raised on productive value. In all other cases the revenue from land taxes will be larger.

2.10 Conclusion

74. This chapter has shown that if a land tax is raised the following should be considered:

- The land tax base;
- The land tax rate; and
- The deductibility of the land tax from income tax.

75. The effects of a rural land tax when raised on market values of agricultural land are more severe than when raised on the productive potential (agricultural use value) of the land, and this effect differs between regions. The distortionary effects of using market values as the base for calculating land values are, therefore, larger than in the case where productive value is used. This will effect the profitability of different regions of the country, and, through its effect on profitability, may distort production patterns. This kind of distortion is most severe in those regions that are closest to the market, i.e. when non-market factors influence the market value of land the most. The way in which the productive potential of the land is calculated will determine the level of the tax rate.

76. One explanation for opposition to an agricultural land tax by farmers is that current landowners believe that the cost to them may end up being considerable more than the tax alone. This study has shown that farmers will also incur a loss in land values. In terms of a 1 per cent land tax rate levied on

market values, a land tax will have a average negative effect of 5,3 per cent on predicted real land prices. In the case of a 2 per cent rate levied on market values, the effect resulted in a 12,32 per cent decline in the market values. It should, however, be noted that these results represent a worse case scenario, as it is assumed farmers cannot shift the tax burden to consumers or tenants through higher prices or rentals.

77. It is often argued that the tax-induced decline in land prices encourages access to land for new farmers such as participants in a land reform programme, young people or tenants wishing to own land. It has, however, been shown that the effects of a land tax will not only fall on the commercial farmer but also on the young and emerging farmer. It can thus be concluded that although land will be cheaper, profits will be lower and farmers will thus not necessarily be better off with the land tax and the land market will not favour new entrants.

78. This chapter also showed that, over the long term, the most severe effect of a land tax is on the level of short term liabilities of farmers, as farmers are forced to use more debt to operate their farms at an optimal level.

79. The effect of the forward and backward linkages between agriculture and the rest of the economy also have to be accounted for in assessing the total impact of a land tax. This study has shown that the multipliers in agriculture are the highest relative to the other economic sectors.² Thus, although the funds removed from agriculture will be re-invested into the local community, there will be a loss in total welfare for the relevant rural communities.

80. In conclusion, the research shows that, when measured against the principles for an efficient and coherent tax system, the potentially distortionary effect of the rural land tax on the agricultural sector can be minimised by regarding the tax as a provisional payment of income tax.

81. Further, the research reported here has shown that the decision to value land according to its market or use value should rest on local circumstances, including the capacity of the municipalities to implement a specific assessment mechanism. However, it is clear that there should be bias towards use value methods for agricultural land, as market valuations cause considerable distortions in areas where the discrepancy between market and use value is the greatest. In this respect, the experience in the United States has been that most local authorities now value land on the basis of its use value.

² See also Eckert, JB; Liebenberg, GF and Trotskie, DP 1997. *Compiling an Agricultural SAM for the Western Cape*. Department of Agriculture of the Western Cape, Elsenburg.

CHAPTER 3

THE CAPACITY OF RURAL MUNICIPALITIES IN SOUTH AFRICA¹

3.1 Introduction

82. The transformation of local government in South Africa is taking place in terms of the Local Government Transition Act, Act 209 of 1993. The interim (1993) Constitution as well as the Constitution of the Republic of South Africa, Act 108 of 1996 confirms this. Section 152 of the Constitution charges municipalities to strive, within their financial and administrative capacities, to:

- Provide democratic and accountable government;
- Ensure the provision of services to their communities in a sustainable manner; and
- Promote social and economic development within a safe and healthy environment.

83. According to the Constitution, rates on property are a **constitutionally guaranteed** source of revenue for local governments, while Sections 228 and 229 explicitly prohibit provinces from introducing such a tax. Despite the fact that it is a revenue source for local government, national and provincial legislation will most probably continue to regulate how it is charged, assessed and collected. In this regard, the *White Paper on Local Government*² spells out the basic design of a new local government system, addressing the following important aspects:

- The specific powers and functions of the different categories and types of municipalities;
- Demarcation of their areas of jurisdiction;
- Reducing the number of municipalities from the existing 843;
- The link between small towns and their surrounding rural areas;
- The current two-tier structure; and
- Fiscal relations between municipalities.

84. From a constitutional point of view any new system of local government must take cognisance of the primary role of municipalities, namely the provision of essential municipal services (such as water, sanitation, electricity, etc.) to all local communities. A new system of local government must, however, also consider an important secondary role of local government, namely the promotion of economic and social development, which includes participation in national and provincial development programmes. The *White Paper* stresses the need to build the capacity of municipalities, especially in rural areas, as a matter of extreme urgency.

85. However, to achieve these constitutional goals, any future system of local government will have to come to terms with the following realities:

- Managing major processes of transition in an orderly and equitable fashion requires an appropriate Constitutional and legislative framework and realistic time frames. Municipalities must be perceived to be legitimate, based on adequate representation, accountability, viability and sustainability. Municipalities must have adequate sources of revenue to exercise their powers and perform their functions. If not, their legitimacy may become questionable. To be sustainable, local government must be affordable.

¹ This Chapter is based on Franzsen, R. 'The capacity of municipalities in rural areas to introduce, assess and collect a rural land tax.' University of South Africa (UNISA). Unpublished report.

² Ministry for Provincial Affairs and Constitutional Development, March 1998.

- The creation of municipalities throughout the country has necessitated the establishment of rural local government structures in many areas where it was ineffective or non-existent in the past. Before there can be any clarity on a viable system of local government finance, there must be clarity on the future local government structures, its powers and its functions. Generally, finance should follow function - although this does not always happen. An important area of concern in this regard is the division of functions and powers (especially fiscal powers) in a two-tier rural local government model. Ideally the devolution of functions and powers should go hand-in-hand with the fiscal means to perform those functions and exercise those powers. The Financial and Fiscal Commission will have to play a pivotal role as regards the proper funding of the local government sphere.
- There is still a proliferation of complex and ‘overlapping’ legislative provisions, inherited from the apartheid era, that undermines legitimate local government and invites constitutional attacks of rating ordinances. Furthermore, there are various inhibiting data limitations. The following examples should suffice:
 - (i) The 1996 population census was conducted on the basis of magisterial districts which makes it difficult - if not impossible - to relay much of the information to local government jurisdictions;
 - (ii) Not all land has as yet been surveyed by the office of the Surveyor General. The problem is especially acute in the former homeland areas; and
 - (iii) Insecurity of tenure rights pertaining to urban and rural land exists in many areas. This is especially relevant in the context of tribal land.

Data limitations and a lack of uniformity of available data (e.g. pertaining to property tax), amongst other issues, prevent the full implementation of a tax/fiscal capacity component into the formula for intergovernmental fiscal transfers to local government.

- According to the *White paper*, Metropolitan Councils (MCs) and District Councils (DCs) must act as regional mechanisms for redistributing wealth from affluent areas to disadvantaged areas under their jurisdiction by providing financial support to primary councils. It states that richer consumers could be required to pay more than the cost of a particular service to subsidise the poor. The expenditure side of the budgets of many Metropolitan (MCs) and District Councils (DCs) bear testimony that redistribution is, at least to some extent, already occurring at the secondary tier of local government; and
- An important principle expounded upon in the *White Paper* is the need for realistic and affordable budgeting. On the expenditure side municipalities must ensure that the services they provide are at a level that is affordable to themselves and to households which pay for these services. Municipalities must ensure that they recover the cost of providing services.

86. Local government must overcome the legacies of apartheid, such as the difficulties of amalgamating racially segregated urban municipalities on the basis of economic and historical realities rather than race and the absence of effective municipal government in many jurisdictions, particularly in rural areas. Overcoming these obstacles has serious financial and fiscal implications for local government. In June 1997 Project Viability³, for example, found that an alarming number of municipalities were in dire financial straits.

87. The purpose in this Chapter is to survey the current status of local government in South Africa, with a focus on non-metropolitan areas. The evolving new local government structures are explained, as are their main sources of revenue. This is followed by an assessment of their existing capacity to raise taxes, with the emphasis on a land tax. This latter assessment is based on field research that was conducted with the majority

³ Set up by the national government in November 1996.

of the 42 DCs in South Africa. A summary of the results is presented here: the detailed assessment on a provincial basis is reported in the original research report.

3.2 Local government structures (municipalities)

Metropolitan and non-metropolitan municipalities

88. In terms of the Local Government Transition Act 209 of 1993 clear distinctions can be drawn between municipalities in metropolitan areas and those in non-metropolitan areas.

89. Section 155 of the 1996 Constitution envisages three different categories of municipality:

- Category A: A municipality with exclusive municipal executive and legislative authority in its area of jurisdiction;
- Category B: A municipality that shares municipal executive and legislative authority with a Category C municipality within whose area of jurisdiction it falls; and
- Category C: A municipality that has municipal executive and legislative authority in an area that includes more than one municipality.

90. The different transitional structures provided for in that Local Government Transition Act, read with the above-mentioned categories of municipality in the 1996 Constitution, are listed in the following figure:

Transitional local government structures

Metropolitan areas	Non-metropolitan areas
Secondary tier	Secondary tier
Metropolitan Councils Category C	District Councils (Category C)
Primary tier	Primary tier
Metropolitan Local Councils (Category B)	<i>Urban:</i> Transitional Local Councils (TLCs) (Category B)
	<i>Rural:</i> Transitional Representative Councils (TRepCs) (Category B) Transitional Rural Councils (TRCs) (Category B)

Note: In terms of the Local Government: Municipal Structures Bill Metropolitan Councils may in future become Category A councils.

Non-metropolitan municipalities

91. It is important to note that there is no clarity on the meaning of 'rural' in the context of non-metropolitan local government. The *White Paper*⁴ states that 'rural' is variously used to include a wide range of settlement types, such as:

- The urban fringe outside the boundaries of metropolitan councils or TLCs;
- Small, fledgling urban municipalities (e.g. Vischkuil and Magaliesburg in Gauteng and Oyster Bay TRC in the Eastern Cape);
- Dense rural settlements (e.g. planned betterment settlements in former homeland areas and informal settlements, which are generally unplanned and largely unserved);
- Small rural settlements (e.g. unplanned traditional settlements or resettlement areas);
- Agri-villages;
- Dispersed or scattered settlements (e.g. homestead settlements on tribal land, commercial farm land or other privately-owned or public land); and
- Extensive farming areas with only a few homesteads.

The present transitional system of non-metropolitan local government

92. The Local Government Transition Act provides for different types of rural municipalities in non-metropolitan areas, and provinces have some freedom to choose suitable structures.

District Councils (DCs)

93. Currently there are 42 DCs throughout South Africa. Together with the 6 MCs, they cover the total surface area of South Africa - i.e. they provide wall-to-wall local government.

Primary municipalities in rural areas

94. Within the area of jurisdiction of a district council, primary local government structures exist in the form of transitional local councils (TLCs) in urban areas, and transitional representative councils (TRepCs) or transitional rural councils (TRCs) in rural areas.

95. TLCs vary from secondary cities (e.g. Germiston, Kimberley, Port Elizabeth and Witbank) to small towns and villages. They have executive powers and service delivery functions and (at least in theory) act as autonomous municipalities. TLCs are represented on the district council within whose area of jurisdiction they are located.

96. Generally TRepCs and/or TRCs have neither executive powers nor any service delivery functions. Presently they function as consultative and/or advisory structures to district councils. The responsibility to provide infrastructure and to deliver services in the rural areas falls largely on the shoulders of DCs and the relevant line departments (e.g. Health, Water Affairs, and Public Works) at the national and provincial spheres of government.

