UNIVERSITY OF THE WITWATERSRAND, JOHANNESBURG

SCHOOL OF ACCOUNTANCY

Research Report submitted to the Faculty of Commerce, Law and Management in partial fulfilment of the requirements for the degree of Master of Commerce

Taxation in Agriculture:
A comparative analysis between Australia, New Zealand and South Africa

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DECLARATION

I declare that this research report is my own unaided work. It is submitted for the degree of Master of Commerce at the University of the Witwatersrand, Johannesburg. It has not been submitted before for any other degree or examination in any other university.

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ABSTRACT

Agriculture is important to the economy and should reduce inequality by creating an environment that is susceptible to creating employment opportunities and ensuring food security (USAID). These factors are the reasons why countries have forgone the opportunity to maximise tax revenue and instead provide certain concession for farming operations.

There is a view that though governments need to make investments in agriculture, these investments should not harm producers elsewhere. (OECD, 2019a)

By integrating qualitative reviews and comparative synthesis, this study employed a comparative methodology. This study critically analyses the South Africa tax provisions in Agriculture with Australia, New Zealand and OECD guidelines

The main findings of the study are that:

- Tax concessions are common across countries and that the typology of taxes levied generally fall within a set category. (OECD, 2005)
- South Africa provides slightly more concessions than Australia and New Zealand, however the impact of these concessions differ in accordance with the nature and objectives of the concession;
- Tax incentives in the farming sector improve the income of farmers directly and are not necessarily focused on the consumers or improving access to food; and
- That continued existence of certain concessions may be counterintuitive to economic growth and environmental sustainability goals.

Key Words: Farmer, Employment, Food Security, Agriculture, Farming Operations, Taxpayer, Concessions, tax measures, taxation

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I thank God for giving me the strength and ability to start and experience this journey. I appreciate the opportunity to learn and understand my country's economic history and appreciate the opportunities that lie ahead.

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A special thanks to my family, you have been a great inspiration. Thank you for the love and support throughout this journey.

DEDICATION

This study is dedicated to my late beloved grandmother, Clara Ramabulana, who taught me the power that education has in changing one's circumstances. I have promised her to be a perpetual learner and that I will flourish and make her proud. I know you are celebrating from the heavens above.

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LIST OF ACRONYMS

ACT/ ITA	Income Tax Act 58 of 1962
AU	African Union
AUD	Australian Dollar
CGT	Capital Gains Tax
CIT	Corporate Income Tax
CSARS	Commissioner of South African Revenue Services
GDP	Gross Domestic Product
ITC	Income Tax Court
NZD	New Zealand dollar
OECD	Organisation for Economic Co-operation and Development
PSE	Producer Support Estimate
PIT	Personal Income Tax
R&D	Research and Development
SAICA	South African Institute of Chartered Accountants
SARS	South African Revenue Services
SCA	Supreme Court of Appeal
TBVC	Transkei, Bophuthatswana, Venda and Ciskei
TBVS	Tax Benchmarks and Variations Statement
TES	Tax Expenditure Statement
VAT	Value Added Tax

1. INTRODUCTION

1.1. Introduction and Background to the study

South Africa's adoption of the 1996 Constitution was not only a big breakaway from its previous segregation policies but it also "marked the enactment of one of the world's most liberal constitutions". Amongst the provisions introduced under the constitution are rights that are aimed at ensuring the physical well-being and health of all South Africans, including the right to food" (Koch, 2011). Section 27(1) of the Constitution states that "Everyone has the right to have access to— (a) health care services, including reproductive health care; (b) sufficient food and water..." Section 27(2) further places a duty on the state to "take reasonable legislative and other measures, within its available resources, to achieve the progressive realisation" of each of these rights."

Internationally, the human right to food was enacted a lot earlier. "The human right to food came into effect in international law as part of the International Covenant on Economic, Social and Cultural Rights of 1966. (Koch, 2011). Article 11 of the International Covenant on Economic, Social and Cultural Rights of 1966 places an obligation on member states "to recognise the right of everyone to adequate food and requires active interventions on the part of states to counteract hunger." In 2015, South Africa became the 163rd State Party to the International Covenant on Economic, Social and Cultural Rights of 1966.

Clarity of this obligation is provided in General Comment No. 12 of the International Covenant on Economic, Social and Cultural Rights of 1966 which indicates that the right to adequate food is realised "when every man, woman and child, alone or in community with others, has physical and economic access at all times to adequate food or means for its procurement." Therefore, the obligation is not explicitly placed on the state to physically provide food to its citizens but the obligation is more implicit and requires the state to rather make food accessible, this obligation still calls for an investment in the means through which food is produced being agriculture. (Koch, 2011)

The above being said the agricultural sector remains an important component of the South African economy, largely to realise the right to adequate food but also for the contribution made to the economy at large. The OECD acknowledges that the agro-food complex, which includes both farming and processing industries, has a larger network of backward and forward linkages compared to the primary sector alone. This implies that the connections between the agricultural production and the various suppliers of inputs, as well as the distribution and consumption channels, are more extensive and intricate within the agro-food complex. The importance of the entire value chain, from production to consumption cannot therefore be taken for granted when analysing and supporting the agriculture and food sectors. (OECD, 2020)

Supporting the agricultural sector including by e.g., putting in place tax measures and specific concession for the sector corrects market failure and help government reach its broader objectives of alleviating poverty in the country and may contribute to discharging the international and constitutional obligations to make food accessible. (Mogomo MN, 2022) "While government intervention is considered necessary to correct the market failure in agricultural production, it comes with its problems." (Mogomo MN, 2022)

"South Africa has what is known as a dual agricultural economy. On the one hand, there is a well-developed commercial sector; on the other, most people engaged in agriculture are involved in subsistence-oriented practices in rural areas. According to the OECD's report on South Africa, the "importance of agriculture in the economy is relatively low, accounting for around 2.5% of GDP, and 6% of employment." (OECD, 2020). If consideration was to be given to the entire value chain the conclusion could be slightly different. In 2011, Koch found that due to the "strong backward and forwards linkages to the economy, the agro-industrial sector accounts for about 12 per cent of GDP" (Koch, 2011).

Despite the much welcome technological advances, agriculture remains one of the most labour-intensive industries in South Africa and the world at large. In 2021, employment in the agriculture, hunting, forestry, and fishing sectors were estimated at 868,000, an increase of 17.3 percent as compared to employment in those sectors back in 2013 (Galal S, 2022). Despite South Africa having only 13% arable land (OECD, 2020), agriculture therefore remains the lifeblood of the South African economy and contributes significantly to food security. It is therefore not surprising that the Income Tax Act 58 of 1962 (the Act) provides for some tax concessions for "pastoral, agricultural or other farming operations".

