4

Revenue trends and tax proposals

The focus of this year's tax proposals is to accelerate sustainable growth, investment and job creation, reinforcing South Africa's attractiveness as an investment destination, lowering the cost of doing business, and initiating social security and retirement reforms that increase savings and reduce household vulnerability.

The 2007 proposals provide for moderate personal income tax relief, abolish the retirement fund tax and introduce reforms to dividend taxes.

Gross tax revenue in 2006/07 will amount to R489,7 billion, which is R32,9 billion higher than the figure budgeted a year ago. This outcome is mainly a result of robust economic growth and a steady broadening of the tax base through both legislative changes and administrative improvements by the South African Revenue Service.

Overview

Tax reforms support accelerated growth and job creation while promoting savings

The government's framework for tax policy seeks to broaden the tax base and, where appropriate, lower tax rates to improve the equity of the tax system, while promoting savings and investment. At the same time, policy design aims to minimise the distortionary impact that taxes could have on economic growth and employment creation.

Tax collections have been robust over the past three years as a result of strong economic growth, improved compliance and cyclical factors. The recent tax revenue buoyancy is expected to moderate over the next two years.

The broad underpinnings of the 2007 tax proposals are:

- Supporting economic growth, investment and job creation, business development and confidence
- Promoting financial security of households and reducing their vulnerability through retirement reforms that encourage savings
- Supporting macroeconomic policy objectives.

Several proposals contained in the 2007 Budget will contribute to maintaining business confidence and supporting economic growth. These include proposed interim reforms to the secondary tax on companies and its replacement, over the next two years, with a tax on shareholders' dividends; introduction of a depreciation allowance for commercial buildings; adjustments to the depreciation regime for rail and port infrastructure; and changes in the tax treatment of the disposal of shares.

Abolishing the retirement fund tax

This year's tax proposals encourage long-term savings, including higher levels of domestic savings and provision for retirement. Abolishing the tax on retirement funds is an important further step in the proposed reform of retirement funds. Increases in certain monetary thresholds with respect to retirement funds and estate duties are also proposed.

Introduction of a wage subsidy is to be considered towards the end of the medium-term expenditure framework (MTEF) period as part of a package of social security reforms and to reduce the direct cost of employment.

Moderate personal income tax relief

The personal income tax relief proposed for individuals is intended to compensate for fiscal drag and for the impact of tax base broadening. In real terms, the personal income tax relief is lower than in the recent past, taking into account the buoyant rate of consumption expenditure growth and the need to reduce risks associated with the current account.

The tax proposals take into account the higher tax-to-GDP ratio outcome of 27,1 per cent expected in 2006/07, which is largely a result of the economic cycle and the impact of higher commodity prices. Overall, the proposals reflect a balance between sustaining revenue trends, broadening the tax base and gradually reducing rates.

Coordinating taxation policy across national, provincial and local government

Government is committed to ensuring that the taxation powers of provincial and local governments are exercised within a broader national framework, in line with the spirit and intention of the Constitution. The broad themes underpinning the 2007 tax proposals are relevant to all three spheres of government. The new system of municipal property rates and the proposed provincial fuel levy will therefore be introduced without adversely affecting key macroeconomic objectives, economic sectors or households.

This chapter explains the main tax proposals included in the 2007 Budget and reviews revenue collection trends and estimates for 2006/07. Annexure C elaborates on these and other proposals.

Main tax proposals

The 2007 Budget will provide net tax relief of R12,4 billion. The tax proposals include:

- Replacing the secondary tax on companies with a dividend tax, reducing the rate from 12,5 per cent to 10,0 per cent and broadening the base
- Personal income tax relief for individuals amounting to R8,4 billion
- Abolishing the retirement fund tax
- Treating the sale of shares (equities) held for more than three years as capital gains

- Increasing the tax-free interest and dividend income monetary thresholds
- Streamlining tax and regulatory aspects of retirement funds
- Protecting South Africa's intellectual property rights tax base
- Increasing excise duties on tobacco products and alcoholic beverages
- Increasing the general fuel levy and the Road Accident Fund (RAF) levy.

Consolidated national revenue estimates

Table 4.1 sets out the consolidated national revenue from 2005/06 to 2009/10, consisting of main budget revenue, the receipts of social security funds and foreign technical assistance. Consolidated national revenue in 2005/06 amounted to R430,5 billion, which is 11 per cent higher than the 2005 Budget estimate. The revised figure for 2006/07 is estimated at R496,2 billion, which is 6,2 per cent higher than the 2006 Budget estimate.

Revised consolidated revenue estimated at R496,2 billion for 2006/07

Table 4.1 Consolidated national revenue, 2005/06 – 2009/10

	2005/06	2006/07		2007/08	2008/09	2009/10
R million	Outcome	Budget estimate	Revised estimate	Medium-term estimates		
Total tax revenue	417 334	456 786	489 662	556 562	606 870	659 820
Less: SACU payments	-14 145	-19 744	-25 172	-23 053	-27 075	-29 551
Non-tax revenue[1]	8 559	9 320	11 346	11 093	11 371	11 246
Main budget revenue[2]	**411 748**	**446 362**	**475 836**	**544 602**	**591 166**	**641 515**
Percentage of GDP	*26,1%*	*25,4%*	*27,1%*	*28,1%*	*27,6%*	*27,0%*
Social security funds						
Tax revenue	15 357	16 645	17 412	19 664	22 085	24 434
Non-tax revenue[3]	4 489	2 630	1 459	1 442	1 617	1 825
Total social security revenue	**19 846**	**19 275**	**18 871**	**21 107**	**23 701**	**26 258**
RDP fund receipts and technical co-operation	1 624	1 550	1 550	1 550	1 550	1 550
Consolidated national revenue[4]	**430 505**	**467 182**	**496 248**	**567 249**	**616 407**	**669 312**