⁴ The Strauss Commission (*Commission of Inquiry into the Provision of Rural Financial Services, 1996*) also emphasised the weakness of existing official definitions of rural areas and rural dwellers in South Africa.

97. In the provinces of North West and KwaZulu-Natal there are still so-called ‘remaining areas’ for which no primary rural municipalities exist at present. Within these areas the DCs hold interim responsibility for the provision of services and infrastructure. In some of the former homeland areas DCs and primary urban and rural municipalities are only now being established, and revenue sources for the new municipalities are still extremely limited.

98. It is important to note that there are large differences between the fiscal capacities of metropolitan and non-metropolitan municipalities. Secondly, within non-metropolitan areas there are differences between the fiscal capacity of secondary-tier municipalities and primary-tier municipalities (TRepCs and TRCs), as well as amongst the stand-alone urban municipalities (TLCs). When the viability and affordability of especially municipalities in rural areas are considered, it is important to keep the geographic sizes and population densities of various jurisdictions in mind. To establish the cost of a minimum standard of basic services in rural areas, population density is an important factor.

99. Table 3.1 gives an indication of size, population and the population density for each of the 9 provinces. The table also lists the number of DCs, the various TLCs and TRepCs and TRCs, as well as the number of magisterial districts in all 9 provinces. It does not show the 6 MCs (4 in Gauteng, 1 in KwaZulu-Natal and 1 in the Western Cape) and 24 metropolitan local councils (12 in Gauteng, and 6 each in KwaZulu-Natal and the Western Cape).

Table 3.1: Summary data on the 9 Provinces

Province	Population	Density/km ²	DCs	TLCs	TRepCs/ TRCs	Magisterial Districts
Eastern Cape	5 865 000	35	6	94	76+7	78
Free State	2 470 000	19	4	80	15	52
Gauteng	7 171 000	421	2	14	9+10	23
KwaZulu-Natal	7 672 000	81	7	61	-	52
Mpumalanga	2 646 000	33	3	55	18	23
Northern Cape	746 000	2	6	64	42	26
Northern Province	4 128 000	34	2	13	36	17
North West	3 043 000	26	5	30	18	31
Western Cape	4 118 000	32	7	95	27	42
South Africa	37 859 000	31	42	506	265	344

Sources: Department of Provincial Affairs and Constitutional Development and the Department of Justice

Non-metropolitan local government as envisaged in the White Paper

100. In the light of the challenges faced in the non-metropolitan areas, the *White Paper* makes the case for strong district government. Although some of the challenges will have to be addressed at the primary tier, some demand regional attention. A system of district government, that will build on the capacity of the present system of DCs, but that will also assume new roles and responsibilities, is envisaged.

District governments

101. The *White Paper* correctly points out that District Councils are very different entities in various parts of the country. In the light of the various rural settlement types and other peculiar local circumstances, a measure of flexibility must be retained in a future district government system. The *White Paper* envisages that local government will fulfil the following key roles:

- District governments must be given key responsibilities for district-wide integrated development planning (including land-use planning, economic planning and development and transport planning);
- District governments must act as infrastructural development agents and providers of bulk services (where required) - through the retention of RSC levies;
- District governments must be able to provide on-demand assistance to primary municipalities and should also assume a capacity-building role to enable primary municipalities to assume municipal functions; and
- District governments must provide and maintain appropriate levels of municipal services in areas where (primary) municipalities have inadequate administrative capacity.

Category B municipalities

102. The *White Paper* envisages alternative types of primary municipalities (Category B) in areas which fall within the areas of jurisdiction of DCs (Category C). These include urban municipalities, amalgamated urban-rural municipalities and rural municipalities.

103. *Urban municipalities* will be best suited to secondary cities and larger towns (presently TLCs). They will have a full range of municipal powers and functions (excluding the power to raise and collect RSC levies). The municipal boundaries of these municipalities must enclose the urban fringe.

104. *Amalgamated urban-rural municipalities* can be established through the amalgamation of existing rural (TRepC/TRC) and urban (TLC) municipalities, or the extension of urban municipal boundaries to include a town's rural hinterland. According to the *White Paper* this model is appropriate for small and medium-sized towns where there are clear economic and social linkages between the urban and rural settlements. Much of the evidence suggests that although the costs incurred by the town will naturally increase, there are significant delivery gains in the rural areas with positive economic spin-offs for the area as a whole. Amalgamation could, amongst others, have the following results:

- reduction of costs of government (e.g. overcoming duplication of structures and increasing efficiency of resource allocation);
- broadening the tax base and ensuring that all residents - urban and rural - share in the benefits derived therefrom;
- facilitation of access to public services by rural communities; and
- promotion of the integration of urban and rural development.

105. *Rural municipalities* (present TRepCs and TRCs?) could be retained in some areas, as long as they are allocated a minimum of executive and legislative powers, and are empowered to 'draw down' powers from the district government as they demonstrate sufficient administrative and financial capacity to administer those powers. The varied allocation of powers between the district governments and their constituent category B municipalities will provide flexibility to cater for the diversity of needs and contexts in rural areas, but the division of powers and functions will have to be facilitated by criteria set in national legislation.

106. The *White Paper* envisages that a system of district governments (category C) and category B (urban, amalgamated urban-rural and/or rural) municipalities will operate in all non-metropolitan areas. It does, however, mention the possibility that there may be areas where no sustainable category B municipality is possible (e.g. expansive sparsely populated areas) and where a district government would have to assume responsibility for all municipal functions.

107. In summary, non-metropolitan government must be flexible enough to accommodate the diversity of settlement types, administrative capacities and unique circumstances prevailing in rural areas. It is foreseen that although primary municipalities may differ substantially between and even within district governments, some consistency and uniformity should exist at the district government tier. The development and utilisation of local tax bases (e.g. a rural land tax) will have to be considered with the diversity, but also the need for some uniformity, in mind.

108. For purposes of the present inquiry into the ability of present and/or future non-metropolitan municipalities to introduce and collect a land tax, the focus in the rest of this chapter is on the present system of district councils, for the following reasons:

- (i) DCs (together with MCs) cover the total surface area of South Africa, but primary councils do not. In areas where primary rural municipalities do not exist (e.g. in KwaZulu-Natal and parts of the North West), a land tax – if introduced – would have to be levied by the DCs;
- (ii) Primary rural councils presently have no (or very little) executive powers or functions in terms of the Local Government Transition Act. They were hastily established when the first democratic local government elections were held in 1995 and 1996, and their future is still uncertain. In contrast, DCs have taken over the powers and functions of the former Regional Services Councils (RSCs) and Joint Services Boards (JSBs). RSCs and JSBs had been in operation in most parts of the country (although not in the former homelands);
- (iii) DCs already have experience with the administration of RSC levies and, in a few instances, rates on property, which they administer on behalf of TLCs and/or TRCs within their jurisdictions);
- (iv) The administrative capacity to introduce a rural land tax at DC level presumably exists or could be developed in the short term. Generally primary rural municipalities (TRepCs and TRCs) do not have any capacity to introduce and collect such a tax. The development of administrative capacity in the primary sphere of government will probably take considerably longer;
- (v) In terms of section 10G(6) of the Local Government Transition Act, a DC is responsible for the valuation or measurement of all properties within so-called remaining areas (in North West and KwaZulu-Natal) or within the jurisdiction of representative councils; and
- (vi) Even if a rural land tax is introduced at DC level, the revenue can be allocated to the primary rural municipalities. Should the latter be retained under a future local government dispensation, and should their administrative capacities be developed, the full administrative burden of charging, assessing and/or collection could be devolved to these municipalities.

109. In the provinces where primary municipalities have been established for rural areas, these generally function merely as advisory bodies to the relevant DC. They have no executive powers or functions. This implies that, at present, DCs are the only structures that may be in a position to introduce a land tax in the local sphere of government.

3.3 Intergovernmental revenue sources available to local government

110. Section 214(1) of the Constitution states that an Act of Parliament must provide for the equitable division of revenue raised nationally among the three spheres of government. Section 227(1)(a) states that local government is entitled to an *equitable share* of revenue raised nationally to enable it to provide basic services and perform the functions allocated to it.

111. In July 1997 the Financial and Fiscal Commission published a discussion document⁵ setting out its initial thinking on a financing regime for local government. The document addresses the FFC's proposed formula for the division among MCs and DCs of the share of nationally collected revenue accruing to local governments. The aim of the formula is to ensure horizontal equity among municipalities in the various provinces and possibly within each MCs and DCs.

112. The FFC suggests that these transfers should be directed to the MCs and DCs, rather than via the provinces or to primary municipalities directly.

113. National legislation must provide for any other allocations to provinces, local government or municipalities from the national governments' share of nationally collected revenue, and any conditions on which these allocations may be made. Such legislation must, *inter alia*, take into consideration the need to ensure that municipalities are able to provide basic services and perform the functions allocated to them, the fiscal capacity and efficiency of municipalities, as well as their development needs. Section 227(2) of the Constitution makes it clear that the additional revenue raised by a municipality may not be deducted from its share of revenue raised nationally, or from other allocations made to it by the national government. However, there is no obligation on the national government to compensate municipalities that do not raise revenue commensurate with their fiscal capacity and tax base - i.e. a high premium is placed on municipalities' tax effort.

114. The *White Paper* argues that the maximum degree of fiscal independence is in the best interest of both the local and national spheres of government, and that intergovernmental transfers must be rational, predictable and accountable. Municipalities should know well in advance what amount of money they will receive, when they will receive it and for what purpose (if conditional). This will ensure that grants and the local revenue bases operate in support of each other. Predictability of fiscal transfers is also emphasised by the FFC. Fiscal independence of municipalities should, at least in theory, result in increased financial discipline and local accountability.

115. In various cases DCs have received provincial grants to help establish primary rural municipalities. Most noticeable in this regard are the grants administered by the Bosveld District Council and Northern District Council in the Northern Province.

3.4 Own sources of revenue for local government

116. As the introduction of new taxes must be considered in the light of the overall tax regime at all spheres of government, but especially at the local sphere, a brief overview of the revenue sources currently exploited by local government is necessary.

117. Section 229 of the Constitution states that a municipality has the power to impose:

- Rates on property;
- Surcharges on fees for services provided by or on behalf of the municipality; and
- Other taxes, levies and duties appropriate to local government or to the category of local government into which that municipality falls if authorised by national legislation.

⁵ Titled, *Local Government in a System of Intergovernmental Fiscal Relations in South Africa*.

118. A municipality's power to raise revenue in this manner may be regulated by national legislation and may not be exercised in a way that materially and unreasonably prejudices national economic policies, economic activities across municipal boundaries, or the national mobility of goods, services, capital or labour. Furthermore, a municipality may not impose income tax, value-added tax, general sales tax or customs duties.

119. Below, the current sources of own revenue used by municipalities are presented.

Current revenue sources for municipalities

Municipality	Own Revenue Sources
Metropolitan Councils (MCs)	Services levy (payroll tax) Establishment levy (turnover tax) An equitable portion from all the constituent local councils
Metropolitan Local Councils (MLCs) and Transitional Local Councils (TLCs)	Rates on property (property tax) Income from trading services User charges and licences
District Councils (DCs)	Services levy (payroll tax) Establishment levy (turnover tax)
Transitional Representative Councils (TrepCs) or Transitional Rural Councils (TRCs)	None

120. Table 3.2 shows the contribution of each of these own sources of revenue to the income generated by primary urban municipalities. The table gives no indication of the financial viability of individual municipalities and also does not reflect the income from the turnover and payroll taxes (amounting to more than R2,1 billion) collected by MCs and DCs. Therefore, it does not give a clear picture of the current total revenue for *all* municipalities. The data clearly show that the bulk of own revenue generated by metropolitan and urban municipalities consists of income from trading services and 'rates on property'.