In a 2005 study on Taxation and Social Security in Agriculture, the OECD opined that "special treatment of agriculture is commonplace and pervades the systems of taxation of income, property and asset transfer" (OECD, 2005). Past studies however suggest that the cost of subsidising agriculture specifically in developed countries as compared to developing countries is high. The estimated fee was about $245 billion in 2000, "which was five times the total development assistance received by developing countries" (Mokgomo NM, 2022).

In 2005, the OECD concluded that tax policies relating to agriculture differ from one country to another, however all tax policies can generally be categorised into the following typologies (OECD, 2005):

- "taxes on income, profits and capital gains;
- social security contributions (which are a mixture of tax, duty and insurance);
- taxes on payroll and workforce which concern farm operators as employers;
- taxes on property (including taxes on property transfer); and
- taxes on goods and services (including sales tax and VAT)" (OECD, 2005)

The other observation has been that most beneficiaries of government subsidies in all forms are those that generally farm on large pieces of land, in the main commercial farmers. Large scale farmers often do not follow the most environmentally friendly procedures in their farming processes and are yet the biggest beneficiaries. The impact of such incentive is marred and may though assisting the country in meeting production and food supply goals do it at the cost to the environment or even trade where there is oversupply (Mokgomo NM, 2022).

From the observation of tax systems of their then, thirty (30) or so member countries, OECD had learned that utilisation of fuel rebates on farm vehicles was one of the most used concession. Of most importance the OECD noted that in order to get a full understanding of the impact of the concessions that each country has in place, there is a need to understand the historical context of such concessions. According to the OECD, because some of these concessions have been in use for many years and little information is available on the historical context, continuance of some would seem to be more of a political stance than a question of impact. (OECD, 2005)

Besides the lack of historical context that could distort their measure of impact of concession for the agricultural sector, in South Africa, the concessions have not come without abuse mainly from the very farmers targeted to benefit. This is evidenced by the number of court cases that dealt with legal interpretation or application challenges over the past years. Recently, SARS published the Draft Guide on the Taxation of Farming Operations to assist in interpreting these concessions, an evaluation is therefore necessary to determine whether court precedents, SARS interpretation notes and guideline have resolved the application challenges that existed?

Furthermore, an evaluation will be made of how the concessions available to the South African agricultural sector, compare with those in other countries and whether they can bring the desired results of a productive sector and food security? In this instance a comparison of the tax regime applicable to farming operation in South Africa will be compared to that in other countries (including Australia, and New Zealand) and the literature on taxation of farming operations by the Organisation for Economic Co-operation and Development (OECD) specifically as illustrated in the publication *'Taxation in Agriculture'* will be reviewed.

1.2. The Research Problem

1.2.1. The Statement of the Problem

Background

Tax policies have an impact on the conduct, structure and behaviour of farmers, suppliers to the agricultural industry and those that bring agricultural products to markets. This can in turn influence the rate and extent of "innovation, productivity, and sustainability in the food and agriculture sector." (OECD, 2020) In another study focusing on the evaluation of economic and health Outcomes associated with specifically food taxes and subsidies, convincing evidence was found that "food taxes were associated with higher prices and reduced sales of taxed products". (Andreyeva T et al, 2022)

Amongst other reasons, the abovementioned impact makes it necessary for countries to incentivise the farming sector. Different countries have varying tax systems that can incentivise different farming enterprises. Some countries "incentivise farm investments by reducing taxable income through provisions for depreciation. In other countries, the tax system allows farmers to smooth income variations over time by using tax averaging." (OECD, 2020)

This report will investigate how government support mainly through tax policy influences farming in South Africa. This is done by reviewing existing literature on the impact of taxation on farming operations and by highlighting concessions specific to agriculture in Australia and New Zealand as compared to those in South Africa. The recommendations noted by the OECD in relation to Taxation in Agriculture will also be presented.

1.2.2. **The Sub-problems**

1.2.2.1. The first sub problem is to evaluate the South African tax provisions on agriculture based on the tax typology outlined by the OECD's publication of Taxation in Agriculture.

1.2.2.2. The four areas of interest identified by the OECD in relation to taxation in agriculture will be used to assess the impact of South African tax provisions in this report. The areas are:

1.2.2.2.1. "The impact of income taxes on income levels and variability

1.2.2.2.2. The impact of property taxes on farm transfers and structural adjustments

1.2.2.2.3. The impact of taxation on investment and innovation

1.2.2.2.4. The performance of tax instruments for improving environmental sustainability" (OECD, 2020)

1.2.2.3. The second sub-problem is to evaluate the tax provisions pertaining to Agriculture in Australia and New Zealand

1.2.2.4. The third sub-problem is to compare the South African tax farming provisions with Australia and New Zealand based on the types of tax typology identified. Lessons learnt from the OECD's research will also be summarised.

1.2.2.5. The fourth sub-problem is to analyse if the support provided to farmers assists the country achieve productivity and food security or simply put the realisation of the international and constitutional obligation to the right to adequate food.

1.3. Research methodology

In this study, a comparison was drawn to determine if there are any areas in South Africa's farming provisions that have not been addressed when compared with Australia, New Zealand and the OECD publication.

The study's research design was a comparative approach that was achieved through a qualitative desk review (Van Hoecke, 2015). The design was suitable as the study's intention was to learn and obtain a better understanding of other national legal system and promoting harmonisation of the law (Van Hoecke, 2015).

The sources that were analysed include journal articles, case law, thesis, research reports, income tax legislation (in the main that of South Africa (Income Tax Act 58 of 1962) and also of Australia (Income Tax Assessment Act, 1997) and New Zealand (Tax Administration Act, 1994)) and OECD report on *"Taxation in Agriculture.*

South African tax laws are mainly influenced and adopted from Dutch and English laws, hence the choice to compare the taxation of the agricultural sector with that of European Union (EU) countries that are also part of the commonwealth nations. To strengthen the validity of the comparison, New Zealand was elected as an additional comparative country because RSA, Australia and New Zealand belong to the Commonwealth, which is an organisation of 54 autonomous and equal countries (The Commonwealth 2013).

1.4 **Limitations**

The study is limited to the benefits provided by income tax laws to the commercial agricultural sector in terms of direct income tax savings that the sector gets. The study is also limited to the literature review of the three countries of focus namely South Africa, Australia and New Zealand. Lastly, due to its focus on tax concessions available to the sector, the study is limited in its assessment of the support provided to the sector but acknowledges that there are many other forms of government support.