1. *Includes departmental revenue, transactions in assets and liabilities, and foreign grants received.*
2. *Included over the medium term is the on-budget financing as replacement of the RSC levies.*
3. *Includes own revenue, sale of capital assets and grants received.*
4. *Transfers between funds have been netted out.*

National budget revenue – revised estimates

Variations between the original revenue estimates and final outcomes reflect estimation uncertainty, changes in economic trends, and improved compliance efforts. Table 4.2 highlights budget estimates and revenue outcomes of the major tax instruments for 2005/06 and projected revenue outcomes for 2006/07. Tables 2 and 3 in Annexure B set out these numbers in greater detail.

Table 4.2 Main budget estimates and revenue outcome, 2005/06 and 2006/07

R million	2005/06 Budget estimate	2005/06 Outcome	2005/06 Deviation	2006/07 Budget estimate	2006/07 Revised estimate	2006/07 Deviation	2005/06–2006/07 % change
Taxes on income and profits	**200 855**	**230 804**	**29 949**	**245 816**	**274 300**	**28 485**	**18,8%**
Personal income tax	116 890	125 645	8 755	132 475	139 000	6 525	10,6%
Company tax	68 715	86 161	17 446	95 201	114 771	19 571	33,2%
Secondary tax on companies	8 700	12 278	3 578	13 850	15 700	1 850	27,9%
Tax on retirement funds	4 900	4 783	-117	2 400	2 750	350	-42,5%
Other	1 650	1 937	287	1 890	2 079	189	7,3%
Taxes on payroll and workforce	**4 908**	**4 872**	**-36**	**5 600**	**5 850**	**250**	**20,1%**
Taxes on property	**9 820**	**11 138**	**1 318**	**8 922**	**10 345**	**1 423**	**-7,1%**
Domestic taxes on goods and services	**143 091**	**151 362**	**8 271**	**171 885**	**174 667**	**2 783**	**15,4%**
Value-added tax	105 975	114 352	8 377	131 200	134 562	3 362	17,7%
Specific excise duties	14 509	14 547	37	16 616	16 100	-516	10,7%
Levies on fuel	20 650	20 507	-143	21 800	21 750	-50	6,1%
Other	1 957	1 957	0	2 269	2 255	-14	15,2%
Taxes on international trade and transactions	**13 200**	**18 202**	**5 002**	**23 600**	**23 900**	**300**	**31,3%**
Stamp duties and fees	**900**	**793**	**-107**	**964**	**600**	**-364**	**-24,3%**
State miscellaneous revenue[1]	**–**	**164**	**164**	**–**	**–**	**–**	**-100,0%**
Total tax revenue	**372 774**	**417 334**	**44 560**	**456 786**	**489 662**	**32 876**	**17,3%**
Departmental revenue[2]	8 502	7 642	-860	8 585	9 532	947	24,7%
Transactions in assets and liabilities	646	917	271	735	1 813	1 078	97,8%
Less: SACU payments	-12 053	-14 145	-2 092	-19 744	-25 172	-5 428	78,0%
Main budget revenue	**369 869**	**411 748**	**41 878**	**446 362**	**475 836**	**29 474**	**15,6%**

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

2. The budget estimate for 2005/06 includes an amount for the proceeds of foreign exchange amnesty but the actual outcome excludes it. See note 6 Annex B Table 3

Outcome for 2005/06 and revised estimate for 2006/07

Audited results show that main budget revenue for 2005/06 was R411,7 billion and was in line with the revised estimate. The outcome of main budget revenue for 2005/06 was 11,3 per cent higher than the original estimate in February 2005.

Higher tax collections owing to strong economic performance

Based on the revised macroeconomic projections outlined in Chapter 2 and revenue trends for the first nine months of the fiscal year, the main budget revenue estimate for 2006/07 is revised to R475,8 billion, 6,6 per cent higher than the original budget of R446,4 billion announced in February 2006. The increased revenue estimates result from higher collections of company tax, personal income tax and VAT.

Growing taxpayer base now numbers 4,9 million

Taxes on income and profits are expected to be 11,6 per cent higher than the original budget estimate. Personal income tax is expected to reach R139 billion, which is R6,5 billion above the original estimate, mainly as a result of rising employment and real salary increases. In the first four months of 2006/07, the number of registered taxpayers increased by 176 000, taking the total number to 4,9 million.

Higher collections from VAT and company tax

The revised estimate for corporate income tax is R114,8 billion, which is 20,6 per cent higher than originally budgeted. Company income tax and the secondary tax on companies are respectively expected to generate R19,6 billion and R1,9 billion more than budgeted as a result of higher-than-expected company profits.

VAT receipts are expected to total R134,6 billion, about R3,3 billion above the 2006 Budget estimate. The revised revenue estimate from specific excise duties of R16,1 billion is R516 million lower than originally budgeted. Fuel levies should raise R21,8 billion, broadly in line with expectations.