Table 3.2: Local government revenue sources in the 1996/97 financial year

Rates on property (property tax) and related income	61,24%
Trading profits from sewage & refuse removal, water and electricity	15,08%
Interest	7,86%
Intergovernmental transfers	11,78%
Other income	4,05%
	100,00%

Source: Kapp, C (1998). Property tax workshop for the Department of Provincial Affairs and Constitutional Development, April.

Income from trading services (surcharges on fees for services)

121. Income from trading services is an important source of revenue for local government. The four most important trading services are:

- The provision of water;
- The provision of electricity;
- Sewage disposal; and
- Refuse removal.

122. Although the Constitution sanctions surcharges on fees for services provided by or on behalf of the municipality (s 229(1)(a)), it is uncertain to what extent municipalities will be able to continue to raise a major portion of own revenue through profits on trading services. Issues such as the possible future provision of electricity by regional distributors, the role of the National Electricity Regulator, and compensation to municipalities for losses in revenue from this source all remain to be clarified. An equitable and transparent tariff structure (at least recovering the cost of providing basic services) must be introduced. Furthermore, in terms of the Water Services Act 108 of 1997 water tariff regulations may be promulgated. This may also impact on municipalities' ability to raise revenue from the provision of water.

123. It is clear that any material reduction in a municipality's revenue from these sources will impact significantly on its other sources of revenue, especially the property tax base. Traditionally the property tax base has been subsidised by the substantial income from trading services.

Property tax ('rates on property')

124. Although property taxes conventionally include taxes on movable property and property transfer taxes, in the South African context 'property tax' refers to a tax variously called a 'general rate' or 'assessment rate' (or more generally 'rates on property'). It is an important own source of revenue for metropolitan local councils (MLCs) and local councils (TLCs), in other words for *urban* primary municipalities. It is an annual tax on owners of land and presently charged, assessed and collected in terms of provincial legislation in all 9 provinces. Municipalities generally have a choice between at least 2 of the following tax bases:

- Site rating (i.e. unimproved value);
- Flat rating (i.e. improved value); or
- Composite rating (i.e. land and improvements - but at different tax rates).

125. A property tax or land tax is not currently levied on *rural* land. All colonial land taxes (on primarily rural land) in the various provinces were abolished by national legislation by 1936. The only recent form of property tax on land outside urban municipal boundaries was the tax levied by Divisional Councils in the former Cape of Good Hope. This was phased out by 1989 in terms of the Abolition of Development Bodies Act, Act 75 of 1986.

126. Property tax was an important and widely accepted source of revenue for municipalities under apartheid, but only for White municipalities and in some cases Coloured and Indian municipalities. In most cases generous rebates were granted to residential ratepayers, shifting much of the tax burden to commercial and industrial properties. Many local government councils could also afford to set low property tax rates as a result of the profits (an implicit excise tax) made on the sale of certain trading services. Tax rates were normally set annually after the revenue from all other sources had been considered - in essence making up the shortfall. A brief outline of the characteristics of the property tax is given below.

Synopsis of rates on property (property tax)

Taxable Object	All land within the municipality (irrespective of zoning)
Tax Base	Site rating (i.e. unimproved value); or Flat rating (i.e. improved value); or Composite rating (i.e. land and improvements - but at different tax rates)
Taxpayer	The owner
Method of assessment (to establish capital value)	Land: Comparable sales method Improvements: Subtracting site value from improved value (except KwaZulu: replacement cost)
Assessment	Only registered valuers
Objections and Appeal	Elaborate procedures
Tax rates	Flat rates (expressed as cents in the Rand) Some provinces set a maximum rate
Exemptions	Very few state-owned properties are rateable
Rebates	Improved residential properties Sometimes certain hardship cases
Collection	Normally monthly or biannual instalments
Enforcement	Interest on arrears No transfer unless 'clearance certificate' issued In arrears for more than 3 years: seizure and public sale

127. The *White Paper* identifies a number of issues to be addressed in regard to property taxation, including:

- The extension of the tax base in urban municipalities;
- Reassessment periods; and
- The variety of rating systems presently used.

Regional Services Council levies

128. The regional services levy (a payroll tax) and the regional establishment levy (a turnover tax) are presently the most important sources of revenue for metropolitan and district councils. These levies are levied in terms of the Regional Services Councils Act 109 of 1985 and the KwaZulu and Natal Joint Services Act 84 of 1990 read with section 10(3) of the Local Government Transition Act. The total revenue from these levies amounted to more than R2,1 billion in 1996/97⁶ and the amount budgeted for 1997/98 is R2,9 billion⁷.

129. The future of these levies is uncertain. Firstly, turnover and payroll levies are generally considered to be economically inefficient. Secondly, according to the Third Interim Report of the Katz Commission, there may be problems with the constitutionality of both these levies. However, little if any substantive research on these levies has been done since the Commissions' Third Interim Report was tabled in November 1995.

⁶ Budget Review, 1997

⁷ Budget Review, 1998

130. Despite the Katz Commission's doubts, the *White Paper* argues that these levies will remain an important source of revenue for MCs and DCs, at least in the short term. As DCs are generally dependent on these levies for their entire income, administrative problems need to be addressed to ensure that all potential levy payers are registered and revenue is collected. Information gathered from 28 of the 42 DCs indicates that only a few (particularly in the Eastern Cape) experience serious problems with the registration of new levy payers and/or the collection of levies from currently registered levy payers. Collection rates generally tend to exceed 90 per cent, and some DCs have successfully outsourced the collection of levies. The research also suggests that in the case of many DCs, levy income is currently sufficient to balance their books. However, in the Eastern Cape (e.g. Kei DC and Wild Coast DC) and KwaZulu-Natal (e.g. Ilembe RC), where new councils were established in 1996 and 1997 respectively, levy income will probably continue to be supplemented by intergovernmental transfers in the short term.

The fuel levy

131. The fuel levy is levied and collected in the national sphere of government. However, until 30 June 1997, 1 cent per litre of the fuel levy was allocated to DCs and MCs on the basis of origin (i.e. an amount was paid over to each council in relation to the fuel sold within its boundaries). These amounts so allocated had to be used by these councils for public transport-related expenditures. In most cases it was used to subsidise commuter bus services, with the result that the amounts received were paid over to the Department of Transport. Some DCs, however, had surplus funds available to spend on transport-related infrastructure such as roads and taxi ranks.

A rural land tax

132. Primary rural municipalities generally have no tax base at all and currently rely almost exclusively on *ad hoc* intergovernmental grants (via DCs) to cover their administrative costs. To promote fiscal autonomy and accountability, the problem of inadequate revenue sources - especially acute in rural areas - must be addressed as a matter of urgency. It is in this context that a rural land tax must be considered.

3.5 The capacity of District Councils (DCs) to introduce a land tax

133. Below, the main issues and problems regarding the capacity of rural local government structures to levy a rural land tax are analysed according to the respective provinces. Because local government structures, climatic conditions, physical features and demographic factors may differ substantially between (and even within) provinces, this research focused on an analysis of the information supplied by DCs on a provincial basis. The research report contains data pertaining to the numbers of rural local councils in each district; its surface area, population and population density; the number of councillors and taxpayers; revenue sources and amounts collected; and land use. Here, a summary is given of the problems encountered in each province according to officials in each of the DCs visited, as well as an assessment regarding whether it was possible to introduce a rural land tax and, if so, when this would become feasible.

The Eastern Cape Province

134. The Eastern Cape is the second largest province (170 000km²) and has a population of 5 865 000 and a population density of 35 persons per km². Both local governments and the provincial government are struggling to come to grips with the plethora of old RSA, Transkei and Ciskei laws that regulated local government.

135. There are 6 DCs in the Eastern Cape. The Port Elizabeth-Uitenhage-Despatch area is situated within the Western DC. The rural component is almost exclusively commercial farmland. It is the only district council in the province that does not include any tribal land within its boundaries. Three of the other 5 DCs include both commercial farmland and tribal land, whilst the Kei and Wild Coast DCs consist almost

exclusively of tribal land. Both the latter councils were only established in 1996. TRepCs have been established for each magisterial district. Land in the former Transkei and Ciskei has not yet been properly surveyed.

136. Establishing ownership with reference to tribal land can be onerous. For example, land may be registered in the name of:

- The state (national government);
- The state president (as trustee);
- The tribal authority;
- The tribe (collectively); and
- An individual member of the tribe (i.e. private ownership).

137. Table 3.3 provides an assessment by the relevant DCs of when, in practice, they expect to be able to introduce a rural land tax if the decision were taken to introduce it.

Table 3.3: The feasibility of introducing a rural land tax in the Eastern Cape

District Council (DC)	1998/99	2001/02	2003/04
Amatola DC	No	?	Yes
Drakensberg DC	Yes ¹	Yes	Yes
Kei DC	No	No	?
Stormberg DC	No	Yes	Yes
Western DC	No	Yes	Yes
Wild Coast DC	No	No	?

Note: ¹As not all land within this DC has been surveyed, the feasibility of this assessment is doubtful.

138. There is little possibility that a land tax could be introduced successfully in the areas of jurisdiction of any of the DCs within the next four years, while most of the DCs expect to be able to introduce such a tax within the next five years. This assessment seems to be realistic, especially if the national and provincial spheres of government provide support to DCs in surveying tribal land.

139. Specific problems identified in this Province include:

- The diversity of legislation, brought about by the ‘amalgamation’ of the former Transkei and Ciskei administrations with a part of the former Cape provincial administration, is an inhibiting and complicating factor in the areas of local government and finance;
- A large proportion of land in the Eastern Cape has not been surveyed;
- There was strong resistance from the commercial farming community against the RSC levies as well as the concept of a land tax;
- There is also resistance against RSC levies in the former Ciskei and Transkei where business licences were collected until recently. It is imperative that the introduction of any new tax must be accompanied by the elimination of double taxation (e.g. licence fees as well as RSC levies on the owners of businesses) and a well-structured education programme;

- The cost of assessment of all land in this large and highly rural province will be high;
- There is generally a lack of security of title (uncertainty about land rights) in the former homeland areas;
- The future role (and fiscal powers) of tribal authorities must be clarified;
- Should Port Elizabeth become a MC, it may seriously affect the Western DC. The major portion of the Western DC income is generated in the PE-Uitenhage-Despatch area. It is interesting to note that total budgeted RSC levies for 1997/98 amount to R117 747 000 - which is higher than the totals for 2 of the existing 6 MCs (the Lekoa-Vaal MC (R55 647 500) and Khayalami MC (R105 000 000));
- There is a general lack of administrative capacity in the recently established Kei and Wild Coast DCs in the former Transkei. These councils are struggling to introduce RSC levies (i.e. to register new levy payers and to collect the revenue), suggesting that the introduction of a land tax will be impossible within the next few years.

Free State

140. The Free State covers 130 000km² and its population 2 470 000. The population density is low – at only 19 persons per km².

141. The rural areas of the Free State are made up primarily of commercial farmland. Only 2 of the 4 DCs contain tribal land (Thaba Nchu and the former Qwa-Qwa homeland). The Free State primary rural local government model is relatively well developed in comparison to most of the other provinces. The TRCs generally have good working relations with the relevant DCs and the process of endowing TRCs with executive powers and functions is apparently well under way. Table 3.4 shows that officials at all of the DCs thought a rural land tax could be introduced within the next 2-4 years, which seems to be a realistic assessment.

