WRITTEN SUBMISSION ON POSSIBLE WEALTH TAXES FOR SOUTH AFRICA

SUBMITTED TO THE DAVIS TAX COMMITTEE

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"Taxation is not a technical matter. It is preeminently a political and philosophical issue, perhaps the most important of all political issues. Without taxes society has no common destiny, and collective action is impossible"[1]

Introduction

We welcome the opportunity to make submissions to the Davis Tax Committee regarding the question of wealth taxes in South Africa. We note that the issues of revenue, public budgeting and spending are of deep interest to the public, and national budgets and public spending are issues of focus of many civil society organisations. However, we also note that in spite of the profound importance of these issues, very few of the people and organisations with an interest in them are in a position to provide technical inputs into this question. This should not be taken to mean that the majority of people in South Africa do not have strong opinions and positions regarding increasing the equitability of our tax system.

Unfortunately, current focus of work on social justice issues, modest time-frame of five weeks for comment, and limited technical capacity within our organisations has limited the potential to undertake the educational and consultative processes necessary to inform our submissions. Such processes are required to ensure meaningful engagement with an issue of this nature among the majority of people most affected by South Africa's current tax regime.

It appears however from media reports that we have seen that the people representing those who have greater wealth are better positioned to meaningfully engage in the question in the timeframes provided. This may result in skewed inputs to the Committee. We have attempted to mitigate this by communicating the call for submissions more broadly across the social justice sector at the time of its release.

We welcome the DTCs approach to ensure a participatory and consultative approach and we recommend an extended consultation process whereby the DTC provides technical support to social-justice oriented and community structures to enable broader participation on these questions.

State of South Africa in terms of poverty and inequality

Given the high levels of inequality of wealth and income in South Africa, government must reform its current taxation policies. According to Oxfam's Winnie Byanyima, in South Africa just 3 billionaires have the same wealth as the bottom 50% of the population (that is 28 million people). Using data from the Credit Suisse Global Wealth Report 2016, Oxfam has found that South Africa's richest 1% owns 42% or $272 billion (R3.7tr) of the country's social wealth of $650 bn.[2] While, the World Bank reported that "the poorest 20% consumes less than 3% of total expenditure, while the wealthiest 20% consume 65%".[3] What this tells us is that there is an alarming gap between rich and poor in South Africa. This is

1 Thomas Picketty, Capital in twenty-first century, p.493

2 http://ewn.co.za/2017/05/02/richest-1-owns-42-of-sa-s-social-wealth-oxfam ; http://wid.world/country/south-africa/

3 http://www.destinyconnect.com/2017/05/05/inequality-detrimental-africas-growth-oxfam/

aggravated by the fact that wealth and poverty, 23 years into our democracy, is still largely defined along racial and geographical terms.

Furthermore, the Minister of Finance in his 2017 Budget Speech indicated that "in economic and fiscal terms, South Africa has reached a crossroads". In order to address the pressured economic environment government has, over the last 5 years, undertaken substantial reductions in government budgets at national, provincial and local level. Despite this, national treasury has stated that cuts in spending will not be at the expense of poor households.[4] Yet, in the 2017 Budget Review national treasury indicates that the current rate of growth in the economy "will not be sufficient to markedly reduce unemployment, poverty and inequality" and at the same time "under collection [in revenues] in 2016 has imposed sharper limits on public spending".[5]

What do cuts to government budgets mean for those who have been turned away from their clinic due to shortages in drug availability or for poor children's ability to access the basics for learning to take place like textbooks, desks and toilets? It means that they will be expected to endure for another two to three years the drug shortages or unavailability of toilets or desks. It is not possible to present a budget that undertakes significant cuts in public spending while at the same time protecting front-line services.

It is for this reason that, amongst government's policy options are various fiscal instruments, of which taxation is one of the most influential for public spending. **The purpose of a progressive tax and redistributive policy is to enable the government to rectify and reshuffle the increasingly unequal distribution of income and wealth.[6] The aim of this "reshuffle" is to ensure that government can deliver on its constitutional obligations to provide, amongst others, public health care and education, social development, housing programs and affordable public transport.**

We therefore welcomed the establishment of the Tax Review Committee known as the Davis Tax Committee. Furthermore, we welcome national treasury's budget 2017 proposal to raise additional revenue through reforms in the current taxation policies. This is because progressive taxation policies are, arguably, the easiest way to raise revenue for public spending and to redistribute wealth. Oxfam's report, *An economy for the 99%,* has shown that activities of the wealthy are fuelling the inequality crisis by, amongst others, aggressive tax planning[7] on the part of wealthy individuals. Furthermore, extreme inequality is a very real threat to peace and stability and it is therefore in the interest of both the wealthy and poor to ensure that this situation is addressed. Economic logic suggests that, while more than 60% of the population remains impoverished, there is no possibility for meaningful growth or national stability.