Increased import volumes fuel customs duty revenues

Customs duty revenues are revised upwards by R300 million as a result of high import volumes, which reflect strong underlying economic growth and the relative strength of the rand. South Africa's continued commitment to its trading partners in the South African Customs Union (SACU) will result in a revised tax revenue charge of R25,2 billion according to the revenue-sharing formula, which is R5,4 billion higher than the 2006 Budget estimate.

Table 4.3 sets out the actual revenue collections for 2004/05 and 2005/06, and the estimates for 2006/07 to 2009/10. More detailed information is provided in Tables 2 and 3 of Annexure B.

Table 4.3 Main budget revenue, 2003/04 – 2009/10

	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
		Actual		Revised		Medium-term estimates	
R million				**estimate**			
Taxes on income and profits	171 963	195 219	230 804	274 300	312 150	342 535	373 081
Taxes on payroll and workforce	3 896	4 443	4 872	5 850	6 500	7 150	7 851
Taxes on property	6 707	9 013	11 138	10 345	10 995	11 996	13 130
Domestic taxes on goods and services	110 174	131 983	151 362	174 667	199 210	214 791	232 263
Taxes on international trade and transactions	8 414	13 286	18 202	23 900	27 485	30 167	33 252
Stamp duties and fees	1 360	1 168	793	600	222	232	243
State miscellaneous revenue[1]	-7	-131	164	–	–	–	–
Total tax revenue	**302 508**	**354 980**	**417 334**	**489 662**	**556 562**	**606 870**	**659 820**
Departmental revenue	5 931	5 520	7 642	9 532	9 185	9 378	9 163
Transactions in assets and liabilities	715	682	917	1 813	1 907	1 993	2 083
Less: SACU payments	-9 723	-13 328	-14 145	-25 172	-23 053	-27 075	-29 551
Main budget revenue	**299 431**	**347 854**	**411 748**	**475 836**	**544 602**	**591 166**	**641 515**
Percentage of GDP	*23,2%*	*24,3%*	*26,1%*	*27,1%*	*28,1%*	*27,6%*	*27,0%*
Gross domestic product	*1 288 952*	*1 430 673*	*1 580 119*	*1 755 340*	*1 938 934*	*2 141 747*	*2 379 299*

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

Tax revenue trends

South Africa's robust tax system and the positive effects of recent tax reforms, improvements in administration and compliance are reflected in the continued strength of revenue collection.

Tax revenue buoyancy and forecasting

The continued buoyancy of tax revenues reflects strong economic growth, the positive effects of recent reforms, improvements in tax administration and compliance. Healthy revenue trends contribute to the recent increase in the tax-to-GDP ratio, with tax receipts growing at a faster rate than reported GDP.

The tax-to-GDP multiplier is the ratio by which tax revenue changes for a given change in nominal GDP. Over the long term, in the absence of significant changes in the tax system and/or the structure of the economy, tax revenues are expected to increase by the same percentage as GDP. That would imply a tax multiplier, or buoyancy factor, of one. The average value of the tax multiplier since 1983/84 is 1,06. However, there have been significant peaks (1,76 in 1985/86 and 1,68 in 2005/06) and troughs (0,54 in 1991/92 and 0,71 in 2000/01). These fluctuations have been due to cyclical factors, such as swings in commodity prices, the external value of the currency and shifts in the business cycle.

There are indications that the higher gross tax revenue buoyancy experienced over the past few years may be slowing down during 2007/08.

Three tax instruments account for about 80 per cent of all revenues

When analysing the relationship between gross tax revenues and GDP (see the box on revenue buoyancy), the composition of tax revenues should be considered. The three main tax instruments (personal income tax, VAT and company income tax) account for about 80 per cent of gross tax revenues. The contribution of two of the three tax instruments has changed significantly over the past 20 years.

VAT is the most stable source of tax revenues

Of the three, VAT has been the most stable source of revenue. Improvements in tax administration, tax compliance and the increased share of consumption expenditure as a percentage of GDP have contributed to the increase in VAT receipts as a percentage of total tax revenues since 2003/04. The balance in the contribution by incorporated businesses and individuals (and unincorporated businesses) to total tax revenues has been restored, following a significant divergence in the 1990s.

Revenue estimates and 2007 tax proposals

Table 4.4 sets out the estimates of revenue before tax proposals for 2007/08, based on the macroeconomic assumptions set out in Chapter 2 and the existing tax structure. Annexure C contains additional proposals of a more technical nature.

Personal income tax collection expected to increase by 17,9 per cent

Main budget revenue in 2007/08 is estimated to be R557 billion before any tax changes are proposed. Personal income tax is projected to increase by 17,9 per cent to R164 billion. Company tax and VAT are projected to raise R139,3 billion and R155 billion, up 21,4 per cent and 15,2 per cent respectively.

Overview of tax proposals

Tax proposals promote investment and business development

Table 4.5 provides the anticipated revenue impact of the 2007 tax proposals, the net effect of which is to reduce the estimated total tax revenue by R12,4 billion.