1.5 **Chapters overview**

The Study is structured as follows:

Chapter 1: Introduction – The impact of taxation on Agriculture

This introductory chapter will introduce the background and significance of the research, the problems and sub-problems identified, the research methods used and the limitations to the study.

Chapter 2: A historical overview of South African agriculture and the role that taxation played

This chapter will provide a historical overview of South African agriculture and the role that the taxation played in the promotion of employment and food security.

Chapter 3: Taxation of farming in South Africa

This chapter will provide the legislative context of taxation of farming income and evaluate the requirements for the concessions as per available court precedent, South African Revenue Services (SARS) Interpretation Notes and guidelines. The chapter will also examine the Draft Guide on the Taxation of Farming Operations to establish if it provides the much-needed clarity on what comprises farming for purposes of benefiting from the concessions.

Chapter 4: Taxation of farming in Australia and New Zealand -A comparison between the taxation in South Africa; Australia and New Zealand and lessons learnt from OECD's publication on Taxation in Agriculture

This chapter will attempt to establish how South Africa's concessions compare to those in other countries. This will be achieved by comparing the farming operation tax in South Africa to those of other countries (including Australia and New Zealand) and reviewing the literature on taxation of farming operations by the Organisation for Economic Co-operation and Development (OECD).

Chapter 5: The Impact of overall support to farmers on production and food Security in South Africa

This chapter will analyse if the support provided to farmers assists the country achieve productivity and food security or simply put the realisation of the international and constitutional obligation to the right to adequate food.

Chapter 5: Conclusion

This chapter will summarise the findings of the study and propose areas requiring further research and/or opportunities for legislative development.

2. A HISTORICAL OVERVIEW OF SOUTH AFRICAN AGRICULTURE AND THE ROLE THAT TAXATION PLAYED.

2.1. Introduction

This chapter provides an overview of the South African taxation system with a special focus on South Africa's historical context and the role that taxation has played in shaping the South African agricultural sector and the dual system that exists to this day.

2.2. Background

In South Africa, taxation is as old as colonisation as it has been a part of South Africa since the early 1600s. Levying of tax commenced in the colonies where tax was imposed on property sales and customs taxes were imposed on goods imported specifically into the Cape Colony by the Dutch East India Company. Through various commissions of enquiry taxation transformed over the years to the point of national application and the system South Africa practices today. (Koekemoer AD et al, 2019)

2.3. Agriculture and tax in South Africa- a historical context

Taxation has an interesting history in South Africa, with many chronicles including of the hut tax; marriage tax; dog tax; livestock rate; poll (head/ general rate) tax and culmination into the Bambatha Rebellion of January 1906 in Natal. In 1850, the colonial administration initiated a system where traditional leaders would retain their titles and power in return of a stipend or the so-called hut tax. (Redding, 2000) Collection of this tax was apparently met with no resistance due to a few reasons and in the main, the fact that the tax was "tied to access to farm and grazing land, and people did not wish to lose that access." (Redding, 2000) The official formula of the time was simply "no tax, no land" and nonpayers could have their right to occupy land rescinded. (Redding, 2006)

In 1875, the hut tax was unilaterally doubled to fourteen shillings and yet the people still complied. This was followed by a promise which was later broken by the colonial administration to never increase taxes again. (Redding, 2000) It was only following the introduction of a poll tax that the people rebelled, dubbed the Bambatha Rebellion. The tax was not only viewed as a breach of the promise made in 1875 but said to be a pure impossibility by the chiefs who approached the magistrate and indicated that the people had experienced "dry and rainless years, coupled with the fact that all the arable land has been taken up by Europeans and Indians, who have forced us to use the poor, waste lands, soil that has now been thoroughly worked out". (Redding, 2000) The amount of agricultural "land available to Africans was strictly limited by the state from the 1880s onward." (Redding, 2006)

Today, South Africa's agriculture sector is said to be dualistic and consists of a developed commercial farming sector which co-exists with many subsistence farms. (OECD, 2006a) According to Bundy (1972), the dualist model of the South African economy is a misleading one given that "the distance between the races in economic, cultural, and political spheres was not an original state lessened by capitalist development, but rather the outcome of that development". Bundy concludes thus following a long analysis of how South African's agricultural economy evolved over the years, measuring the period since the rural African population's "pre-colonial existence as pastoralist
cultivators to their contemporary status: that of sub-subsistence rural dwellers" (Bundy, 1972)

According to Bundy, the transition into the now 'so called' dualist system can be credited to "the diminution of Africans' lands by conquest and annexation, the creation of 'reserves', the deterioration of these into eroded, overstocked and overcrowded rural ghettoes, and their function as the supply source of migratory labour." (Bundy, 1972) In Bundy's view the sudden land shortage caused by dispossession explains how those who were once herders and farmers became unable to provide a living ending up with a failed African agriculture in South Africa. (Bundy, 1972)

The 1930s were characterised by aggressive plans to establish native reserves (eventually culminating in the formation of the so called TBVC[1] states) (Redding, 2006). These unilateral plans (known as betterment schemes) which "imposed principles of scientific management on African agriculture in a misguided effort to make it more productive", were influenced by publication of the findings of the 1930–32 Native Economic Commission and did not take

[1] Bantustans known as Transkei, Bophuthatswana, Venda, and Ciskei

into consideration "how the vast majority of Africans was [sic] to raise enough food to survive in the rural areas." (Redding, 2006)

By some sheer luck or misfortune, the implementation of the betterment schemes was delayed by the outbreak of World War II in 1939, however implementation proceeded with earnest following the adoption of segregation policies in 1948 (Redding, 2006). The betterment schemes were highly unpopular amongst Africans, mainly due to their heavy reliance on practices such as cattle culling and fencing. (Redding, 2006) Unless well explained, the effect that these policies would have had on the number of animals that rural farmers could keep and the limitations in grazing lands would have of course been met with resistance.

So, the adoption of the segregation policies from 1948 onwards saw an emergence of policies and legislation that significantly limited the country's black population to agricultural land; financial support and overall agricultural development support related services. As a result, the gap between commercial and subsistence farmers widened greatly. (OECD, 2006b) Lack of access to productive farming land and the fact that Africans who had now been employed in industries were no longer sustaining themselves would have led to a high food demand which resulted in the thriving of commercial farmers.