Table 3.4: The feasibility of introducing a rural land tax in the Free State

District Council (DC)	1998/99	2001/02	2003/04
Bloemarea DC	No	Yes	Yes
Eastern FS DC	No	Yes	Yes
Goldfields DC	No	Yes	Yes
Northern FS DC	No	Yes	Yes

142. The main problem areas encountered were:

- Representatives of the DCs estimated that the cost of assessment of all rural properties will be substantial; and
- It may be difficult to introduce any new tax in a situation where current revenue sources seem to be adequate to fulfil the constitutional obligations of local government, as is the case, for example, with the Goldfields DC.

Gauteng

143. Gauteng is the smallest province measured by physical size (17 030km²). It has a population (1996 census estimate) of 7 171 000 and by far the highest population density in the country (421 persons per km²).

144. Gauteng boasts 4 MCs and 2 DCs (called services councils). Because it is so highly urbanised and geographically relatively small, Gauteng is in many respects unique. There is very little tribal land in Gauteng. The Eastern Gauteng DC will be implementing a rating system (property tax) throughout their respective areas of jurisdiction as from 1 July 1999 (the 1999/2000 financial year). Within its jurisdiction all land is being assessed at present and a valuation roll is in preparation. In principle all landowners will therefore be rateable as from 1 July 1999 in terms of the Local Authorities Rating Ordinance 11 of 1977 – that is, on the same basis as urban property owners. Table 3.5 reflects this justifiable optimism regarding their potential to introduce a rural land tax.

Table 3.5: The feasibility of introducing a rural land tax in Gauteng

Services Council	1998/99	2001/02	2003/04
Eastern Gauteng SC	No	Yes	Yes
Western Gauteng SC	No	Yes	Yes

145. Problem areas:

- There is fierce resistance against the present assessment of rural properties by the Eastern Gauteng Services Council. The lack of cooperation by property owners has already set back the process several months, and has resulted in the postponement of the introduction of the property rating in TRepCs by at least one year;
- Once a valuation roll is published, many objections and appeals are expected; and
- Gauteng's experience in attempting to broaden its urban property tax to include rural properties should at least serve as a valuable learning experience for the other provinces.

KwaZulu-Natal

146. KwaZulu-Natal has the highest population (7 670 000) of all 9 provinces, and the population density of 81 persons per km² ranks second after Gauteng. Rural areas consist largely of tribal land, although there are sizeable commercial farmland and conservation areas.

147. KwaZulu-Natal has 1 MC and 7 Regional Councils (RCs). Presently it has no primary local government structures in rural areas, although such structures seem to be evolving in the form of sub-regions within each of the seven RCs. All 7 RCs consist, to a greater or lesser extent, of unsurveyed tribal land that makes it difficult to establish a fiscal cadastre. Traditional leaders are *ex officio* members of the RCs, resulting in very large councils (in excess of 250 members in some cases).

148. Table 3.6 shows that officials in these DCs are relatively pessimistic about the feasibility of introducing a rural land tax, at least in the near term, although some think it possible in about five years' time. Again, this seems to be a realistic assessment based on the problems at hand.

Table 3.6: The feasibility of introducing a rural land tax in KwaZulu-Natal

Regional Council (RC)	1998/99	2001/02	2003/04
Ilembe RC	No	No	?
Indlovu RC	No	?	Yes
Ugu RC	No	Yes	Yes
Umzinyathi RC	No	Yes	Yes
Uthukela RC	No	?	?
Uthungulu RC	No	?	Yes
Zululand RC	No	?	?

149. Problem areas identified include:

- In probably all 7 (RCs) (but at least within the 4 RCs that supplied data) there are tracts of as yet unsurveyed land;
- In the case of tribal land the lack of security of title, i.e. the uncertainty about land tenure rights, will impact on the feasibility of the introduction of a rural land tax;
- Establishing a valuation roll, particularly in tribal areas, will be costly. Although densely populated, KwaZulu-Natal is still largely rural;
- The future role of the traditional leaders in the local sphere of government will have to be clarified. Without their cooperation the introduction of any tax is bound to be unsuccessful; and
- Should Pietermaritzburg become a MC, it will impact dramatically on the tax base of the Indlovu Regional Council.

Mpumalanga

150. Mpumalanga covers 79 530km² and, with a population of 2 646 000, has a population density of 33 persons per km². There are large tracts of tribal land in 2 of the 3 DCs. The Mpumalanga government opted to establish TLCs for rural areas in the former KwaNdebele, rather than TrepCs. Apparently this makes it easier to access development funding, although the reasoning is not clear.

151. Mpumalanga also has to cope with the intricacies of legislation from the three former homelands of Kangwane, Gazankulu and KwaNdebele, as well as the former Transvaal. Furthermore there are large unproclaimed settlements, even 'cities' (e.g. Nkomazi East and Nkomazi West to the east of Nelspruit) in some rural areas.

152. By their reckoning, all 3 the DCs will be able to introduce a rural land tax within the following 3-4 years. However, this may be optimistic given the scale of informal settlement and the high proportion of unsurveyed land in the former homeland areas.

Table 3.7: The feasibility of introducing a rural land tax in Mpumalanga

District Council (DC)	1998/99	2001/02	2003/04
Eastvaal DC	No	Yes	Yes
Highveld DC	No	Yes	Yes
Lowveld & Escarpment DC	No	Yes	Yes

153. The main problem areas identified in the province are:

- The diversity of local government legislation from the former administrations, which will have to be addressed as soon as possible;
- Not all land has been properly surveyed;
- The lack of security of title (uncertainty about land tenure rights) in especially former homeland areas, which must be addressed;
- The future role (and fiscal powers) of tribal authorities must be clarified; and
- The cost of assessment, especially of tribal land, will be high.

Northern Cape

154. At 363 200 km², the Northern Cape is by far the largest province, more than double the size of the second largest, the Eastern Cape. However, with a population of only 746 000 the population density is a mere 2 persons km². If Kimberley (a secondary city) and the other urban municipalities are excluded, the population density would probably be closer to 1 person per km².

155. There are 6 DCs in the Northern Cape. The Hantam DC covers 80 000km² (roughly 4,5 times the size of Gauteng), but has a rural population of only 14 000 persons. Officials in these DCs estimate that they would be able to introduce a rural land tax within the next three years. However, the huge size and low population (landowner) density in the Northern Cape suggests that a rural land tax may be impractical. Even in the Diamantveld DC (of more than 30 000km²) a uniform land tax does not seem to be a viable option throughout the DC's jurisdiction. This council has sparsely populated extensive commercial farming areas, but also boasts smallholder areas under irrigation.

Table 3.8: The feasibility of introducing a rural land tax in the Northern Cape

District Council (DC)	1998/99	2001/02	2003/04
Benede Oranje DC	No	Yes	Yes
Bo Karoo DC	No	Yes	Yes
Diamantveld DC	No	Yes	Yes
Hantam DC	No	Yes	Yes
Kalahari DC	No	Yes	Yes
Namaqualand DC	No	Yes	Yes

156. Problem areas identified include:

- The size of DCs will be a challenge to any land tax administration. Providing effective *and* affordable local government in the extremely sparsely populated rural areas of vast DCs is a daunting prospect;
- Soil quality and, hence, farming conditions differ appreciably within some of the DCs, where irrigation and extensive livestock farmers can co-exist (e.g. Benede Oranje DC and Diamantveld DC); and
- A cost-benefit analysis is imperative in order to establish whether the cost of assessing properties and collecting a land tax is justifiable in the light of the tax revenue that can be generated.

Northern Province

157. The Northern Province is 123 100km² in extent, and the population is 4 128 000, resulting in a population density of 34 persons per km².

158. This relatively large province has only 2 DCs. Within the geographic area of the Northern DC there are more than 1 200 rural villages (i.e. unproclaimed informal settlements). Furthermore, the province has to cope with the intricacies of legislation from three former homelands and from the former Transvaal province. Some areas in the former homelands are presently (still) administered by the province, which also collects property rates from these areas. This practice is probably unconstitutional, and has become a bone of contention. Officials in the two DCs believe that they would be able to introduce a rural land tax within the next five years. However, this assessment seems to be optimistic given the nature of the problems faced by the DCs.

Table 3.9: The feasibility of introducing a rural land tax in Northern Province

District Council (DC)	1998/99	2001/02	2003/04
Bosveld DC	No	?	Yes
Northern DC	No	Yes	Yes

159. The major problem areas in the province seem to include:

- The Northern Province needs to unify and simplify the diversity of legislation pertaining to local government and local taxation;
- The huge size of the present 2 DCs (especially the Northern DC) seems to create logistical and administrative problems. Administering a rural land tax equitably and efficiently within such vast jurisdictions with limited resources seems impossible;
- The provincial government collects property rates in some former homeland settlements. Apart from probably being unconstitutional, this creates friction between the Northern DC and the provincial government;
- Not all land has been properly surveyed;

- Assessing land in 2 huge and highly rural DCs will be problematic and costly;
- The lack of security of title (uncertainty about land rights) in especially former bantustan areas will have to be addressed if a usable fiscal cadastre is to be established; and
- The future role (and fiscal powers) of tribal authorities will have to be clarified.

North West

160. The North West province covers 116 500km², has a population of 3 043 000 people and its population density is 26 persons per km². The province consists of portions of the former Transvaal, Cape Province and Bophuthatswana. Thus, the local government legal framework presently differs between and even within DCs. There are 5 DCs in the province, each with some tribal land.

161. There are only a few, relatively small TRepCs for some of the informal settlements in the province. There are large so-called remaining areas within the jurisdiction of the district councils. These DCs all argue that it will be possible to introduce a rural land tax within the next 2-4 years, as is shown in Table 3.10. This assessment may be optimistic, while it does seem possible for the tax to be introduced within 5 years.

Table 3.10: The feasibility of introducing a rural land tax in North West Province

District Council (DC)	1998/99	2001/02	2003/04
Bophirima DC	No	Yes	Yes
Central Region DC	No	Yes	Yes
Eastern Region DC	No	Yes	Yes
Rustenburg DC	No	Yes	Yes
Southern DC	No	Yes	Yes

162. Problem areas encountered by the DCs include:

- Diverse and ‘overlapping’ local government legislation. With respect to urban property rating the former Cape Province, Transvaal or Bophuthatswana legislation is applicable - depending on the location. If a local government model in terms of which urban municipalities amalgamate with their rural hinterland is followed this will impact on the tax base. Uniformity within the province is imperative;
- Ownership of tribal land is problematic. However, this is a short-term problem that could be addressed in terms of land reform programmes;
- Not all land in the province has been properly surveyed;
- Initial assessment of all rural land for purposes of a valuation roll will be costly;
- The lack of security of title (uncertainty about land tenure rights) in some areas will have to be addressed;
- The future role (and fiscal powers) of tribal authorities will have to be clarified; and

- There are a number of large settlements, often perceived as ‘rural’ settlements, that are in reality urban communities (e.g. the ‘city’ of Winterveld in the Eastern Region DC). If distinctions are to be drawn between urban property taxes and rural land taxes, these settlements need to be classified as urban.

Western Cape

163. The population of the Western Cape (129 600km²) is 4 118 000 and the density 32 persons per km². The province has 1 metropolitan council and 7 DCs. Rural areas consist primarily of commercial farmland, and all land has been surveyed. There is no tribal land. Generally the Western Cape (as well as the Northern Cape and to a limited extent the Eastern Cape) has a long history of regional local government, building on the former regional services councils and before them the divisional councils. Table 3.11 shows that two of these DCs are able to implement a land tax forthwith, while all will be able to do so within the next 2-4 years. This assessment seems to be realistic.