Table 4.4 Estimates of revenue before tax proposals, 2007/08

R million	2006/07 Revised estimate	2007/08 Before tax proposals	Percentage change
Taxes on income and profits	**274 300**	**326 500**	**19,0%**
Personal income tax	139 000	163 900	17,9%
Company tax	114 771	139 300	21,4%
Secondary tax on companies	15 700	18 000	14,6%
Tax on retirement funds	2 750	3 000	9,1%
Other	2 079	2 300	10,6%
Taxes on payroll and workforce	**5 850**	**6 500**	**11,1%**
Taxes on property	**10 345**	**11 000**	**6,3%**
Domestic taxes on goods and services	**174 667**	**196 865**	**12,7%**
Value-added tax	134 562	155 068	15,2%
Excise duties	17 400	17 812	2,4%
Levies on fuel	21 750	22 988	5,7%
Other	955	997	4,4%
Taxes on international trade and transactions	**23 900**	**27 485**	**15,0%**
Stamp duties and fees	**600**	**612**	**2,0%**
Total tax revenue	**489 662**	**568 962**	**16,2%**
Departmental revenue	9 532	9 185	-3,6%
Transactions in assets and liabilities	1 813	1 907	5,2%
Less: SACU payments	-25 172	-23 053	-8,4%
Main budget revenue	**475 836**	**557 002**	**17,1%**

Growth, business development and job creation

Reforms to the taxation of dividends

Reforms proposed to secondary tax on companies

While dividend taxes are a familiar feature of taxation worldwide, they are typically imposed at a shareholder level, with treaty relief for foreign investors. Some have argued that South Africa's secondary tax on companies raises the cost of equity financing to the detriment of economic growth. To help lower the cost of doing business, government proposes to phase out the secondary tax on companies and replace it with a dividend tax.

Base of taxable dividends will broaden beyond current narrow interpretation

This reform will happen in two phases. During the first phase and in line with previous reforms, the proposals reduce the rate and broaden the base. The dividend tax will apply at a rate of 10 per cent, down from the current 12,5 per cent secondary tax on companies rate. This will apply to all distributions. The base of taxable dividends will broaden beyond the current narrow interpretation of profits.

Phase two, commencing in 2008, will entail conversion to a dividend tax on shareholders, with administrative enforcement through a withholding tax at company level. The implementation of this phase will depend on the renegotiation of several international tax treaties.

Table 4.5 Summary effects of tax proposals, 2007/08

R million	Effect of tax proposals	
Tax revenue		568 962
Non-tax revenue		11 093
Less: SACU payments		-23 053
Main budget revenue, before tax proposals		**557 002**
Budget 2007/08 proposals:		**-12 400**
Taxes on individuals and companies	**-14 655**	
Personal income tax	**-8 870**	
Adjust personal income tax rate structure	*-8 400*	
Adjustment in monetary thresholds (estate duty, savings, etc.)	*-470*	
Abolish retirement fund tax	**-3 000**	
Business Taxes	**-2 785**	
Reform of secondary tax on companies	*-2 000*	
Depreciation:commercial buildings, environment, rail, etc	*-600*	
Adjustment of threshold: Public Benefit Organisations	*-185*	
Indirect taxes	**2 255**	
Increase in General Fuel Levy	*950*	
Increase in alcohol taxes	*795*	
Increase in tobacco taxes	*685*	
Abolish stamp duties on short term leases	*-90*	
Abolish ad valorem duties on certain products	*-85*	
Main budget revenue (after tax proposals)		**544 602**

Phase one will become effective from 1 October 2007, except for certain immediate anti-avoidance measures taking effect as of 21 February 2007. Phase one will apply to all distributions made on or after the general effective date, even if those distributions stem partly or wholly from pre-effective date profits. The net estimated revenue loss from the first phase of this reform will amount to R2 billion during 2007/08 (in respect of the six-month period from 1 October 2007 until the end of the fiscal year).

Taxation of gains on long-term equity investments

Tax burden on equity investments to be reduced

The gains realised on the sale of shares can be taxed either as ordinary income or capital gains, depending on facts and circumstances. However, the facts and circumstances test is problematic. It results in some large institutions receiving capital gains tax treatment on the sale of shares, and many other players paying ordinary income tax. In order to provide equitable treatment, all shares disposed of after three years will trigger a capital gains tax event. This proposal will not affect the ordinary income tax treatment of executive employee share schemes. It will, however, require anti-avoidance rules that will prevent taxpayers from transferring new assets into shareholdings held for the three-year period. The above proposal will take effect on 1 October 2007.

Depreciation

The tax regime related to depreciation of fixed and moveable assets will be reviewed to ensure a greater degree of consistency. The following interim amendments are proposed.

Rail locomotives, wagons and port assets

Depreciation period for new rail locomotives and wagons reduced

One way of reducing the cost of doing business in South Africa is to improve the efficiency of transport networks and ports. It is proposed to reduce the tax depreciation periods for new rail locomotives and rail wagons from 14 years to five years. It is also proposed that new quay walls and other port facilities qualify for deductions over 20 years. This would match other infrastructure depreciation periods, such as those applying to aircraft runways.

Commercial buildings

Changes to the tax depreciation of commercial buildings

The Income Tax Act provides for the depreciation of buildings used for manufacturing and similar processes. However, it does not provide for tax depreciation for certain commercial buildings. It is proposed that tax depreciation allowances for the economic wear-and-tear of newly constructed commercial buildings (and upgrades) be implemented. It is envisaged that the rate will be 5 per cent per year (i.e., a write-off period of 20 years).