White farmers reaped substantial advantages through extensive support from the government, which encompassed privileges such as credit access and technical assistance, expansion of the railway system, and assurance of fixed prices for their agricultural products. (Lahiff, 1997) Over the years the predominantly white commercial farming sector was supported through the assistance provided to farmers, including aid during droughts and floods, advantageous trade tariffs, subsidies on interest rates, tax benefits for purchasing farm machinery, and government investment in agricultural education, research, and advisory services. (OECD, 2006b)

OECD is of the view that the tax concessions on farm machinery has contributed to overcapitalisation of the agricultural sector in turn resulting in unemployment and low wages in the agricultural sector, Stats SA echoes this view. The commercial sector has been served by a largely unskilled black labour force which has been largely shed due to improvements in farming machinery and technology amongst other factors (perhaps including the wider definition of unemployment) over the years. According to Statistics South Africa (Stats SA, 2000) the commercial agricultural sector was the single largest employer, accounting for about 30% of all employment of black people living in the rural areas as of 1998. Recently this number has diminished significantly, an indication that the though still important, the agricultural sector's role is changing and technological advancement may see it more focused on production than employment.

3. TAXATION OF FARMING INCOME IN SOUTH AFRICA

3.1. Introduction

In South Africa taxation of farming operations income is mainly administered in terms of Section 26 of the Income Tax Act read with the First Schedule. "Section 26 stipulates the persons and circumstances that this section will find application while the First Schedule sets out how to compute the taxable income of the persons engaged in farming operations." (SARS Draft Guide, 2022)

This chapter will evaluate the taxation specific to farming operations with a focus on concessions available to South African farmers post 1994. This will be achieved by providing the legislative context of taxation of farming income and evaluating the requirements for the concessions as per the Act, available court precedent, South African Revenue Service (SARS) Interpretation Notes 69 and 79 and the Draft Guide on the Taxation of Farming Operations. The provisions of the Income Tax Act relating to the special regime for taxation of farming operations as stipulated in Section 26(1) of the Income Tax Act will be specifically considered.

The chapter will also evaluate the impact of taxation in agriculture by considering the four primary areas of interest developed by the OECD namely "the impact of income taxes on income levels and variability; the impact of property taxes on farm transfers and structural adjustments; the impact of taxation on investment and innovation; and the performance of tax instruments for improving environmental sustainability" (OECD, 2020)

3.2. Background

In almost 30 years since democracy, there has been limited progress in achieving significant transformation in South Africa's agricultural sector. White farmers continue to dominate the sector in terms of output. With the exception of wool, mohair, and cattle farming, the involvement of black farmers in the production of major agricultural commodities averaged only 5% in 2019. (Sihlobo W and Qobo M, 2021) South Africa has however since introduced several measures to bring more inclusivity into the sector including land redistribution programmes whose success or failures have been the subject of many studies. Black farmers are slowly starting to feature in the previously white dominated commercial farming space and those that make it into the commercial agricultural sector similarly benefit from the tax measures available to taxpayers in general and those concessions specific to the agricultural sector. Various subsidies outside the tax system exist and some are specifically targeted at increasing inclusiveness.

Since 1994, the South African government has enacted a series of institutional and policy reforms. These reforms encompassed several measures such as the discontinuation of marketing boards and the agricultural credit board, elimination of specific tax benefits, reduction in direct subsidies for inputs, introduction of new labour laws in the agricultural sector, initiation of land reform programs for land restitution and redistribution, and implementation of development initiatives aimed at providing research and development services to emerging farmers who have benefited from land reforms. (OECD, 2006b)

3.3. Taxation on farming operations

During the mid-1990s, the government made changes to the tax regulations pertaining to agriculture. Under the revised treatment, capital investments in the sector could be deducted over a span of three years, with annual rates of 50%, 30%, and 20% respectively. This adjustment effectively reduced the implicit subsidy previously provided for capital equipment, which had been allowed to be fully deducted within a single year. (OECD, 2006b).

In 2000, South Africa introduced the Diesel Refund System which provides refunds on tax and road accident fund levies paid when purchasing diesel fuel by qualifying sectors on their qualifying consumption. "The diesel refund is governed by the Customs and Excise Act, but is administered through the VAT system, which requires a person to be registered for VAT." (SARS, 2023) The concession amount to approximately 31.6% refund of the fuel levy and 100% refund of the road accident fund levy. Farming, mining, and the forestry sectors are beneficiaries of this concession. (OECD, 2006b)

The Value-Added Tax Act 89 of 1991 also provides a "special dispensation to a vendor that carries on agricultural, pastoral or other farming activities" (SARSb) this allows farming operations to purchase certain goods at zero rate or import without VAT duty. This applies strictly for goods that will be utilised by the farming operation e.g., animal feed and medicine; fertiliser; pesticides; seedlings and seeds. (SARSb) The OECD critises this incentive for the potential it must increase "use of pesticides and fertilisers due to discounted value added taxes" (OECD, 2005)

Paragraph 13 of the First Schedule provides South African farmers who are compelled to dispose of their livestock due to drought, stock disease, damage to grazing by fire or plague and livestock-reduction schemes during a particular year of assessment to within five years (5) of the occurrence deduct expenditure for replacement stock. In this case the farmer has an option to make the deduction from the income of the year in which the disposal was made (provided that SARS was duly notified) or from the year that the replacement livestock is bought. In instances where livestock was disposed of in response to a government call for livestock reduction, the farmer has ten (10) years within which to claim the deduction. (Koekemoer AD et al, 2019)

The growing of timber constitutes farming operations in South Africa and farmers in this regard are allowed tax deduction for the cost of trees; cost of planting the trees and cost of tending, thinning, weeding and maintenance of the trees in term of paragraph 15(1)(a) of the First Schedule. (Koekemoer AD et al, 2019) The case of Kluh Investments v SARS has clearly set precedent on the fact that the plantation and the land on which it is grown are treated different for tax purposes. So, owning the land on which someone else grows a plantation does not entitle the landowner of paragraph 15(1)(a) concessions when disposing of the land. The farmer is the plantation owner and not the landowner in such case.

Para 4(1)(b) of the First Schedule allows deductions for income tax purposes the market value of livestock held by the farmer at commencement and recommencement of farming. In instances where a farmer has died and an executor commences farming, the concession will not apply to the executor. In a similar vein, para 12 of the First Schedule allows a farmer who personally incurred expenditure in connection to his own farming operation, to deduct any developmental expenditures including control of alien or invasive plants; the expenditure for prevention of soil erosion; erection of dipping tanks, dams/boreholes, fences, roads/bridges, electrical connections etc. Expenditures on control of alien or invasive plants and prevention of soil erosion are deemed to always create loss and therefore to be always deductible whereas expenditures on the other items cannot create loss and are limited to available taxable farming income (Koekemoer AD et al, 2019).