While noting that the responsibility for implementing many of the necessary changes sits with the various fiscal and monetary authorities (National and provincial treasuries, the South African Revenue

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[4] http://www.treasury.gov.za/documents/national%20budget/2017/review/FullBR.pdf
[5] 2017 Budget Review, pg. 1
[6] http://aidc.org.za/download/taxation/Taxation-booklet-AIDC-FINAL.pdf
[7] Aggressive tax planning involves individuals, corporations, and trust using tax planning to organize their affairs to reduce or eliminate the amount of tax owing. While many of the practices undertaken are considered legal one could argue that such practices contravene the object and spirit of a system of fair taxation.

Service and – to some extent – the South African Reserve Bank), we are encouraged by the impetus and power placed on the DTC to drive such an important consultation process. We further note the need to ensure that the process itself is truly consultative and transparent.

We strongly recommend that a wealth tax be implemented as a mechanism of redressing South Africa's highly unequal distribution of wealth as a matter of urgency.

Making Tax Work For Women's Rights

It is important to note that tax policies are not gender neutral. In South Africa, women, in particular poor black women, are often employed in low pay sectors and are required take on a disproportionate amount of unpaid care work. Furthermore, they find themselves economically and socially facing high levels of discrimination in the work place and society and high levels of violence. According to statistics South Africa, women are more impoverished, with a poverty headcount of 58.6% as compared to 54.9% for men.[8] In a context of budget cuts, poor women bear the brunt of government spending cuts. It is important to emphasize that taxation policy has important implications for gender equity. **As a result, any reforms the Committee recommends must be examined from the point of view of their gendered impact.**[9]

Rising inequality in South Africa and the Role of a Wealth Tax

The introduction of a wealth tax[10] has been long called for in South Africa. Professor Sampie Terreblanche in the early 1990s recommended that persons with assets over two million rand should be taxed 0.5% percent annually for between 10 and 20 years in order to address inequality by those who directly or indirectly benefited from Apartheid.

However, South Africa's income inequality has grown since Professor Terreblanche recommendation. This is because rich households have benefited from a range of economic reforms both local and international. Many of these reforms have facilitated the growth of the financial services industry in particular the highly secretive industry of wealth management.

According to the Wealth and World Income database[11], the top 1% in South Africa had a fiscal income share of 19.2% of the economy in 2012. This share has nearly doubled since the early 1990s.[12] While in 2012, South Africa's richest 10% accounted for 65.1% of total wealth as compared to around 55.5% share of total wealth in 2000.

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[8] http://www.statssa.gov.za/?page_id=739&id=1

[9] http://www.unrisd.org/80256B3C005BCCF9/%28httpPublications%29/3E2A372203C1650DC125701300557100?OpenDocument; ds.ukzn.ac.za/files/GenderTaxSA_policy_brief_final.pdf

[10] We recognize that there are different options for implementing a package of wealth taxes of which is the implementation of a land tax, a national tax on the value of property in addition to existing charges. Other options are reforms in tax on pension/provident funds; capital gains tax, inheritance tax for example.

[11] http://wid.world/

[12] http://www.fin24.com/Economy/these-3-billionaires-at-top-of-sas-inequality-shocker-20170116

Declining personal income tax rates for the rich in South Africa

It has been argued that one of the reasons for the global increase in the income share of South Africa's richest 10% over the last two decades is declining top marginal tax rates. In line with international trends,[13] in South Africa, marginal tax rates applicable to the rich were similarly reduced gradually from a high of 75.5% in 1948 to the current level of the newly introduced top marginal income tax rate of 45%.[14] In addition, due to aggressive tax planning on the part of the wealthy, more and more of their income is being disguised. For example by setting up shell companies, putting their money in overseas bank accounts in countries with lower tax rates, taking part of their compensation in stock options and so forth.[15]

Research has also shown that substantial reductions in top marginal rates of personal income tax globally has been closely associated with rising top income shares. South Africa has been no exception. Dick Forslund's analysis of personal income taxation in South Africa found that more than R190 billion was forfeited in tax revenue in 2014 alone.[16]

Forslund argues that the same life style today, measured by the Consumer Price Index, has been taxed less and less for more than a decade. Forslund calls this: "compensating for fiscal creep". In 2005, when inflation stood a 4%, the top tax bracket was raised from R300, 000 to R400, 000, or by 33%. Furthermore, his argument shows that it is a complete myth that tax pressure on the small middle class and the rich has increased. The exact opposite is the case, the rich and middle class have paid less tax.