Table 3.11: The feasibility of introducing a rural land tax in the Western Cape

District Council (DC)	1998/99	2001/02	2003/04
Breede River DC	Yes	Yes	Yes
Klein Karoo DC	Yes	Yes	Yes
Overberg DC	No	Yes	Yes
Sentrale Karoo DC	No	Yes	Yes
Southern Cape DC	No	Yes	Yes
West Coast DC	No	Yes	Yes
Winelands DC	No	Yes	Yes

164. Generally the capacity exists to charge, assess and collect a rural land tax. It will, however, be a difficult task to ‘sell’ such a tax to the potential taxpayers if it is an additional tax. The divisional council levy was abolished a decade ago and replaced by the RSC levies currently levied by district councils.

165. Problem area:

- The initial cost of establishing a valuation roll will be high. The divisional council values (where records were retained) are totally out of date.

3.6 General summary

166. A number of general conclusions regarding the capacity of DCs to levy a rural land tax can be drawn from the analysis of these councils, based on the information supplied in the original research report and summarised above.

Key information on DCs

167. Population figures vary widely across districts, as does the size of their areas of jurisdiction. The districts in the Northern Cape and Northern Province are very large. Accurate population figures could not be supplied, as the Census 1996 data are not yet available, and population figures are disseminated according to magisterial districts, while quite a number of DC boundaries do not accord with magisterial districts.

168. While the large districts are in arid areas, and therefore have fewer farms to survey and there is less non-agricultural rural land, the long distances will increase the cost of such an exercise. Furthermore, these areas are sparsely populated, and may not be able to afford the administrative costs, especially as the net take from the tax is expected to be lower.

Number of councillors and employees

169. The number of councillors reflects, to some extent, the population density within DCs (i.e. the number of TLCs and TRepCs). Councillors were elected indirectly in all provinces except in KwaZulu-Natal and the North West, where they were directly elected. In KwaZulu-Natal councils are very large because all traditional leaders are *ex officio* councillors and because of the system of direct representation.

170. The number of employees in the DCs varies widely, although the majority of councils seem to average between 20 and 35 employees. DCs that were established to replace former Cape Province RSCs traditionally have more employees, as they perform various agency functions (e.g. roads, health and ambulance services) on behalf of the provincial government. Only 2 (newly established) DCs in the entire country complained that they were understaffed. As explained below, a number of councils were confident that a land tax could be introduced without an increase in personnel.

171. A number of DCs gave an *estimate* of how many additional staff members will have to be employed to administer (i.e. introduce, assess and collect) a land tax. The results are shown in Table 3.12 below.

Table 3.12: Estimated number of extra staff required to administer a rural land tax

Additional Employees	District Council (DC) and Service Council (SC)
NIL	Eastern Gauteng SC; Hantam DC; Sentrale Karoo DC; West Coast DC; Western Gauteng SC
1-2	Breede River DC; Rustenburg DC; Winelands DC
3-5	Amatola DC; Bloemarea DC; Bophirima DC; Lowveld & Escarpment DC; Highveld DC; Stormberg DC; Ugu RC
6-8	Klein Karoo DC
More than 8	Uthungulu RC; Drakensberg DC; Eastern Region DC; Umzinyathi RC

Income from RSC levies

172. The total income from RSC levies varies considerably among DCs. There are 6 DCs whose income from RSC levies for 1997/98 is not expected to exceed R5 million. These are all in 'deep' rural, relatively large and sparsely populated areas that rely largely on stock farming. A further 9 councils expect their total RSC levy income to be less than R10 million.

173. The Eastern Gauteng Services Council (R262,1m) and Western District Council (R117,7m) have by far the largest income from RSC levies. The levy income of Eastern Gauteng Services Council even exceeds that of the Pretoria TMC. Only 8 councils' total levy income is expected to exceed R50 million in 1997/98.

174. Councils determine their own rates in consultation with the Department of Finance. At least the following 7 DCs give farmers a rebate of 25 per cent on the standard rates of the levies:

- Gauteng: Eastern Gauteng SC and Western Gauteng SC;
- Mpumalanga: Eastvaal DC and Highveld DC;
- Northern Province: Bosveld DC;
- North West: Rustenburg DC; and
- Western Cape: Winelands DC.

175. RSC levies are paramount sources of revenue for the DCs. It is doubtful (see also the White Paper) that these levies will be abolished in the short or medium term. The introduction or not of a rural land tax will, therefore, have to be evaluated in the light of the probable retention of these levies.

The number of levy payers and the percentage of levies collected in TLCs and TrepCs jurisdictions

176. In most of the districts the number of levy payers outside TLCs are less than 40 per cent of the total number of levy payers. Only 3 of the surveyed DCs have more levy payers registered outside TLCs than within: Hantam DC (70 per cent), Bophirima District Council (65 per cent) and Central Karoo DC (52 per cent).

177. Only 1 council, the Kalahari DC, reported that more than 50 per cent of its levy income came from outside TLCs. However, in this case 5 of the TRepCs are mining towns, where mining is responsible for 80 per cent of levy income and agriculture only 2 per cent. Although 52 per cent of levy payers in the Central Karoo DC are located outside the TLCs, their contribution is only about 20 per cent of levy income. In the case of Hantam and Bophirima DCs, where 70 per cent and 65 per cent of the levy payers are located outside TLCs respectively, their contribution amounts to 36 per cent and 33 per cent of total levy income. In 3 councils in the Eastern Cape as well as the Goldfields DC in the Free State, the amount collected within TLCs exceeds 95 per cent, whilst the 2 councils in Gauteng and 4 of the KwaZulu-Natal councils indicate that less than 10 per cent of total levy income comes from outside the TLCs. The Diamantveld DC and Northern DC also collect less than 10 per cent from levy payers outside TLCs.

178. Generally, therefore, the contribution from rural areas tends to be small in comparison to even the smaller towns, especially in the more densely populated jurisdictions.

Collection of RSC levies

179. A number of DCs indicated that they are experiencing problems with the registration of new levy payers and/or the collection of levies from registered levy payers. Ugu Regional Council indicated problems only in respect of the registration of new levy payers, and Klein Karoo DC only in respect of collection, while a number of DCs admitted to problems in both respects (Bophirima and Eastern Region District Councils in North West; Amatola, Drakensberg, Kei and Stormberg DCs in the Eastern Cape and Ilembe and Uthungulu Regional Councils in KwaZulu-Natal).

180. However, the majority of DCs have no or few problems with the collection of RSC levies, and collection rates are generally high. Three councils reported collection rates of 98 per cent and above; 9 of between 90 and 97 per cent, 4 between 80 and 89 per cent and only 3 below 80 per cent.

181. The majority of the DCs spend far more in rural areas than in TLC areas, and thus more than is collected from rural levy payers. Northern Province DCs generally spend between 50 and 60 per cent of their

levy income in rural areas, while in the North West and Mpumalanga more than 80 per cent is spent in these areas. In the rest of the country there is a less pronounced redistributive pattern.

Information on rural land

182. Very little land in the former homeland areas has been properly surveyed. This problem is especially acute in the Eastern Cape, KwaZulu-Natal, Mpumalanga and the Northern Province. It is not a problem in Gauteng, most of the Northern Cape and the Western Cape. Only a few councils are in the process of establishing a Geographic Information System (GIS) with substantial data on land use and management. This should be encouraged, as DCs seem to have little information on actual land use. This problem is also more acute in the former homeland rural areas, where a substantial proportion of the land is often used for residential purposes. Land that is officially classified as rural is, therefore, often indistinguishable from urban uses.

183. Only the Eastern Gauteng Services Council has thus far embarked on the creation of a valuation roll for the total surface area under its jurisdiction, although the Western Gauteng Services Council has recently completed a valuation roll of all business premises within its jurisdiction.

184. As land data is wanting in many jurisdictions and not all land yet properly surveyed, this aspect will have to be addressed urgently if a rural land tax is to be considered as a source of revenue by DCs.

The introduction of a rural land tax

185. No DC (or any primary rural municipality) is capable of introducing a land tax in the 1998/99 financial year. The Eastern Gauteng Services Council aimed to introduce property rates from 1 July 1998, but due to delays with the establishment of the valuation roll, the introduction has been postponed by at least a year. The majority of DCs will, however, be able, with logistical support (proper land surveys, assessment, etc), to introduce a land tax within 4 to 6 years.

186. It is clear that the introduction of a rural land tax will have cost implications for the implementing authorities, especially in the case where properties are valued according to their market value. Once in place, there will also be costs involved in maintaining a legitimate, accurate and equitable valuation roll.

187. Even if a proper market value-based roll is substituted for a so-called measured roll⁸ or a use value-based roll, initial assessments and continuous reassessments will have to be made. The lack of data makes it impossible to estimate the total cost of preparing a valuation roll throughout the country. Only a few DCs have thus far embarked on the estimation of this cost in their area of jurisdiction and/or on an estimation of the cost of doing so.

188. Although it is evident that assessment will be a cost factor to be considered, it is also noteworthy that the information gathered pertaining to land use and land management could become a valuable resource in itself to be used for other purposes, or even to be sold for commercial use.

Capacity to administer a land tax

189. It is clear that primary rural municipalities (where they exist) have no capacity to administer a land tax. However, the capacity to administer such a tax generally exists at the district council tier. Although information was not received from all 42 DCs, and in most instances conclusions had to be drawn from the opinions of or estimates made by individual officials, it can be inferred that it is possible for the majority of DCs to introduce a rural land tax in the not too distant future. A lot will, however, depend on the logistical support provided by the national and provincial spheres of government.

⁸ See section 10G(6) of the Local Government Transition Act.

190. In summary, while the DCs in the **Northern Cape** may have the capacity to introduce the tax within the next 2-4 years, the expected low revenue yield may preclude the possibility of doing so. The problem of a low expected revenue yield in the **Eastern Cape** is compounded by the lack of capacity amongst most of the DCs, especially as 5 of the 6 DCs have tribal land within their areas of jurisdiction. It is unlikely that they will be able to introduce the tax within 4 years without support from the provincial and national spheres. The same argument applies to the **Northern Province, Mpumalanga, the North West and KwaZulu-Natal**. The only provinces that are likely to be able to introduce the tax within this period are **Gauteng, the Free State and the Western Cape**. Nevertheless, it should be technically feasible for all DCs to introduce a rural land tax within 5 years, given the required support from the other spheres of government.

3.7 Conclusions

191. This analysis of rural municipalities shows that there are a number of factors that mitigate against the introduction of a rural land tax in the near term:

- Large areas of the country are so sparsely populated that it seems unlikely that a rural land tax will yield a positive net revenue there;
- From the information supplied by half of the DCs (see Table 3.12), it is clear that, by their own estimates, some of the DCs will have to employ additional staff in order to implement a rural land tax successfully;
- Some of the tribally owned land in South Africa (about 15 per cent of the agricultural land in the country) has not yet been surveyed. Experience elsewhere has shown that this is no easy task;
- There are virtually no primary local authorities with the capacity to deliver services of any kind. Therefore, it is evident that DCs will have to be charged with the responsibility to implement the tax, even though the Subcommittee has argued in favour of primary authorities; and
- Few DCs will be able to introduce a rural land tax within 4 years.

192. However, despite these *caveats*, the research has also shown that most DCs will be able to introduce a rural land tax within the next 4-6 years. Further, most DCs receive very little tax revenue from rural areas, while a large proportion of their spending is in rural areas.

193. Finally, this research has also shown that it is unlikely that RSC levies will be replaced with other revenue sources, if only because of their key importance as an existing source of revenue. Thus, if the principle of maintaining the total tax burden is to be adhered to, and a rural land tax is to be introduced, tax relief measures will have to be implemented or a rural land tax will have to be treated as a provisional tax payment for income tax purposes.