To claim development expenditure in terms of para 12 of the First Schedule, the farmer need not be the owner of the farming property (CSARS v Kluh, 2016). As a general rule deductions cannot be made for any developmental expenditure in relation to the farmer's own dwelling, even if it on the farm (Koekemoer AD et al, 2019).Though the farmer may claim for the cost of labour and materials used in line with paragraph 12 (1) of the First Schedule, expenses incurred for machinery or plant equipment utilised to carry out the works is not deductible.

Regarding labour related expenditures, paragraph 12 of the First Schedule allows the wages of employees who were employed to carry out the capital works to be deducted as part of the cost of the capital cost. Other payroll related taxes would then be dealt with per the normal pay as you earn provisions and tax threshold set therein (Koekemoer AD et al, 2019).

Farmers (excluding companies) whose farming land is acquired or expropriated by the state, local authority or specified juristic person are also entitled to a special tax concession in the tax year in which such farming land was acquired. The tax payable on the excess profit stemming from the acquisition is then multiplied at the lowest rate per the tables. The Draft Guide also indicates that paragraph 65 of the Eighth Schedule to the Income Tax Act may apply to defer the capital gains tax on the disposal of the land. This would be a fair approach considering that the disposal was not voluntary (SARS Draft Guide, 2022).

Section 9HB provides that no capital gains tax payable in instances where a farmer has bequeathed his livestock and/ or produce to his spouse on the date of death. The immovable property is however treated as proceeds and is subject to capital gains tax in line with applicable the Eighth Schedule to the Income Tax Act (Koekemoer AD et al, 2019).

In instances where one's asset has been destroyed, stolen, or disposed of in accordance with the law, paragraph 65 of the Eighth Schedule to the Income Tax Act enables a taxpayer including farmers to defer a capital gain obligation. The condition for deferment being that an expenditure of at least the same value as the receipts and earnings from the disposal has been or will be used to obtain one or more substitute asset(s), and the proceeds from the disposal must be equal to or greater than the initial cost of that asset. SARS Draft Guide, 2022).

Section 12B of the Income Tax Act is also an important tool as it provides for a 50% in the first year; 30% in the second year and 20% of the cost in the third year as a special depreciation allowance deduction on machinery, implements or articles (excluding livestock) which are brought into use for the first by the farmer in his farming operations and owned by through an instalment credit agreement. Motor vehicles aimed at conveying passengers; caravan; air crafts and office furniture are amongst the items specifically excluded from the ambit of the provision.

A special dispensation for farming operations also exists through section 26(1) of the Act read with the First Schedule. The requirements of section 26(1) will be discussed in more detail below. Besides the First Schedule, those carrying on farming operations may also be entitled to deduction of expenses from taxable income in terms of section 11 pertaining to general deduction allowed in determination of taxable income. These deductions include amongst others certain legal expenses that may been incurred by the taxpayer during the year of assessment; sums expended for the repair of machinery, implements, utensils and other articles employed by the taxpayer for the purposes of his trade.

Section 26(1) of the Income Tax Act (the Act)[2] stipulates that the calculation of taxable income for individuals engaged in pastoral, agricultural, or other farming activities shall be based on the regulations outlined in this Act, with consideration given to the guidelines specified in the First Schedule. Therefore section 26 (1) broadly provides for the persons and circumstances under which tax gets determined for income that is derived from farming operations. The First Schedule to the Act then provides how taxable farming income should be computed (SARS Draft Guide, 2022).

To understand the application of section 26 (1) of the Act and reap its full benefits, it is important to comprehend the meaning embedded in its key terms which include "taxable income"; "person"; "carrying on pastoral, agricultural and other farming operations". The

[2] Income Tax Act 58 of 1962

first two phrases are defined in section 1 of the Act and but to reiterate their definitions in order to provide context to the reader, not much time will be spent in their meaning.

3.3.1. **Taxable Income**

The term "taxable income[3]" is defined in section 1(1) of the Act and means the aggregate of:

> "(*a*) the amount remaining after deducting from the income of any person all the amounts allowed under Part I of Chapter II to be deducted from or set off against such income; and
> (*b*) all amounts to be included or deemed to be included in the taxable income of any person in terms of this Act;"

The First Schedule strictly applies to income or loss that is derived from farming operations and therefore will not apply to income that a farmer may have derived from non-farming operations, the normal income tax rules will apply to the latter income. (SARS Draft Guide, 2022)

The SARS Draft Guide indicates that when declaring income on an income tax return, special provision has been made to select that its for farming income. A farmer will therefore be able to declare farming income as well as non-farming income separately on a return." Once income from farming operations is determined it will be combined with other taxable income that the farmer may have derived from other sources to form the taxpayer's overall taxable income. (Williams, 2006)

In addition to understanding the meaning of the terms in section 26(1), it is imperative that farmers keep an accurate record to enable them to demonstrate the direct connection between their income and its source, especially when involved in farming operations and other business activities. This will ensure that the correct tax rules are applied and that the taxpayer is not subject to unnecessary penalties or disputes with SARS.

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[3] In terms of section 1(1), the term "income" means "the amount remaining of the gross income of any person for any year or period of assessment after deducting therefrom any amounts exempt from normal tax under Part I of Chapter II".

3.3.2. **Person**

Section 1 of the Act defines the word 'person' to include an insolvent estate; a deceased estate; any trust; and any portfolio of a collective investment scheme. The definition of 'person' in the Act has developed over the years to specifically exclude foreign partnerships. In terms of section 24H of the Act partnerships are generally considered to be tax-transparent entities in South Africa, meaning that the partnership itself is not taxed on its income, but rather the partners are taxed on their share of the partnership's income.

3.3.3. **Carrying on pastoral, agricultural and other farming operations**

The term "carrying on pastoral, agricultural and other farming operations" or each of the phrases contained in that term are not specifically defined in the Act. In terms of the SARS Draft Guide (2022), "guidance must be sought from its grammatical meaning, legislation and from case law".

From a judicial perspective, two schools of thought prospered until the Supreme Court of Appeal's decision in the CSARS v Smith[4]case in 2002. The first view was that a subjective criterion should be applied to determine whether a taxpayer was carrying on pastoral, agricultural and other farming operations. The enquiry would then be whether the "taxpayer intended in good faith to engage in farming operations". (Katzke, 2009) The other view was an objective one premised on the factual question of whether the "farming operations had an objectively reasonable prospect of profitability"? (Katzke, 2009) In this regard the determination would be made based on a case-by-case basis.