Recent measures to increase taxes on the wealthy are offset by other measures that reduce their tax burden, resulting in no real increase in revenue. The increase of the four highest tax rates by one percentage point (so that the income above the top tax bracket placed at R701, 300 today is now taxed at 41%), was, in aggregate, neutralised in the 2015/16 Budget. The tax brackets were lifted by 4.2% (minus R8.5bn in revenue), and the tax rebates for private medical insurances were increased (minus R920m). **These two measures, and the one percentage point increase in tax rates (+R9.42bn), was budgeted so that the combined result would produce nothing, exactly zero Rand.**[17]

It is clear that the changes, since 2000, in personal income tax have undermined the principle of a progressive taxation. What has happened is that wealthy South Africans have been paying a constant share of their income in tax, despite their real income increasing year on year. A progressive tax system is one where as a person becomes wealthier they inevitably pay a larger and larger share of their income

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[13] In OECD wide average top statutory rate declined in each of the last three decades from 66% in 1981 to 51% in 1990 and to 41% in 2008. - http://www.oecd.org/social/OECD2014-FocusOnTopIncomes.pdf

[14] http://www.unisa.ac.za/static/corporate_web/Content/Colleges/CEMS/Schools,%20departments,%20bureau,%20centres%20&%20institute/SA%20Business%20Review/documents/Sabview_16_3_chap_1.pdf

[15] http://www.zerohedge.com/news/2013-02-15/how-super-rich-avoid-paying-taxes

[16] http://aidc.org.za/download/taxation/Taxation-booklet-AIDC-FINAL.pdf

[17] https://www.dailymaverick.co.za/opinionista/2015-11-04-the-political-budget-crisis-and-alternatives-to-austerity-part-one/#.WS7ROROGN0w

in tax. **It is for these reasons that government cannot rely on PIT alone but must introduce a wealth tax to ensure that the full wealth of an individual is appropriately taxed.**

High Net Worth Individuals and tax avoidance

The economist Dick Forslund's analysis of "high net worth individuals"(HNWIs)[18] in South Africa **found that the 7 000 HNWIs were suspected by SARS of evading personal income tax**. HNWIs are assumed to have annual income of over R7 million and/or owning wealth of over R75 million. Furthermore, Credit Suisse found that personal wealth in South Africa largely comprises financial assets, which contribute 65% of the household portfolio[19]. Forslund found that the **tax loss in 2012 alone from these 7 000 individuals was at least R19 billion**. However, SARS found close to 30 000 NHWIs during one year of investigation, 20 000 of them after contacting only one financial institution. Taking these numbers into account Forslund makes the following finding:

> "if every new batch of 10 000 tax dodging HNWIs found by SARS starts to pay taxes as do the 4 000 individuals who have a taxable income over R5 million, the state would collect another R40 billion per 10 000 super rich individuals, presently under the radar of the tax authorities. R40 billion is the equivalent to over 1% of GDP"[20]

Furthermore, the Wealth Report 2017 issued by Knight Frank and Citi Private Bank[21], defines a HNWI as "a person whose investible property, excluding their principal residence, totals between $1 million and $30 million" – the equivalent of about R13 million and R400 million. In its Global Wealth Report from November 2011, Credit Suisse[22] expected the number of US dollar millionaires in South Africa to increase from the 71 000 in 2011 to about 243 000 by 2016. "According to Credit Suisse, 116 000 South Africans today are members of the global top 1% of wealth holders."

The political implication of this for public service provision is important. As Forslund argues, already, on the basis of the 30 000 HNWIs found by SARS, the gain in yearly tax revenue from personal income taxes would be well over R100 billion, or 2.3% of GDP in 2016**. Bringing these revenues from the evasive HNWI in would allow for a completely different budget.**[23] For example, higher education fees amount to R26 – 28 billion per year and an appropriate wealth tax framework would definitely be able to contribute to the provision of free higher education.[24] Furthermore, once the full wealth of individuals is

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[18] These individuals by SATS are assumed to have annual income of over R7 million and/or owning wealth of over R75 million.