Environmental capital expenses

Rules to account for growing environmental oversight

In line with global trends, South African businesses are increasingly subject to environmental regulatory oversight. However, the Income Tax Act has not kept abreast of the importance of expenditure in this regard. Environmental capital structures (such as dams and tanks) are often not depreciable. In addition, environmental clean-up, restoration and decommissioning are often seen as non-deductible capital expenditures. It is proposed that the above capital expenditures qualify for depreciation allowances or immediate deductions, depending on the circumstances.

Corporate reorganisation and BEE transactions

Further easing of tax obstacles to corporate reorganisation and BEE

An important issue for black economic empowerment (BEE) transactions is the ability of BEE partners to raise financing. Amendments to the Income Tax Act are proposed to ensure that BEE and other similar restructurings do not encounter undue additional tax costs. A detailed discussion of these proposals is provided in Annexure C.

Relief for individuals

The 2007 Budget provides tax relief for individuals in the form of increases in both the primary and secondary rebates, and upward adjustments across the income tax brackets. These adjustments make provision for personal income tax relief amounting to R8,4 billion.

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Table 4.6 Personal income tax rate and bracket adjustments, 2006/07 and 2007/08

2006/07		2007/08	
Taxable income (R)	**Rates of tax**	**Taxable income (R)**	**Rates of tax**
0 – 100 000	18% of each R1	0 – 112 500	18% of each R1
100 001 – 160 000	R18 000 + 25% of the amount above R100 000	112 501 – 180 000	R20 250 + 25% of the amount above R112 500
160 001 – 220 000	R33 000 + 30% of the amount above R160 000	180 001 – 250 000	R37 125 + 30% of the amount above R180 000
220 001 – 300 000	R51 000 + 35% of the amount above R220 000	250 001 – 350 000	R58 125 + 35% of the amount above R250 000
300 001 – 400 000	R79 000 + 38% of the amount above R300 000	350 001 – 450 000	R93 125 + 38% of the amount above R350 000
400 001 and above	R117 000 + 40% of the amount above R400 000	450 001 and above	R131 125 + 40% of the amount above R450 000
Rebates		**Rebates**	
Primary	R7 200	Primary	R7 740
Secondary	R4 500	Secondary	R4 680
Tax threshold		**Tax threshold**	
Below age 65	R40 000	Below age 65	R43 000
Age 65 and over	R65 000	Age 65 and over	R69 000

The primary rebate is raised to R7 740 from R7 200, increasing the income tax threshold for taxpayers below 65 years to R43 000

Adjustments in medical caps

Monthly monetary caps for medical scheme contributions increased

As mentioned in the 2006 *Medium Term Budget Policy Statement*, the monthly monetary caps for tax-free medical scheme contributions will be increased with effect from 1 March 2007, from R500 to R530 for each of the first two beneficiaries, and from R300 to R320 for each additional beneficiary.

Savings and retirement reform

An efficient and equitable framework for individual retirement

The proposed reforms to retirement saving, outlined in Chapter 6 as part of the broader social security reforms, are aimed at providing an efficient and equitable framework for individuals to provide for their retirement. Mandatory contributions, compulsory preservation, portability and enhanced regulation together provide the foundation for the retirement funding reforms.

The tax treatment of retirement savings must complement these regulatory and institutional reforms. Details of these reforms will be published by the National Treasury in a separate discussion paper, including reforms to the tax system that seek to maintain sufficient incentive to provide adequately for retirement, while addressing inequities and complexity in the current system.

In keeping with practice in many other countries, the reforms will see a shift towards an expenditure model of retirement fund taxation, in which contributions to retirement funds are eligible for full or partial deductibility, investment growth is tax exempt and benefits are taxable. As part of this, a uniform and more equitable tax treatment of contributions to pension, provident and retirement annuity funds will be phased in over time, consisting of three parts – favourable tax treatment of a basic savings element, some tax encouragement of a supplementary component, and no special tax treatment above a specified ceiling. The reforms will improve equity and more effectively encourage long-term savings by lower and middle income individuals.

It is hoped the complete package of reforms will be finalised during the course of 2007, following further consultation in the light of social security reform discussions. However, several elements of the reform package outlined below will be implemented in 2007.

Several elements of reform package will be implemented in 2007

Abolition of retirement fund tax

Retirement fund tax on interest and rental income will be abolished with effect from 1 March 2007. This is consistent with the shift to the retirement savings taxation model outlined above. It will result in improved returns for retirement fund members and should be seen as a counterpart to the proposed limitations on tax deductibility of retirement fund contributions by high-income individuals.

Retirement fund tax is abolished from 1 March 2007

Simplifying retirement fund thresholds

The tax rules permitting lump sum withdrawals upon retirement are overly complex, resulting in unnecessary compliance costs. To alleviate these difficulties, government will simplify the tax system for lump sum withdrawals. To streamline the tax administration process, withholding taxes on lump sum retirement fund payments to persons with taxable income of less than R43 000 per year (the revised income tax threshold) will be abolished.

Streamlining the tax regulatory regime for retirement funds

Retirement funds have to comply with two sets of regulatory legislation, making for an unnecessarily complex regulatory landscape. A streamlined tax administration environment will reduce the indirect costs incurred by retirement fund members, resulting in improved retirement savings. As a first step, regulatory requirements contained in the Income Tax Act and related regulatory notes will effectively be moved to the Pension Funds Act. This will result in reduced regulatory costs without sacrificing oversight.