In 2002, the case of *CSARS v Smith* came before the SCA, this was a watershed decision in that it urged some legislative amendments "to limit the ability of taxpayers to set off assessed losses from secondary trades against profits from primary trades." (SAICA, 2003) Section 20(2) defines assessed losses as "any amount by which the deductions admissible under section 11 exceeded the income in respect of which they are so admissible."

[4] *CSARS v Smith* 2002 (6) SA 621 (SCA)

Dr Smith was a medical professional who in 1982 purchased a farm with the intention of using it for stock farming. This weekend activity unfortunately brought him consistent losses leading him to convert his focus to game farming instead. He later sold a portion of the farm in 1990 which he found unsuitable for game farming. In 1993 he disposed of the remaining portion apparently due to ill health. A few weeks later he purchased a well-stocked game farm which he further improved, however business did not go well for him and he disposed of that farm in 1996. He then claimed losses in his income tax return for 1992 until 1995,

SARS was however of the view that Dr Smith had not been carrying out a genuine farming operation within the provision of section 26(1) and could not be entitled to set off the losses against his income. According to SARS, Dr Smith's business had never had or shown the possibility of turning a profit which is expected of any other trade including farming (SAICA, 2003)

Dr Smith's appeal to the Special Tax Court succeeded in that the court considered the evidence placed before it and made an objective consideration. According to the court despite lacking a prospects to generate profit during the years in question, the person consistently undertook farming activities with a sincere intention to eventually achieve profitability. This conclusion was drawn based on a holistic consideration of the taxpayer's testimony and objective factors that were used to evaluate the evidence, including the property's size, suitability, the time and effort invested in its management, and the likelihood of profitability. The court did not find any of the factors conclusive when considered in isolation.(SAICA, 2003)

SARS then approached the SCA and the court had to determine whether the court a quo' interpretation of section 26(1) and conclusion was appropriate. The SCA held that in its ordinary meaning, the phrase 'carrying on farming operations' can be subjected to different interpretations but that in the context section 26(1) the phrase can be interpreted to simply mean "'a particular form or kind of activity' or it could bear a more commercial nuance, 'a business activity or enterprise'." The court was of the opinion that section 26(1) was intended to apply to profit making activities as there is no reason why the legislature would have wanted those who farm as a hobby to benefit from the concessions provided. So, an objective enquiry into the farming operations had an objectively reasonable prospect of profitability cannot according to the court be elevated above the subjective enquiry. (SAICA, 2003)

In 2005, SARS closed the debate above by introducing section 20A into the Act. Section 20A became effective in retrospect from 1 March 2004 and ring fences or limits instances where a taxpayer can claim losses made. Section 20A provides that:

1) Subject to subsection (3), where the circumstances in subsection (2) apply during any year of assessment in respect of any trade carried on by a natural person, any assessed loss incurred during that year in carrying on that trade may not be set off against any income of that person derived during that year otherwise than from carrying on that trade, notwithstanding section 20(1)(b).

2) Subsection (1) applies where the sum of the taxable income of a person for a year of assessment (determined without having regard to the other provisions of this section) and any assessed loss and balance of assessed loss which were set off in terms of section 20 in determining that taxable income, equals or exceeds the amount at which the maximum marginal rate of tax chargeable in respect of the taxable income of individuals becomes applicable, and where –

   (a) that person has, during the five-year period ending on the last day of that year of assessment, incurred an assessed loss in at least three years of assessment in carrying on the trade contemplated in subsection (1) (before taking into account any balance of assessed loss carried forward); or
   (b) the trade contemplated in subsection (1), in respect of which the assessed loss was incurred constitutes –

      (iv) ……………………;
      (v) …………………….;
      (vi) farming or animal breeding, unless that person carries on farming, animal breeding or activities of a similar nature on a full-time basis;"

Part time farming is listed as a tainted trade in terms of section 20A and those engaging on it on a part time basis will not be able to set off the losses incurred therein against any other income earned during the period of assessment. (Grotepaas, 2018)

3.3.4. 'Pastoral' and 'Agricultural'

The Act does not define the phrase "pastoral". However, in line with the view that guidance should be sought from its grammatical meaning and case law, the SARS Draft Guide (2022) relied on the definition of "pastoral" as defined in Lexico.com which "refers to the use of land for keeping or grazing of sheep or cattle." In terms of the SARS Draft Guide (2022) "Goat farmers, pig farmers and game farmers will also be considered as conducting pastoral farming operations." The said definition is also in line with the term as utilised by the African Union which views pastoralism as "a way of life based primarily on raising livestock, particularly small ruminants, cattle and camels." (AU, 2010) The type of livestock could then depend on what each region domesticates.

"Agriculture" is also not defined in the Act and the guide borrows the definition of the term from the Merriam-Webster Dictionary and means "the science, art, or practice of cultivating the soil, producing crops, and raising livestock and in varying degrees the preparation and marketing of the resulting products." In terms of the guide "keeping of livestock for the sale of its meat, dairy farming and raising sheep for wool also fall under the category of farming." The Agricultural Research Council Act[5] defines agriculture as "the utilization of the means of production and the utilization by man of the natural agricultural resources for the production of, among other things, sufficient food, fibre and drink of quality".

The English law definition is a bit more broad and defines agriculture to include "horticulture, fruit growing, seed growing, dairy farming and livestock breeding and keeping, the use of land as grazing land, meadow land, osier land, market gardens and nursery grounds, and the use of land for woodlands where that use is ancillary to the farming of land for other agricultural purposes, and "agricultural" shall be construed accordingly."

3.3.5. Carrying on farming operations

With reference to the discussion on what 'carrying on pastoral, agricultural and other farming operations' above, it is clear that even prior to the Smith case and the amendment that lead to the ring-fencing provision SARS's interpretation of section 26(1) was to somehow sniff out

[5] Agricultural Research Act no. 86 of 1990

taxpayers trying to abuse the system by setting off losses acquired from their hobbies from the favourable concessions aimed at those legitimately carrying on 'pastoral, agricultural or other farming operations. (Katzke, 2009) According to Kabot (2014), when a transaction potentially involves tax avoidance, it becomes less probable that a taxpayer will provide an unbiased or objective statement regarding their intention. It would be unrealistic to assume that the taxpayer's declared intention would remain unaffected by the inclination to evade taxes.