[19] https://businesstech.co.za/news/banking/144003/how-much-poorer-south-africans-are-in-2016-including-the-super-rich/

[20] http://aidc.org.za/download/taxation/Taxation-booklet-AIDC-FINAL.pdf

[21] http://content.knightfrank.com/research/83/documents/en/the-wealth-report-2017-4482.pdf

[22] https://publications.credit-suisse.com/tasks/render/file/index.cfm?fileid=88E41853-83E8-EB92-9D5895A42B9499B1

[23] http://aidc.org.za/download/taxation/Taxation-booklet-AIDC-FINAL.pdf

[24] https://www.dailymaverick.co.za/opinionista/2015-11-04-the-political-budget-crisis-and-alternatives-to-austerity-part-one/#.WS7ROROGN0w

taken into consideration through the implementation of wealth tax government would be able to raise more funding for key social services.

SUBMISSION PROPOSALS

1. Wealth Tax

We propose that a wealth tax be implemented on the basis of all assets owned by South Africa's richest 10%. The tax proposal should ensure that "wealth" is defined as the net value of individual assets, which includes financial holdings, business interests and tangible assets.

Furthermore, alongside the implementation of a wealth tax, the personal income tax policy must be implemented in a progressive manner. In other words, the tax policy must ensure that individuals living in South Africa with higher taxable incomes pay progressively higher proportion of their income in tax. This must be coupled with progressive government spending that seeks to address poverty and inequality. It is critical that the committee make recommendations that ensure the rich are taxed their fair share while pprotecting our social spend- particularly for the most vulnerable and disenfranchised who are currently at risk of carrying the tax burden- women and the poor.

2. A national wealth tax on residential property values

We welcomed the announcement by the Finance Minister in his budget 2017 that properties less than R900 000 would no longer be subject to transfer duty. This will have a positive impact for prospective first time homeowners. It is critical that government implement mechanisms that provide relief for lower- and middle income households to enable them to enter the property market.[25] Furthermore, access to affordable housing has long been recognised as a key to advancing socio-economic rights and wellbeing of women and their position in society.[26]

We propose that a national wealth tax on residential property values be implemented in a progressive manner by targeting property values within a reasonable threshold. For example, the Alternative Information Development Centre (AIDC), published a short report in 2011 on what an increase of this tax could have given to the City of Cape Town in 2010, if the tax rebate on house values was increased from R200, 000 to R600, 000, and the property rate doubled from about 0.55% to 1.10%. Rebates and exemptions for the disabled and pensioners would remain in place, and the result would be over R2 billion in additional resources to the City. The reform would be neutral for house values between exactly R1 million, and below that down to R 600 000 there would be a tax cut for such households.[27]

This AIDC case study informs an argument in favor of a national wealth tax on residential property values. The aim of the tax should be to facilitate a national approach that ensures greater equity in the raising of revenue via property ownership. **We propose that just the introduction of a 1% national tax**

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25 http://www.treasury.gov.za/documents/national%20budget/2017/review/FullBR.pdf
26 http://za.boell.org/sites/default/files/perspectives_2.13.pdf
27 http://firstthing.dailymaverick.co.za/article?id=72473#.WS7WphOGN0w

on property values, in addition to the municipal rates and/or special ratings areas, would be able to bring significant resources into the public purse.

3. A Comprehensive Tax Policy Strategy

We propose that, in addition to the introduction of a wealth tax and national wealth tax on residential property values, the commission ensures that the following is given due attention:

- **No Increases in VAT**

Due to South Africa's high levels of income inequality, VAT is a highly regressive tax and has an adverse effect on income distribution. Any increases in VAT (*indirect tax*) will be regressive and should not be used to substitute progressive taxations option such as wealth tax, progressive land tax and property taxes. Amongst important policy changes are National Treasury's initiative to zero-rate certain basic food items. **We welcome this recognition of the disproportionate burden of both VAT and household spending on food within the poorest households in South Africa**. We strongly support the development of a taxation system that not only play a role in raising much-needed revenue but that is genuinely redistributive in nature. **We thus do not recommend increases to VAT in general.**

We do however support a VAT structure that is progressive through VAT on luxury goods for example yachts, art, private planes, luxury vehicles and so forth.