A less complex regulatory landscape

Foreign collective investment schemes

It has come to government’s attention that foreign collective investment schemes in the hands of long-term insurers are inadvertently subject to a higher level of tax than schemes held directly by beneficiaries. Changes in policyholders’ portfolio preferences can result in foreign collective investment schemes moving in and out of the controlled foreign company regime. This places a large administrative burden on the scheme’s manager to

Amendments to alleviate higher tax and compliance burden

monitor such movements. Legislative amendments to alleviate the higher tax and compliance burden will be introduced.

Tax-free savings thresholds

Interest, dividend and capital tax-free threshold adjustment

In line with adjustments made in previous years, it is proposed to increase the interest and dividend income tax-free threshold for individuals younger than 65 years from R16 500 to R18 000 and for individuals aged 65 years and older from R24 500 to R26 000. It is also proposed to increase the threshold for the tax-free income of foreign dividends and interest from R2 500 to R3 000 per year. As part of the overall package of encouraging savings, the annual exclusion threshold for capital gains or losses will be increased from R12 500 to R15 000.

Estate duties, donations tax and capital gains tax

Estate duty exemption increased to R3,5 million

The exempt threshold for estate duties was increased from R1,5 million to R2,5 million in 2006. It is proposed to increase this threshold further to R3,5 million in 2007. It is also proposed to increase the monetary threshold below which no capital gains tax is imposed at death from R60 000 to R120 000; and the threshold below which no donations tax is payable from R50 000 to R100 000.

Lump sum death benefits

Tax-free treatment of lump sump payments covering death at work

The Income Tax Act provides for certain lump sums paid in respect of the death caused by an occupational injury to be tax-free. However, payments of a similar kind made outside the Compensation for Occupational Injuries and Diseases Act (1993) framework are as a rule subject to income tax. It is proposed that payments in respect of death while at work be tax-free up to a monetary cap of R300 000.

Customs and excise duties

Updating customs and excise definitions

Reclassification of excise duty revenues on imports

Customs duties as defined in the Customs and Excise Duty Act (1964) incorrectly include excise duties on imports. Excise duties on imported goods will, in keeping with international practice, be classified as excise duty revenues and not as customs duty revenues. This will provide for a more consistent international comparison of tax revenues and better reflect trends in customs revenues. Government will consult with SACU member states to effect similar changes to their legislation.

Excise duties: alcoholic beverages

Excise duties on alcoholic beverages will be increased in accordance with the policy decision to target a total tax burden (excise duties plus VAT) of 23, 33 and 43 per cent on wine products, malt beer and spirits, respectively. No increase in the excise duty on traditional beer is proposed. The proposed increases vary between 8,0 and 10,5 per cent as indicated in Table 4.7.

Excise duties: tobacco products

Excise duties on tobacco products will be increased in accordance with the policy decision to target a total tax burden (excise duties + VAT) of 52 per cent for all categories of tobacco products. The proposed increases vary between 5,3 and 10,7 per cent, as indicated in Table 4.7.

Tobacco taxes increase in line with policy

At least one tobacco company has started to import a smokeless tobacco called *snus*. Although the market for this product is currently small, an appropriate tax treatment will be introduced.

Ad valorem excise duties

Government proposes to abolish the *ad valorem* excise duties on products as listed in Table C.5 in Annexure C. The estimated revenue loss due to this proposal is R85 million.

More ad valorem excise duties are abolished

Table 4.7 Changes in specific excise duties, 2007/08

Product	Current excise duty rate	Proposed excise duty rate	Change in excise duties Nominal	Real
Malt beer	R36,68 / litre of absolute alcohol (62,35c / average 340ml can)	R39,61 / litre of absolute alcohol (67,34c / average 340ml can)	8,0%	3,1%
Traditional African beer	7,82c / litre	7,82c / litre	0,0%	-4,9%
Traditional African beer powder	34,70c / kg	34,70c / kg	0,0%	-4,9%
Unfortified wine	158,09c / litre	171,53c / litre	8,5%	3,6%
Fortified wine	287,88c/ litre	316,67c/ litre	10,0%	5,1%
Sparkling wine	465,58c/ litre	512,14c/ litre	10,0%	5,1%
Ciders and alcoholic fruit beverages	183.38c / litre (62,35c / average 340 ml can)	198,05c / litre (67,34c / average 340 ml can)	8,0%	3,1%
Spirits	R55,21 / litre of absolute alcohol (R17,80 / 750 ml bottle)	R61,01 / litre of absolute alcohol (R19,68 / 750 ml bottle)	10,5%	5,6%
Cigarettes	556,08c / 20 cigarettes	615,65c / 20 cigarettes	10,7%	5,8%
Cigarette tobacco	782,47c / 50g	824,18c / 50g	5,3%	0,4%
Pipe tobacco	206,55c / 25g	218,47c / 25g	5,8%	0,9%
Cigars	R34,16/ 23g	R37,73/ 23g	10,5%	5,6%

Fuel levies

General fuel levy

It is proposed to increase the general fuel levy by 5 c/l for both petrol and diesel, taking the levy on these products to 121 c/l and 105 c/l, respectively. The increase in the general fuel levy will become effective on 4 April 2007.

Petrol and diesel tax up by 5 c/l

Road Accident Fund levy

It is proposed to increase the RAF levy on both petrol and diesel by 5 c/l, from 36,5 c/l to 41,5 c/l, with effect from 4 April 2007. This adjustment is intended to cover the growth in RAF claims and improve capacity to deal with the existing claims backlog. See Chapter 6 for a discussion of the RAF restructuring.