CHAPTER 4

RECOMMENDATIONS

4.1 Introduction

194. During the course of its investigation, the Subcommittee became aware that there are two areas of uncertainty that will influence any actions taken by the authorities with respect to a tax on rural land in South Africa. These are the capacity of the authorities to implement such a tax, and the impact that the tax will have on the citizens of this country. These two issues form a vital part of the assessment of recommendations for the implementation of a rural land tax in terms of the principles of an efficient and coherent tax system, as was argued in paragraph 29 above. In this Chapter, these two issues are discussed against the background of the findings of the research that was conducted by the Subcommittee. This is followed by our recommendations for further action.

4.2 Tax principles

195. The Subcommittee has evaluated its research findings in terms of underlying principles of an efficient and coherent tax system. In this regard, the Subcommittee has concentrated on the efficacy of a rural land tax and on the ability of the different levels of government to implement such tax. The efficiency and equity of the tax should be measured against its potential revenue yield, the distribution of the tax burden and on the microeconomic effects of the tax.

196. The Subcommittee is aware of the fact that there are many ways that local service provision might be funded and where the objectives of devolution of tax and local control over service provision funded by such taxes can be achieved. The Subcommittee recognises the importance of empowering lower levels of government through the transfer of own revenue sources.

197. The Constitution of the Republic of South Africa Act grants municipalities the right to levy rural land taxes. In the course of its deliberations, the Subcommittee considered both the relative advantages and disadvantages of a rural land tax but far more significantly the mechanisms for its efficient and equitable implementation. Whilst acknowledging that a rural land tax may have certain social advantages like encouraging the economic use of land because of the increased holding costs thereof, and be supportive of land reform, the Subcommittee concluded that appropriate measures, such as a rebates system, would be required to accommodate the productive use of land.

4.3 The capacity to implement a rural land tax

198. In its Interim Report, the Subcommittee recommended against the use of a rural land tax in the national sphere of government, either as a means of raising revenue or as an instrument of the land reform programme. The Government accepted this recommendation. However, the Subcommittee was unable conclusively to recommend for or against the use of such an instrument in the provincial or local sphere, although it did express a preference for its use in the local sphere in the event that the tax was found to be of benefit. Subsequently, however, the adoption of the Constitution has provided some clarification on this issue: it ruled out the provincial sphere, and explicitly empowered municipalities to raise taxes on property.

199. Notwithstanding this clarification, however, there is still uncertainty surrounding the final shape of local government in South Africa. During the course of its research, the Subcommittee came to realise that

decisions on the final shape of local authorities matter to their ability and willingness to implement such a tax. To complicate matters further, the Subcommittee is aware that legislation passed in the national sphere of government will probably allow the provinces some discretion in deciding on what kind of rural municipal structures they eventually adopt.

200. An added problem is that, while much progress has been made in ordering the relationship between the central government and the provinces in the field of management of relations with municipalities, there is less certainty regarding the other two legs of this relationship. It appears, for example, that the relations between provinces and municipalities have not developed much beyond those ruling under the previous dispensation. This means that, in some provinces, the relationship works according to as many as four different sets of rules. Further, there does not seem to have been much progress in regularising the relationship between the national government and municipalities, especially in respect of their fiscal relationship.

201. These uncertainties matter in assessing the capacity that exists within municipalities to take on new responsibilities such as the implementation of a rural land tax. For example, in its Media Statement of October 1996, the Subcommittee intimated that it preferred that the tax should be raised in the primary tier of local government, rather than at the secondary tier. However, the research of the Subcommittee, as reported in Chapter Three above, shows that primary rural municipalities generally do not have the capacity for this task. Furthermore, it is not even clear whether primary rural municipalities will exist in the future, while even in the transition phase large parts of the country do not have them. Lastly, the nature of the relationship between provinces and rural municipalities and between the national government and rural municipalities will also determine whether the latter have the capacity to be charged with this responsibility. The more support rural municipalities receive from the other two spheres, the greater their capacity to undertake such tasks.

202. With this in mind, it is necessary that the Subcommittee first turns its attention to recommendations for further action in the local sphere of government. However, the Subcommittee is aware that decisions in the local sphere regarding the implementation of a land tax (including the decision not to implement it) cannot be successful unless they take place within a national framework. Therefore, it will follow these recommendations for local action with recommendations for further action in the national and provincial sphere regarding framework legislation.

4.4 The impact of a rural land tax

203. The decisions taken by a municipality regarding a rural land tax (within national framework legislation) will have consequences for the municipality itself, and for the community that it serves. The purpose of the research project assigned by the Subcommittee was, *inter alia*, to assess these consequences, which flow from both the fact of the introduction of the tax, and from the specific design of the tax. In this respect, the Subcommittee has investigated the consequences of decisions around:

- The definition of the tax base;
- The optimal rating system;
- The taxpayer;
- The method and frequency of valuation;
- The tax rate and the desirability of rate-capping;
- Tax relief measures;
- Measures of tax assessment and collection; and
- The relationship with other taxes.

204. The issues identified here, must also become the major elements on which national framework legislation must focus in order to establish an efficient and coherent tax regime. In the following sections, therefore, recommendations are made for further action in the municipal sphere under each of these headings. These will be followed by recommendations for action in the national and provincial spheres. As the first set

of recommendations is addressed to municipalities, the discussion starts with a consideration of the appropriate tax authority.

4.5 The tax authority

205. In its Media Statement No. 15 (see Appendix 1), the Subcommittee argued that the most appropriate tax authority for a rural land tax would be primary local structures. However, the research results show clearly that this is not feasible in the near term, even though the absence of implementation capacity and an own revenue base could be compensated for by arrangements such as arranging for the function to be executed on an agency basis or fiscal transfers, etc. Further, it is not yet clear that primary rural municipalities will remain part of the Constitutional dispensation in the country.

206. For this reason the Subcommittee recommends that:

- 1. The authorities responsible for the implementation of a rural land tax should be the DCs throughout the country, unless a DC itself devolves the function to a primary municipality;**
- 2. The purpose of such a rural land tax should in all cases be to provide additional services to the communities within the area of jurisdiction of the DC and with a proportion of the benefits being allocated specifically to rural dwellers;**
- 3. The authority so conferred should also include the authority not to introduce such a rural land tax. However, in this instance the FFC is advised not to recommend compensatory transfer payments to authorities who have not implemented a rural land tax;**

207. In this regard the Subcommittee has noted with concern the practice in the Northern Province, where the provincial government has assumed the authority to retain the property taxes raised in the towns in former homeland areas. The Subcommittee wishes to caution against an extension of this practice to the levying of a rural land tax.

4.6 The definition of the tax base

208. In its Media Statement No. 15, the Subcommittee pointed out that decisions would have to be made regarding which land (property) should be included in the tax base, and which rating system should be used. With respect to these issues, the Subcommittee deliberated on a number of questions, namely, which land should be included, whether mineral and water rights should be included; and what rating system would best serve the needs of the community. The following considerations were taken into account:

- The Subcommittee could not find any reason why privately owned or state land or any sub-category of these should be excluded from the definition of the tax base, and is in this respect in agreement with the majority of those who submitted written and oral comments on this issue. With respect to tribal land, the Subcommittee argued that, while there are many practical problems with the introduction of a land tax in these areas, there is no reason in principle why this land should be excluded from the definition of the tax base. In the longer term the different laws introduced by the Department of Land Affairs that aim to give legal recognition to less formal land rights will narrow the legal difference between this category of land rights and privately-owned rights. Therefore, the disabilities often associated with these forms of land holding, such as lack of transferability and its use as collateral, will weaken over time;
- However, the Subcommittee also considered the many problems associated with the taxation of such land, as is evident from the results of the research undertaken on its behalf. These include the difficulties that will be encountered in surveying and registering such land, the

weak capacity of most municipalities in these areas, and the absence of most local government services, etc. While many of the comments received by the Subcommittee did not favour special treatment for this category of land, the Subcommittee recognised the severity of these practical difficulties;

- The Subcommittee also addressed the vehement opposition to a tax on rural land expressed by organised agriculture, the mining industry and the hospitality industry. In this respect, the Subcommittee is of the opinion that such opinions are best heard at the DC level, where considerations of the level of services that are to be provided from the proceeds of the tax can be fully accounted for;
- With regard to mineral rights, the Subcommittee took the view that, since mineral rights are excluded from the tax base in urban areas, and since policy on mineral rights has not yet been finalised, these could be excluded from the tax base;
- With regard to water rights the Water Act has been changed so as to enable land rights to be severed from water rights, and for a system of water licences to be introduced. Access to such licenses obviously affects the use value of rural land; and
- With respect to the rating system, the Subcommittee is aware that urban municipalities generally have an option (and tend to adhere to their choices in this regard) between at least two of the following tax bases: site rating, flat rating or composite rating. The result is that different systems can be found in contiguous areas without causing insurmountable problems.

209. Taking these arguments into consideration, the Subcommittee recommends that:

- 4. Because use values are recommended as the proper basis for valuation (see recommendation No. 11), the tax base should in all cases be defined as surface rights in all rural land including water licences but excluding mineral rights, within the area of jurisdiction of the DC, including privately-owned land, state land and land held under other forms of tenure. This definition should be adhered to by all DCs;**
- 5. DCs should be allowed the discretion to exempt tribal land from the liability to be taxed for a fixed period of, say, five to ten years. In those cases where there may not be a clear basis for levying a rural land tax in areas under customary law, DCs should work urgently in conjunction with the Department of Land Affairs to correct the situation;**
- 6. However, to allay the fear that such exemptions will tempt DCs to increase tax rates on commercial farm land, they should only be allowed to exercise this discretion (see No. 5) if they receive compensatory grants from the national or provincial spheres of government;**
- 7. All DCs should proceed forthwith, in collaboration with the offices of the Surveyor General and the Registrar of Deeds, to ensure that all rural land within their areas of jurisdiction is properly surveyed and all tenure rights ascertained, whether or not they intend to introduce a rural land tax. Registered owners of the land should at least be responsible for registering the outer perimeters of the land over which ownership is asserted, and for the costs attached thereto;**

4.7 The taxpayer

210. During its deliberations, the Subcommittee has not found any reason to change its position on this issue. Therefore, the Subcommittee recommends that:

8. *The primary responsibility for paying the rural land tax should vest in the owner of the land;*
9. *In the instance of limited real rights (e.g. usufruct, servitudes, etc) the liability should be shared between the owner of the bare dominium and the holder of the limited right;*

4.8 The method and frequency of valuation

211. The Subcommittee has spent considerable time in evaluating the merits and demerits of the different methods of valuation, and reported extensively on the various options in its Interim Report. Subsequent deliberations have been based on the submissions made to the Subcommittee and the results of the research that was conducted during the course of this investigation. The Subcommittee is of the opinion that, among the many issues that have to be accounted for, there are two that are key which will determine what method is optimal:

- Because agriculture is the key economic sector in the rural areas, the needs of this sector should be paramount. Here the research conducted on behalf of the Subcommittee has shown a clear bias in favour of use value. Non-farm factors, especially in areas close to urban concentrations, cause a discrepancy between the agricultural value of land and the market value. Levying a land tax on market values will have a disproportionately disruptive effect on the sector. In addition, there is a long tradition of valuation according to use value methods in agriculture¹, and economists have developed appropriate tools to expedite these methods; and
- On the other hand, it is fair to argue that the existing capacity within municipalities is biased towards market valuation methods, as these have traditionally been used in urban areas. Property valuers other than those involved in agriculture have more experience with these methods. Furthermore, not all land in rural areas is used for agriculture.

212. These arguments lead to a paradox: in the absence of firm guidelines, there will be a bias towards using market valuations in areas closer to existing urban concentrations, as this has been the practice in these areas. Yet, it is precisely under these circumstances that market valuations result in the greatest distortions in the agricultural sector when compared to use values at the same tax rates. Nevertheless, the degree of distortion is less the lower the tax rate. As market values result in a higher assessment of the value of land under such circumstances (i.e. when non-farm factors have their greatest influence), the rate at which the tax is levied can be much lower.