It is therefore not sufficient that the income in question was derived from a farm, the taxpayer should have been carrying on farming operations. In the Commissioner of Inland Revenue v D & N Promotions (Pty) Ltd[6] case, dealt with the question of whether interest income received by a taxpayer from a cooperative should be considered as part of their "farming income" for tax purposes. The taxpayer argued that the interest income was directly linked to their farming activities, while the Commissioner of Inland Revenue argued that it was not. There must be a direct correlation between the income generated and its source, which is the farming operations encompassing various agricultural activities. An indirect or distant connection will not be considered sufficient. (SARCc)

The court in Commissioner of Inland Revenue v D & N Promotions (Pty) Ltd case ultimately found that the interest income received by the taxpayer was not directly linked to their farming activities and therefore could not be considered part of their farming income. The court noted that while the taxpayer was a member of the cooperative and earned interest on their account with the cooperative, this did not necessarily mean that the interest income was directly related to their farming activities. To be recognised as a farmer and qualify for the application of Section 26 of the Income Tax Act, it is not enough for an individual to solely earn income from farming. They must also actively engage in farming operations in order to meet the criteria of being classified as a farmer (Grotepaas, 2018)

The term "farming operations" is also not defined in the Act, according to the Guide the term should be interpreted according to its ordinary meaning as applied to the subject matter with regard to which it is used. The enquiry is a factual one and whether a taxpayer is genuinely

[6] *Commissioner of Inland Revenue v D & N Promotions (Pty) Ltd (1993, NPD), 55 SATC 89, (1993)*

carrying on farming operations depends on the facts of each case. (CSARS v Kluh Investments case[7] and SARS 2022)

The Guide points us out to consideration laid down in the ITC 1698[8] case which indicated that the following factors though not conclusive assist to establish whether a taxpayer is carrying on a farm operation:

> "The size and location of the property on which the operation is being conducted, the portion of that property being used for that purpose, capital expenditure, turnover, labour, the regularity and purposefulness of the activity, the time and effort spent thereon by the taxpayer in relation to his other gainful activities, if any, and the existence of a real prospect of profit (or lack thereof). The list is not exhaustive and the permutations of such activities are infinite. None of these considerations is necessarily in itself decisive."

As discussed above, application of section 26 (1) of the Act has led to various interpretations and disputes most of which were resolved through the courts. Most of this was probably fuelled by the growing interest for diversifying farming operations in South Africa, possibly as a means of generating additional income and reducing risk. Farmers in South Africa and across the world diversify their farming operations for several reasons, including enabling them to manage risk associated with specific crops, livestock, or markets. (Kahan, 2009) in this manner farmers can spread their risk and be less vulnerable to external factors such as weather, disease outbreaks, or price fluctuations.

Diversifying farming operations can create new revenue streams and increase overall income. For example, a farmer who grows citrus fruit may also start a small-scale vegetable farm or a tourism operation on their land. (Delgado, 1997) Diversifying farming operations can also help farmers tap into new markets or customer segments. For instance, a farmer who previously only sold their produce to wholesalers may start selling directly to consumers through farmers' markets or online platforms.

[7] *Commissioner, South African Revenue Service v Kluh Investments* (Pty) Ltd [2016] ZASCA
[8] *ITC 1698* (2000) 63 SATC 161 (SEC) at 170

Taxpayers should also be aware that in certain instances, their additional activities may fall outside the ambit of section 26(1) and not meet the criteria for the concessions meant to benefit farmers. It is hence crucial that farmers understand the instances when section 26(1) applies; the ring-fencing provisions and keep accurate records of their income and expenses related to the diversified operations and appropriately report this income on their tax returns. Farmers should therefore keep in mind that diversifying their operations can have significant tax implications or even trigger additional tax obligation.

In instances where activities fall outside section 26(1), farmers will then be taxed as per the ordinary income tax provisions. The Guide (SARS, 2022) has in line with some cases that dealt with similar facts, provided examples of such instances and this include instances where a farmer may derive income from providing agricultural services to other farmers including fruit packing; transporting or harvesting their crop. It appears too that should a farmer sell minerals; sand or gravel off his land or manufacture food products such as wine or jam from a harvest sourced from another this will not fall in the ambit of section 26(1) but could be taxed as a manufacturing process and perhaps qualify for certain deduction under section 12C.

Income derived from renting out farming property is also excluded from the application of section 26(1) on the basis that the lessor is deriving such income based on the fact that he owns the land and not because he is undertaking farming operations. (ITC 1665) This unless the rental agreement is structured in such a manner that the lessor becomes entitled to a percentage of the yielded crop or livestock in which case the lessor will be deemed as a person undertaking farming operations. (Williams, 2006; SARS, 2022) Interestingly in an instance where a lessor who has leased out land for farming purposes, incurs expenses pertaining to the construction of soil erosion works, section 17A allows a deduction to the lessor "provided a certificate by the Executive Officer designated under section 4 of the Conservation of Agricultural Resources Act, 1983 (Act No. 43 of 1983), or his assignee is produced to the effect that such works have been approved under the provisions of the said Act." Section 17A applies regardless of the fact that the rental income derived is not from farming operations and hence not falling within the ambit of section 26(1).

Where the diversified operations involve selling goods or services, farmers may need to register for VAT. This means they will need to charge VAT on their sales and submit regular

VAT returns to the South African Revenue Service (SARS). Should the diversified operations involve buying or selling assets, such as land or equipment, farmers may be subjected to Capital Gains Tax. Farmers should hence keep records of the purchase price, any improvements made to the asset, and the sale price to enable them to calculate the capital gain or loss.

In certain instances, farmers who may feel philanthropic and identify a need to donate a portion of their land to a community or non-profit organization should be aware that such donation may be subject to donations tax. Donations tax is levied at a flat rate of 20% on the cumulative value of property donated provided the property does not exceed R30 million and at a rate of 25% on the cumulative value of donated property exceeding R30 million. (SARS) "However, should the land be disposed of by way of donation in terms of the Land Reform Programme, as contemplated in the White Paper on South African Land Policy, 1997 and which has been approved of by the Minister of Land Affairs or if the land in question was acquired under a land reform initiative, no donations tax will be payable on the value of such land under section 56(*o*)" of the Income Tax Act. (SARS Draft Guide, 2022)

Diversifying farming operations can also impact estate planning. If a farmer passes away, their estate may be subject to estate duty. Estate Duty would be levied in this instance on the farmers' "worldwide property and deemed property of a natural person who is ordinarily resident in South Africa and on South African property of non-residents." (SARS). So farmers specifically those that operate as sole proprietors should therefore seek professional advice to understand this implication.