Biofuels

In December 2006, Cabinet endorsed the draft biofuels industrial strategy, which will be finalised in consultation with key stakeholders by May 2007. The fuel tax regime for biofuels and bioethanol in particular will be reviewed during 2007.

Table 4.8 Total combined fuel levy on leaded petrol and diesel, 2005/06 – 2007/08

	2005/06		2006/07		2007/08	
	93 Octane petrol	Diesel	93 Octane petrol	Diesel	93 Octane petrol	Diesel
General fuel levy	116,0	100,0	116,0	100,0	121,0	105,0
Road Accident Fund levy	31,5	31,5	36,5	36,5	41,5	41,5
Customs and excise levy	4,0	4,0	4,0	4,0	4,0	4,0
Equalisation fund levy	–	–	–	–	–	–
Illuminating paraffin marker	–	0,01	–	0,01	–	0,01
Total	**151,5**	**135,5**	**156,5**	**140,5**	**166,5**	**150,5**
Pump price: Gauteng (as in February)[1]	420,0	384,5	550,0	517,8	561,0	542,1
Taxes as % of pump price	*36,1%*	*35,2%*	*28,5%*	*27,1%*	*29,7%*	*27,8%*

1. Diesel (0,05% sulphur) wholesale price (retail price not regulated).

Liquid fuels industry

Task team submitted its report to the Minister of Finance in early February

The task team appointed by the Minister of Finance to investigate possible reforms to the fiscal regime applicable to windfall profits in the liquid fuels sector, with particular reference to synthetic fuels, submitted its report on 9 February 2007.

The task team also explored the regulatory environment pertaining to the liquid fuels industry. The Minister of Finance has referred these matters to the Minister of Minerals and Energy for further consideration. The Minister of Finance will, in due course, respond to the fiscal recommendations of the task team.

Report proposes an additional tax on synthetic fuels

The task team proposed, firstly, an additional tax on existing synthetic fuels producer volumes at a level commensurate with a permanent structural increase in oil commodity prices, and triggered at an appropriate threshold/price. Preliminary indications are that this threshold should be between US$45 and US$55 per barrel of crude oil.

To cater for the volatility of oil prices, the task team also recommends that, unlike the previous tariff protection/subsidy system that imposed a fixed percentage on additional revenues (i.e. 25 per cent), a progressive sliding rate of taxation apply, according to a formula linked to the oil price.

Incentive for new production capacity

Secondly, the task team recommended a progressive incentive regime for investments in new synthetic fuel and biofuel plants. This proposed incentive consists of the following basic elements:

- Tax credits at low petroleum product prices, and a tax at high prices, thereby constituting a combined protection and windfall mechanism. Initial indications are that these thresholds should be US$40 and US$65 respectively.
- Both bioethanol and biodiesel to qualify for the lower general fuel levy.
- The investment regime to apply irrespective of the type of fuel produced and technology used, to encourage more efficient and lower-cost options.

Decision on windfall tax will follow consultation

Both proposals have merit – particularly the idea that during times of structurally higher crude oil prices it is appropriate to impose an additional tax on synthetic fuel producers. Government's initial response is to accept both proposals in principle. However, the actual design and relevant thresholds will require additional work and consultation with relevant stakeholders, taking into account their cost structure and future investment plans, along with South Africa's long-term liquid fuels requirements. A final decision will be made following consultation, and preferably by 31 July 2007, although the proposals are only expected to take effect from 1 January 2008.

Public benefit organisations

Further tax relief for public benefit activities

The Income Tax Act allows individuals and companies to deduct donations made to qualifying public benefit organisations (PBOs) up to a maximum of 5 per cent of their taxable income during the tax year. It is proposed that the threshold for tax-deductible donations be increased to 10 per cent for both individuals and companies. The objective of this proposal is to encourage charitable contributions.

In 2005, government introduced a system of partial taxation for PBOs, accompanied by a tax-free income threshold of 5 per cent of gross income or R50 000, whichever is the greater. This means that PBOs that conduct trading activities may continue to do so without losing their tax-exempt status. They will, however, pay income tax on income from trading activities exceeding the relevant threshold. Given the important role played by many PBOs, it is proposed to increase the R50 000 threshold to R100 000.

Amended tax treatment for sport bodies

The tax treatment of national sporting codes that have separated their professional and amateur sporting arms into separate bodies has resulted in certain anomalies. Amendments are proposed to allow the professional and amateur bodies to merge their legal structures so that qualifying expenses incurred by the professional bodies to develop amateur sports can be deducted.

Stamp duties

Two sets of transaction taxes currently apply to trading in investment securities: stamp duty in the case of unlisted shares, and uncertificated securities tax (UST) in the case of exchange-traded securities. To simplify administration and to eliminate anomalies created by this dual treatment, it is proposed that all secondary trade in shares (listed or otherwise) be subject to a single securities tax. Amendments are proposed to simplify exemptions and clarify the impact on derivative products and partial disposals.

Abolition of stamp duties on short-term leases

Given the proposed migration of the tax on unlisted shares into the UST Act, which will be renamed the Securities Tax Act, the only remaining transactions that will be subject to stamp duties will be leases. Long-term leases relating to fixed property are subject to stamp duty, while changes in the ownership of fixed property will attract a transfer duty charge. It is proposed that the stamp duties on short-term leases (less than five years) be abolished. The relationship between the VAT Act, Transfer Duty Act and stamp duties on long-term leases will also be examined.