213. The Subcommittee has also considered alternative instruments for assessing the use value of agricultural land. The research commissioned by the Subcommittee has shown that in 30 states in the USA, and in Chile, for example, there are prescriptions for public participation in the process that succeed in making the values arrived at transparent, and therefore more legitimate. While these processes result in higher administrative costs, they reduce the number (and expense) of the disputes that inevitably arise as a result of assessments. These participative approaches are often accompanied by mass valuation techniques. An example of such techniques was used in the research process on which the results in Chapter Two are based. The purpose of these techniques is to lower the cost of assessment, and to increase their accuracy.

214. Finally, there can be no prescription regarding the frequency of valuation. Objectively, the more frequent the valuation, the more equitable and efficient the tax will be when measured in terms of its impact. However, more frequent valuations increase the cost of administering the tax. In practice, land prices in agriculture tend to be more stable than in urban areas, so that valuations can be less frequent than in the case of urban valuations.

¹ In the United States, use values are used to assess agricultural land for the purposes of levying land taxes in 48 of the states.

215. *Taking these arguments into consideration, the Subcommittee recommends that:*

10. *All DCs should adhere to section 10G(6) of the Local Government Transition Act, No. 209 of 1993 and prepare a valuation roll that includes – as a minimum - the unimproved value of all rural land within their areas of jurisdiction, whether or not they intend introducing a rural land tax. Central Government should finance the outlays for the initial valuations;*
11. *DCs should assess land by use value methods, as the preferred means of assessing the value of such land;*
12. *DCs should explore the merits, under their particular circumstances, of innovative methods of assessing the use value of agricultural land, including public participation processes, mathematical programming algorithms, etc.;*
13. *DCs should plan the frequency of valuations of rural land within a limit of 5 years, with the view to optimising between tax efficiency and equity on the one hand, and administrative cost on the other. In the event that new legislation or the implementation thereof should materially effect existing valuations, procedures should be in place to have effected properties re-evaluated;*

4.9 Tax relief measures

216. The most common tax relief measures include exemptions from, rebates off and deferrals of the tax liability. All of these measures are used in urban areas in South Africa. These relief measures are all conventionally used to enhance the fairness of the tax. While such measures have the potential to increase the cost of administering the tax, some additional costs can be avoided if the taxpayers perceive that the system is fairer.

217. Furthermore, these instruments can be used to pursue a range of policy objectives. For example, in many countries that tax agricultural land, a rebate is granted as a means of protecting the agricultural character of the area, and deferrals are used in times of stress created by the weather (e.g. droughts and floods). A further possibility in the South African circumstances would be to grant an exemption from the tax liability for all tribal land until such time that the land has been surveyed and assessed, and the new laws providing legal protection to the owners (and/or holders of other enforceable tenure rights) have come into effect.

218. Should the recommendation to treat the tax as a provisional tax payment for income tax purposes be followed, tax relief measures can be limited to the bare minimum, which will make for much less complex legislation.

219. However, it should be acknowledged that there are large numbers of persons enjoying land use, e.g. in the communal land areas, and who are not required to be included in the tax net. These persons should be accommodated by some form of a *de minimis* exemption. The intention is that poor people who cannot afford such a cash outlay or who have no means of recovering the land tax through the income tax system, should be exempted.

220. *Taking these arguments into consideration, the Subcommittee recommends that:*

14. *DCs should seriously consider following transparent processes that encourage public participation when deciding on the tax rate (as recommended in section 4.8 above), and on tax relief measures in rural areas;*
15. *In considering this possibility, DCs should be led by a consideration of the costs and benefits of such processes, i.e. by weighing the additional costs of a longer process against the benefits that will flow from a more transparent, and hence more legitimate, process;*

16. *DCs should ensure that their policy on the kind of relief measures they are prepared to consider, and the extent of such relief, is well known among the community of tax payers before the need arises to make such concessions;*
17. *DCs should, as a matter of policy, exempt tribal land from a rural land tax until such time as the land is properly surveyed and assessed and those using such land are afforded sufficient legal protection. However, the qualification mentioned in recommendation 6 above should apply;*
18. *A rural land tax should only be payable on land which has a use value in excess of an amount to be determined by the Minister of Finance acting in consultation with the Ministers of Agriculture and Constitutional Development or by persons who enjoy the use of land and have a gross income as defined in the Income Tax Act, No. 58 of 1962 in excess of an amount to be determined by the Minister of Finance acting in consultation with the Ministers of Agriculture and Constitutional Development;*

4.10 The tax rate and the desirability of rate-capping

221. The Subcommittee is of the view that the tax rates should be determined by individual municipalities subject to approval from the Department of Finance, and that the tax be treated as a provisional tax payment for income tax purposes. If this recommendation is followed it is not necessary to make any recommendations on tax rates or rate-capping.

4.11 The relationship with other taxes

222. The Subcommittee has argued that it does not expect RSC levies to be abolished (paragraph 193), and that transfer payments between the national and local spheres of government must be rational, predictable and accountable (paragraph 114). In dealing with the relationship with income taxes, four alternatives can be considered.

223. **First**, the rural land tax can be treated as an additional tax. Should this be implemented, the following will apply:

- It will be difficult to measure the total tax burden;
- Resistance can be expected from taxpayers, with the resultant problems of compliance in implementing and maintaining the system;
- Comprehensive tax relief measures will have to be formulated, which will add considerably to the complexity of the legislation; and
- It will result in the biggest distortions in the land market (see paragraphs 48 and 54). As a result, there will be a significant impact on the management of short term liabilities of especially emerging farmers (see paragraph 59), and on the surrounding rural economy (see paragraph 65).

224. **Second**, the tax can be treated as tax deductible for income tax purposes. The results will be that a net tax cost of up to 55 per cent of the land tax payable will arise. While the impact on farmers and the rural economy will be less than in the first case, these disadvantages will still be present.

225. **Third**, the tax can be treated as a set-off against assessed income tax. The result is that the land tax will become a minimum tax, and will be even less distortionary than the previous two alternatives. However, it will still require comprehensive relief measures, and, therefore, complex legislation.

226. **Fourth**, the tax can be treated as a provisional tax payment for income tax purposes. This will have the following consequences:

- It will be possible for the taxpayer to claw back the land tax paid if there is not sufficient assessed income tax in her/his particular case;
- The land owner will have to be registered for income tax purposes to benefit from any potential claw back. Needless to say, this will add significantly to the narrowing of the tax compliance gap in respect of the income tax;
- The need for tax relief measures will fall away;
- The land tax will have a negligible effect on land prices, the short term finance requirements of especially emerging farmers and the surrounding rural economies;
- The co-operation of existing and emerging farmers and their representative organisations in the design, implementation and maintenance of the tax can be expected; and
- Under this alternative it will be necessary for the local authority to obtain authorisation from the Department of Finance before a land tax can be implemented, to ensure that the necessary administrative capacity exists for proper implementation of the tax, in addition to approval of the tax rate.

4.12 Recommendations to the national government

227. The Subcommittee has thus far addressed its recommendations to the DCs, as it is in this sphere that a rural land tax should be decided upon, both in respect of whether the tax should be levied, and if so the manner in which it will be implemented. However, the Subcommittee believes that it is vital that framework legislation be passed in the national sphere to ensure the orderly introduction of the tax, and to ensure that it fits into national fiscal policy, including the intergovernmental fiscal framework.

228. Yet the Subcommittee recommends that the DCs be charged with this responsibility not necessarily because they are the ideal institutional vehicle, but because of the lack of an alternative. The Subcommittee has, during the course of its investigation, constantly been frustrated by the lack of progress in regularising local government matters. During the course of the research carried out on its behalf, the high level of frustration of many of the representatives of the DCs that participated was also evident.

229. The result is seen in outcomes that may suit some provincial or local objective, but that frustrate national policy. For example, there are DCs that cover a larger surface area than Gauteng: a number of them are sparsely populated, and a number very densely populated. This cannot be conducive to efficient rural development policy and planning no matter what good reason provinces may have for their establishment. Also, many DCs have boundaries that cut across magisterial borders, making detailed demographic analyses all but impossible. Above all, the Subcommittee has become aware of the uncertainty created by the lack of a coherent fiscal framework to order fiscal relations between the national government and municipalities, and between provincial governments and municipalities.

230. *For these reasons the Subcommittee recommends that national framework legislation be passed that will provide a flexible, empowering environment within which rural municipalities can fulfil their constitutional obligations regarding development within the communities they represent. More specifically, the framework legislation should encompass the following:*

- 19. *A DC should not implement the tax unless it decides that primary rural municipalities in its area of jurisdiction do not have the capacity to do so. Framework legislation should cover***

the conditions under which such a transfer of authority can take place, and a right of appeal (in terms of Section 41 of the Constitution) by the primary rural municipality to defer such a delegation or to precipitate it where a DC does not want to effect the transfer, should exist;

20. *The definition of all surface rights to land in rural areas as part of the tax base, including privately held land, state land and tribal land;*
21. *The definition of the taxpayer as the owner of the land, where the owner is defined in terms of existing private property rights as well as in terms of the legal recognition granted to different forms of tenure;*
22. *A provision for the assessment of agricultural land according to its use value and not market value, and for a choice of assessment methods for other rural land;*
23. *A provision for the reassessment of properties at intervals of no longer than 5 years;*
24. *The provision of guidelines regarding the types of tax relief that are allowable, and the conditions under which such measures may be implemented, namely prescriptions for more transparent and participative processes;*
25. *A cap on the tax rate only by stating the requirements of the rural land tax (e.g. that it allows economic activities to continue unhindered as far as possible; that it allows rural municipalities to play the role envisaged for them in the Constitution) and not by stating any specific maximum tax rate;*
26. *A stipulation that the tax be treated as a provisional tax in terms of the Fourth Schedule to the Income Tax Act, No. 58 of 1962;*
27. *In order to enhance the efficiency of the tax regime, provision for penalties in cases of non-registration and non-payment;*
28. *National government should ensure that the framework for fiscal transfers between itself and rural municipalities and between the provincial governments and rural municipalities does not provide incentives to rural municipalities to introduce the tax in a manner that is disruptive of ordinary business decisions. This includes provision for compensatory grants in cases where tribal land is not taxed as an interim measure;*
29. *A municipality must only be allowed to implement a rural land tax upon presenting to the Department of Finance a satisfactory business plan that, inter alia, reflects service provision to rural communities and satisfying the Department of Finance that it has the necessary capacity to administer the land tax and after reaching agreement with the Department of Finance regarding the tax rate.*

4.13 Recommendations to the provincial governments

231. The Subcommittee is aware that the provinces may pass legislation and generally make policy with regard to municipal matters, including their own framework legislation to order the levying of a rural land tax. However, the Subcommittee believes that it is more important that the provinces first give their attention to a number of critical issues to regularise local government matters.

232. During the course of its research the Subcommittee noted that in some provinces, especially where steps were supposed to be taken to consolidate multiple former authorities, a myriad of laws still govern municipal issues. This creates uncertainty and, in most cases, perpetuates bad policy, weak

legislation and a lack of implementation capacity. The example of the Northern Province, where the provincial government is, in the view of the Subcommittee, plainly acting unconstitutionally by levying urban property taxes, is only the most visible case. In this and other provinces municipalities are faced with the dilemma of having to manage their affairs under different, and often conflicting, legislation.