Furthermore, research[28] has shown that VAT can exert a gender bias because of women's different consumption patterns. In South Africa poor women purchase more goods and services that promote health, education and nutrition compared to men. This creates the potential that any increases in VAT will result in women bearing a larger VAT burden. **We recommend that the Committee explore tax policies that encourage gender equality and reduce the relative tax burden on poor women.**

- **Tax deductions, credits and exemptions**

As discussed in the DTC second and final report on macro analysis of the tax system and inclusive growth in South Africa there has been a proliferation of tax incentives, deductions, credits and exemptions. [29] Taken together these create an incentive for wealthy individuals to divert their income in a way that enables them to avoid paying their fair share of taxes. Furthermore, there are deductions, credits and exemptions that benefit high income recipients disproportionately. For example, there is a "medical tax credit relief" policy which disproportionately benefits not only the minority with private medical insurance but also the private medical insurance industry. [30] Currently, property owners who earn rental

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[28] https://www.oecd.org/dac/gender-development/44896295.pdf , http://sds.ukzn.ac.za/files/GenderTaxSA_policy_brief_final.pdf;

[29] http://www.taxcom.org.za/docs/20160421%20Second%20and%20Final%20Report%20on%20Macro%20Analysis%20Framework%20-%20Executive%20Summary.pdf

[30] D. Forslund argues that the medical tax credit relief in the 2016/17 budget was increased above inflation while the social grants did not. http://aidc.org.za/download/taxation/Taxation-booklet-AIDC-FINAL.pdf

incomes from properties can claim certain expenses relating to those properties.[31] **We recommend that the proliferation of tax incentives, deductions, credits and exemptions be reviewed in order to minimize their disproportionate benefit to wealthy individuals.**

- **Support International Tax Reform Proposals**

Since the 2008 financial crisis greater attention is being paid to domestic revenue mobilization to meet people's rights to quality public services. International reports have started to highlight, or simply reveal the ways in which "super-wealthy individuals" have been able minimize their personal tax exposure.[32] The Panama Papers helped to illustrate the myriad of ways in which the wealthy have exploited in the international tax system, in particular, secretive offshore tax regimes.[33] According to SARS, roughly 1700[34] South Africans were named in the Panama Papers. **This illustrates how important it is that South Africa play a role in international tax reform proposals to close gaps in international tax rules that enable wealth individuals to avoid paying their fair share in tax.**

- **Perceptions of Taxation**

In line with the general remarks and recommendations of the Katz Commission Report[35] into taxation we recommend that government ensure that the perceptions of taxation be addressed "in a clear, strategic" way. **In line with the Katz Commission we recommend that a considered, far-reaching communications campaign take place that will help build "tax morality and an understanding of rights, obligations and of how revenue raised is used". In addition, we recommend that the principle be accepted that the source of taxation should not determine who benefits from public spending or vice versa.**

- **Tackling Corruption**

To ensure the implementation of a successful progressive tax system it is critical that government address corruption. Corruption undermines the legitimacy of taxation and destroys public services and social investment. We note that the South African government, under the auspices of the Group of 20 (G20) Anti-corruption Working Group (ACWG) has committed to using open data to increase the transparency around government decisions, expenditure as well as the flow of public money within and across borders. This is integral to shedding light on and influencing institutional arrangements that are prone to corruption as well as preventing regulatory capture. In addition – the country's commitments to fiscal openness are currently largely driven by a single government department – National Treasury[36]-

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31 http://www.sars.gov.za/ClientSegments/Individuals/Need-Help/Tax-Questions-Answered/Pages/Individual-Deductions.aspx; http://www.pkf.co.za/media/10025616/pkf-sa-tax-guide-2016.pdf

32 See https://businesstech.co.za/news/wealth/96329/10-things-you-should-know-about-south-africas-ultra-rich/; Tax Justice Africa was founded in 2007. www.taxjusticeafrica.net ; The reports from Global Financial Integrity are published on www.gfintegrity.org

33 https://www.theguardian.com/news/2016/apr/03/what-you-need-to-know-about-the-panama-papers

34 http://www.iol.co.za/business-report/companies/1-700-south-africans-named-in-panama-papers-2026164

35 http://www.treasury.gov.za/publications/other/katz/3.pdf

36 In alignment with Section 216 of the South African Constitution

despite commitments made by various departments through the country 3rd National Action of the Open Government Partnership to increase overall government transparency and make information around beneficial ownership publicly available.

The South African government is yet to finalize the National Anti-Corruption Strategy. At the time of writing this submission, electronic copies of the draft were advertised in the media but were not available despite an announcement by the Department of Justice to undertake public consultations.

We therefore recommend that Committee make recommendations on how to strengthen key institutions responsible for ensuring that taxes are used to deliver public services.

We further call on the Committee to make recommendation on how to ensure effective, rigorous consultation based on best practice in the process of developing and implementing such mechanisms.

END