Protecting the intellectual property tax base

Measures to protect the tax base and intellectual property

South Africans have developed intellectual property with substantial economic value. This intellectual property has benefited from South African infrastructure and in some instances from government subsidies, grants and/or tax incentives. Certain South African companies seek ways to shift this intellectual property offshore as exchange controls are gradually lifted. Measures to remedy the potential loss of intellectual property and the impact on tax revenue collections will be introduced.

Implementing the Municipal Property Rates Act

Ensuring a responsible phasing-in of the new property rates regime

The Local Government Municipal Property Rates Act (2004) regulates municipalities' powers to impose rates on properties. The act provides for the exclusion of certain properties from rates in the national interest; a transparent and fair system of granting relief measures; fair and equitable valuation methods; and objections and appeals processes.

The act took effect on 2 July 2005, and municipalities have four years from this date to fully implement the legislation. However, only a few municipalities are currently implementing a new valuation roll and rating in terms of the act.

Municipalities should prepare for the new property rating system

Implementation will require all municipalities to properly manage the transition from their old rating practices to the new system. A smooth transition is essential. Municipalities that historically have not rated on the market value of land and buildings combined are expected to reduce the rate charged (percentage or cents per rand) to ensure that there is broad continuity in revenue collected from the expanded tax base.

Tax reform measures under review

Wage subsidy and social security tax reform

Wage subsidy to help alleviate unemployment under consideration

Introduction of a wage subsidy is proposed by 2010. The objectives of such a subsidy are to reduce the direct costs of employment, help alleviate the high rate of joblessness and facilitate the proposed social security reform process. For further discussion of how this aligns with proposed social security reforms, see Chapter 6.

PAYE system will be used as an administrative base

It is envisaged that SARS will administer the social security tax and wage subsidy. As this will be a payroll-based tax and the subsidy will be paid to employers, the PAYE system will, to a large extent, be used as the administrative platform. In addition, SARS will have to gather more specific and regular information about employees, as the tax will require that records be kept to match details of contributing and eligible employees. The challenges that will arise from these large-scale fiscal and institutional arrangements will be taken into account in the SARS modernisation programme.

Small business development

A more streamlined regime for very small businesses

Government policy remains focused on reducing the tax compliance burden for businesses, especially small businesses, to promote entrepreneurship, the formalisation of informal businesses, economic growth and job creation. The National Treasury and SARS have commissioned a small business tax compliance cost study. The results of this study should also support the development of a more simplified tax regime for very small businesses to be introduced in 2008.

Flow-through shares

Measures to facilitate high-risk investments in mining

In 2007, the National Treasury will convene a working group to study the concept of flow-through shares – a mechanism that could help junior mining exploration companies to raise funds for high-risk investments.

Property investment vehicles

Collective investment schemes in property and property loan stock companies are property investment vehicles. However, the tax treatment of such entities is fragmented as it is based on the legal form (i.e., trusts versus companies), rather than their common purpose. The regulatory and tax regime relating to property holding entities will be reviewed during the course of 2007.

VAT treatment of internationally traded services

Discussion paper on VAT to be published this year

In the 2006 Budget, government announced that it would seek to provide greater clarity in respect of the VAT treatment of internationally traded services, especially with regard to telecommunications. A discussion document on this topic will be published for public comment in 2007, drawing on international research. The intention of the discussion document and any subsequent proposals will be to offer an opportunity for public consultation, and to provide clarity and certainty for investors.

Measures to enhance tax administration

Modernisation of tax administration

Improved tax administration and simpler registration

Recent years have seen a substantial growth in the tax base and, consequently, the volume of work for SARS. At the same time, there is also need for a broader and more integrated tax register to improve the view of potential taxpayers and to simplify registration. SARS has begun modernising its systems and processes, using the benefits of automation and e-business to become more cost effective, to better manage risk and to improve the quality of service. In 2007/08 SARS will place greater emphasis on e-filing, re-engineering of forms, scanning and imaging and greater reliance on third party data to speed up document processing.

SARS has committed to adopting the World Customs Organisation Framework of Standards, resulting in the need to re-engineer business processes and to draft new customs legislation over the medium term. A formal discussion paper on these matters will be released in 2007.

High-risk non-compliance areas identified

In addition to specific industry focus areas, SARS has identified three cross-industry areas as focal points for 2007/08. These are:

- Trusts, because of their continued use to avoid tax. Initiatives will include greater cooperation with the Master's office to register trusts and identify risk cases, and the allocation of more specially trained auditors.
- The undervaluation and understatement of stock, which will involve additional audit activity and verification.
- Employees' tax. Dedicated audit teams have been established and trained to counter abuses in this area.

Small business tax amnesty

The 2006 Budget announced a small business tax amnesty to facilitate the entry of marginalised small businesses into the economic mainstream and to help non-compliant small businesses to regularise their tax affairs and thus avoid potential penalties in future.

Small business amnesty applications open until 31 May 2007

Amnesty applications may be made until 31 May 2007. By 13 February 2007, the unit had received 47 489 enquiries and 11 301 amnesty applications. The inflow of applications compares favourably with the exchange control amnesty of 2003/04, in which application volumes peaked in the final weeks of the application period. It is anticipated that the pace of applications for the present campaign will gather pace in the coming weeks as awareness continues to be raised about the benefits of this process for small businesses.