233. The Subcommittee is of the opinion that this lack of progress in consolidating legislation is merely a symptom of a lack of progress in providing a sound and coherent provincial policy framework within which local governments can manage their affairs. As noted above, the provinces can only partly be blamed for this state of affairs. The practical result is that, in the case of some of the provinces, there has been little progress in formulating and implementing policy towards matters such as the size of DCs, the capacity of primary rural municipalities and the proper fiscal relationship between the provinces and local governments.

234. *In this respect, the Subcommittee recommends that:*

- 29. *Provinces should pay immediate attention to consolidating the different types of legislation that order rural local government matters within their area of jurisdiction;***
- 30. *Provinces should provide a policy and legislative framework to order the economic, physical and population size of DCs in order to align these with the needs of the development task that DCs have to fulfil;***
- 31. *The implementation of any recommendation accepted by the Government should specifically be subjected to ongoing review, monitoring and evaluation by the respective tax policy analysis divisions in the Department of Finance and the South African Revenue Service; and***

235. It should be noted that the recommendations proposed form a coherent whole and any selective acceptance of recommendations could impact adversely on the acceptability and equity of the recommended land tax system.

236. The successful implementation of a land tax hinges on public awareness of its full implications, benefits and the rights of taxpayers.

237. *In this respect, the Subcommittee recommends that:*

- 32. *These recommendations, upon acceptance by Government, should be published as widely as possible and in a format that is user friendly, simplified and accessible to the affected persons.***

APPENDIX 1

“DISCUSSION DOCUMENT ON LAND TAX – 11 OCTOBER 1996, as published in Government Gazette No. 17 495

1. BACKGROUND

Since the publication of the *Third Interim Report of the Commission of Inquiry into certain aspects of the Tax Structure of South Africa* (November 1995) which contained an interim report of the Subcommittee on Land Tax, various documents were produced and pieces of draft legislation published which impact directly on the possible introduction of a land tax. The following events and publications need to be mentioned in this regard:

- (i) The Commission received numerous written submissions on the possible introduction of a land tax;
- (ii) The Constitution of the Republic of South Africa Bill 1996 was published in May 1996 and referred to the Constitutional Court for certification in terms of sections 71-73 of the interim Constitution;
- (iii) In February 1996 the Department of Land Affairs published its *Green Paper on South African Land Policy*;
- (iv) Proposed draft legislation aimed at amending the Local Government Transition Act 209 of 1993 was published in July 1996 by the Department of Constitutional Development for public comment; and
The draft Constitution has been referred back to the Constitutional Assembly for amendment on 6 September 1996.

In the light of these events, documents and the proposed legislation, as well as the Katz Commission's proposal (par 4.3.1: Katz, 1995) that further investigation be undertaken to ascertain the merits of a land tax in the local sphere of government, the Subcommittee deems it necessary to divulge its current thinking on some of the contentious issues regarding a land tax.

In Chapter 3 of its interim report the Subcommittee recommended that a national land tax should not be implemented in South Africa at this time (Katz, 1995). However, the Subcommittee believed that further research into the possible introduction of a *rural land tax in the local sphere* was indeed required. The Commission and the Joint Standing Committee on Finance in this regard have accepted the Subcommittee's recommendations. It was welcomed by the Department of Land Affairs (see *Green Paper on South African Land Policy* 17-18).

2. FRAMEWORK LEGISLATION

2.1 Introduction

The first issue to be addressed in framework legislation is the relevant local government structure(s) to levy a rural land tax. In this regard the following background is pertinent:

The interim Constitution (s 178(2)) and draft final Constitution (s 229) guarantee 'rates on property' as a source of revenue for local government. Significantly the draft Constitution (s 228) also explicitly prohibits provinces from levying any "rates on property". From a constitutional point of view, a "rural land tax", as a species of "rates on property", could therefore only seriously be considered as a source of revenue for rural local government. As transitional metropolitan substructures (in metropolitan areas) and transitional local councils (in non-metropolitan areas) are already levying (urban) property rates, the introduction of a rural counterpart should probably only be considered for transitional rural councils (TRuralCs) and/or transitional representative councils (TRepCs). (See Part VA [Rural Local Government] of the Local Government

Transition Act 209 of 1993.) All of the above mentioned transitional local government structures function at the primary level. Transitional metropolitan councils (TMCs) and their non-metropolitan counterparts, the district councils, do not currently levy any rates on property.

The Subcommittee is of the opinion that a land tax should be levied at the primary level (i.e. TRuralCs and/or TRepCs) rather than by the district councils, for the following reasons:

- (i) Property rates are presently levied at the primary level (transitional metropolitan substructures and TLCs) in the case of metropolitan and non-metropolitan urban local government;
- (ii) It is vital that a sound structure of local government financing should be established if local government is to be assured its rightful place (par 3.6.4: Katz, 1995);
- (iii) Primary rural local government structures have no other tax bases to utilise at present and they are dependent on a sustainable source of revenue to ensure at least some fiscal autonomy;
- (iv) If the tax is levied at primary level, and the benefits of this tax accrues to the local taxpayer community, acceptance and compliance will be higher and administrative costs lower (Chapter 6 of Appendix B: Katz, 1995);
- (v) Since primary local government structures may be dependent on this source of revenue, a healthy and growing economic environment within which taxpayers in their constituencies operate, will be in their interest;
- (vi) If compensating measures (i.e. in the case of drought, emerging and young farmers, hardship cases, etc) are necessary, local government structures are better informed and situated to evaluate their validity and applicability;
- (vii) Section 229 of the draft Constitution (currently under reconsideration by the Constitutional Assembly) as well as section 178 of the interim Constitution guarantee property rates as a source of revenue for local government; and
- (viii) The 1995 amendments to the Local Government Transition Act ensure that interest groups are well represented on TRuralCs and TRepCs which should counter mismanagement of land tax revenues.

Chapter 7 of the draft Constitution (dealing with Local Government) and section 229 (dealing with municipal rates and taxes) were referred back to the Constitutional Assembly to be amended in accordance with the Constitutional Principles contained in Schedule 4 of the interim Constitution. However, in light of the court's reasoning and what is contained in these measures, the following features will probably also be present in the final Constitution:

- (i) A two-tier local government structure to be established for the whole of the territory of South Africa;
- (ii) The establishment of primary local government structures for metropolitan, urban and rural areas;
- (iii) Provisions for framework legislation at national government level to, amongst others, determine appropriate fiscal powers and functions for each category of local government; and
- (iv) A constitutional guarantee that 'rates on property' will remain a source of revenue for local government.

2.2 Reasons for framework legislation

Framework legislation is prescribed by the final Constitution. Section 155(1) reads as follows:

‘National legislation must determine-

- (i) The different categories of municipality that may be established;
- (ii) Appropriate fiscal powers and functions for each category; and
- (iii) Procedures and criteria for the demarcation of municipal boundaries by an independent authority.’

The framework legislation contained in the proposed draft amendments to the Local Government Transition Act is inadequate in its current form. It is primarily interim measures (for the so-called interim phase of transition) and does not cover all the relevant issues.

2.3 Aspects to be considered in framework legislation

The Subcommittee is of the opinion that the following aspects will have to be considered when drafting framework legislation pertaining to a local land tax:

(i) *Tax base*

An important aspect when taxing land is whether the tax is to be levied on the value of unimproved land (site rating), the improved value of land (flat or uniform rating) or separately on land value and the value of improvements (composite rating).

(ii) *Taxpayer*

A land tax could be levied on the owner and/or the occupier of land.

(iii) *Methods and frequency of valuation of the tax base*

Four methods have been identified by the Commission (Katz, 1995):

- The Comparable Sales Method (Market Value);
- Income Capitalisation Method (Use Value);
- Land Quality Resource Index Method (Use Value); and
- Lease Value (Use Value).

The last three methods of valuation are often preferred because they could more readily apply with the ability to pay principle. Frequent revaluations should enhance the equity and acceptability of the tax.

(iv) *Tax rate and rate-capping*

Any tax has an implicit minimum and maximum rate (Katz, 1995). Rate capping may be necessary as a land tax between 4 and 5 per cent effectively nationalises agricultural land. If too low a rate is levied, the administrative cost will overshadow the fiscal benefits. Various caps for different types of land uses and qualities may be called for.

(v) *Tax relief measures*

Various tax relief measures could be employed. Experience, however, has shown that exemptions, rebates and tax deferrals should be kept to an absolute minimum.

(vi) Assessment and collection

The capacity to assess and collect the land tax must be in place before its introduction. This is necessary to ensure acceptability and compliance of taxpayers and administrators.

2.4 Proposals of the Subcommittee for framework legislation at primary local sphere**(i) Tax base**

All land (i.e. privately owned land, state-owned land and tribal land) within the jurisdiction of TRuralCs and TRepCs must be included in the tax base. The tax base should be limited to surface rights only. In other words, mineral and water rights should be excluded.

Of the three rating systems mentioned, the Subcommittee is of the opinion that flat rating (i.e. taxing the improved value of land) is to be preferred. Taxing improvements (in terms of a flat rating system) can be a disincentive to invest, but this could be countered by applying lower rates, capping and relief measures.

(ii) Taxpayer

It is suggested that the primary responsibility for a land tax should vest in the owner of the land. In the instance of limited real rights (e.g. usufruct, servitudes, etc) the liability should be shared between the owner (of the bare *dominium*) and the holder of the limited right. Present uncertainty concerning ownership and other tenure rights in some areas is a short-term problem.

(iii) Methods and frequency of valuation of the tax base

Although the benefits of the use value methods are recognised by the Subcommittee, the comparable sales method (market value) is preferred, because:

- It is the method currently used in urban areas;
- The capacity exists to assess market value; and
- All land is included in the base - not only land used for agricultural or other productive purposes.

Possible distortions caused by the use of market values of improved land will be addressed if this tax is levied at primary level. (E.g., in Gauteng lower rates could be levied to counter the effect of capitalised non-farm factors.)

It is suggested that revaluations should take place at least every five years. Hardship cases could be accommodated on an *ad hoc* basis.

(iv) Tax rate and rate-capping

The Subcommittee suggests, albeit tentatively, a 2 per cent maximum tax rate for all land in all jurisdictions. Without any empirical evidence to support the proposed 2 per cent cap on the land tax rate for all land, submissions on this issue will be extremely beneficial in the Subcommittee's future deliberations and research in this regard. It was argued that the cap should be substantially lower than a confiscatory 4 per cent, but somewhat higher than 1 per cent to still raise sufficient revenue.

When considering an applicable tax rate, the relation between the land tax and other local taxes (e.g. RSC levies) will have to be considered. Underutilisation of a viable tax base may negatively impact on a local government's claim for grant assistance.

(v) *Tax relief measures*

No exemptions should be made. The relevant local taxing authority is best positioned to decide on rebates and tax deferrals. These measures could be considered in specific circumstances that may differ from area to area (i.e. drought, young and emerging farmers, land reform programmes, establishment of long-term crops, etc).

(vi) *Assessment and collection*

If the capacity to assess and collect a land tax does not exist in a particular jurisdiction in the short term, neighbouring TLCs could perform assessments and/or collection).

The tax must be an annual tax, although, should the capacity exist, it could be collected at shorter intervals (e.g. monthly).

3. SUBMISSIONS

In order to facilitate the drafting of framework legislation, the Subcommittee will welcome public submissions on especially the following issues:

- Which local government structure(s) should levy the land tax?
- Should market value or any other value be used?
- Should the tax be levied on site value or improved value?
- Should rates be capped nationally?
- Should various caps for different categories of properties be used?
- How should tribal land be assessed and taxed?

Apart from the framework legislation, the possible relationship between a land tax and other taxes (e.g. RSC levies) are of particular concern to the Subcommittee. Therefore, submissions on this issue will also be welcomed.”