Diversification can take many forms including what SARS calls supplementary operations, such as "the sale of manure; the sale of firewood; the letting of grazing rights if the rental amount is derived from farming proceeds; the sale of plantation and forest produce; prize money received, for example, best wool or biggest pumpkin; or compensation received from the Government for the compulsory destruction of livestock due to disease. (SARS, 2022)

In conclusion, while diversifying farming operations can be a great way to generate additional income and reduce risk, farmers should be aware of the potential tax implications. It is hence imperative for farmers who elect to diversify their operations to ensure that they are fully cognisant and compliant with South African tax laws. Additional tax obligations should also be factored in for instances where the additional activities fall outside the scope of section 26 of the Income Tax Act.

3.4. The impact of taxation in agriculture

As indicated above South African farmers benefit from a number of concessions either specifically targeted at the South African agricultural sector or the general concessions that may be available to other sectors as well. As per the OECD's assessment this tax provisions whether concessional or not have a considerable impact on income in the farming sector; farming input required from time to time; farm transfer arrangement e.g. when a farmer dies and also decisions to invest.(OECD, 2020)

South Africa "the impact of income taxes on income levels and variability

According to the OECD (2020), income tax includes both personal income tax where the farm is operated by a sole supplier and corporate income tax in instances where the farming enterprise has been incorporated. Personal and corporate income tax are criticised for their negative impact on production and are said to be "the most harmful for a country's overall economic growth". (OECD, 2020)

The caution by the OECD is that policy makers should be careful not to utilise tax as an instrument that discounts activities that will most likely lead to economic growth. (OECD, 2020) So the emphasis is on structuring the tax in such a way that maximum benefits are derived without unreasonably hampering economic growth. Tax expenditure is also favoured by the OECD with the understanding that this will provide an advantage to farmers by reducing their tax liability instead of offering direct cash. (OECD, 2020)

Tax expenditure expenditures include the following:

- Special systems for valuing income: In South Africa this is provided by the First Schedule to the Income Tax Act read with section 26 of the Income Tax Act which intimately defines instances where income is classified as income derived from farming operations for tax purposes. Provided that the section 26 requirements are met, farmers can then benefit from the concessions in the Fifth Schedule.

- Tax averaging systems or tax smoothing: In a 2020 study which considered "the validity of existence of tax smoothing hypothesis in South Africa and Turkey by examining the relationship between budget surpluses and government expenditures" (Karakas and Turan, 2020) concluded does not exist in South Africa. In Australia, tax averaging was hailed as a useful tool to assist farmers to manage fluctuations that farmers may experience in primary income moreso, in areas like horticulture where there could be high income volatility. (OECD, 2020)

- Special property tax valuations: Section 139 of the Constitution, municipalities across South Africa have the right to value properties for rates purposes in order to earn income for the municipality. The rates differ per municipality and value of the property. Income derived from renting out farming property is excluded from the application of section 26(1) of the Income Tax Act given that it is not income derived through farming operations but merely on the basis of the farmer owning the property. (ITC 1665) In this case such income will be taxed like any other and will not benefit from the concessions in section 26 of the Income Tax Act.

The OECD (2020) also highlight that tax allowances for depreciation expenses similar to what section 12B of the Income Tax Act provides but most specifically where accelerated depreciation provisions are allowed can assist in reducing the tax burden on farmers. The understanding is that investments in depreciable assets typically occur in high income years and any deductions allowed will reduce the tax burden. (OECD, 2020)

The impact of property taxes on farm transfers and structural adjustments

OECD is of the view that property and consumption taxes are more progressive and would benefit a country's overall economic growth more than income taxes would. (OECD, 2020) Section 9HB provides that there is no capital gains tax payable in instances where a farmer has bequeathed his livestock and/ or produce to his spouse on the date of death, this does not however extend to the transfer of the land. Furthermore, where a farmer donates land, donations tax is levied at a flat rate of 20% on the cumulative value of property donated provided the property does not exceed R30 million and at a rate of 25% on the cumulative value of donated property exceeding R30 million. (SARS) Exemption to pay donations tax only apply in instances where the donation is in terms of the Land Reform Programme, as per the White Paper on South African Land Policy, 1997 (SARS Draft Guide, 2022)

The OECD (2020) is of the view that if countries levy high taxes on inherited properties this may place an undue burden of the successor farmer and may lead to a need to sell off part of the land to at least maintain liquidity. The burden may also hinder intergenerational farm transfers or discourage successors from proceeding with farming operations.(OECD, 2020)

The impact of taxation on investment and innovation

Research supports the notion that in instances where there is accelerated depreciation on machinery and equipment, farmers tend to invest more in machinery but in certain instances may lead to farmers investing in machinery and implements that they do not need for their operations. (OECD, 2020) As noted elsewhere in this paper in South Africa some of job losses in the sector are blamed on the technological advances that are made possible by excess incentives to the sector.

The OECD (2020) also found that concessions aimed at research and development are depending on their structure most likely to benefit the farmers directly and not society at large. To curb this and manage a situation where most of the benefits accrue to producers, the OECD recommends that countries should introduce a collaboration premium for farmers who choose to collaborate with public funded research organisations e.g. the Agricultural Research Council in South Africa on research and innovation. (OECD, 2020) The "Australian system of Rural Research and Development Corporation – which are co-financed through producer or industry levies and matching funds from the Australian government" (OECD, 2020) are said to be performing particularly well.

OECD noted further that where countries wish to promote long term research and development, tax incentives might not be the most effective instrument and research grants could be more useful. There is however an opportunity to utilise tax incentives to encourage research for innovations that are ready to be brought to market. (OECD, 2020)

The performance of tax instruments for improving environmental sustainability

OECD (2020) has highlighted linkages between the use of taxes that are levied on e.g. farmers in order to change behaviour specifically with regard to reducing pollution e.g. the carbon tax in South Africa. This is said to be more beneficial where the tax levied is instead of being thrown into the pool, strategically directed to e.g. research and development.

The OECD noted that in most countries, "majority of emissions from the agricultural sector are either not taxed at all or are taxed at a very low rate (5% or under)" (OECD, 2020) Mostly criticised is the fact that many countries including South Africa still offer tax concessions on e.g. diesel consumed in farming operations. In South Africa the diesel refund is governed by the Customs and Excise Act but is administered through the VAT system. Continuance of this tax incentive including the rebate on fertiliser and related input is seen to be counterintuitive to environmental sustainability efforts.(OECD, 2020)

Recently, South Africa has introduced a rebate to the value of 25% of the cost of new and unused solar photovoltaic (PV) panels, up to a maximum of R15 000 per individual. Section 12B of the Income Tax Act provides businesses with a 125% tax incentive – for new and unused energy assets such as wind, solar PV, concentrated solar, hydropower and biomass. The call for utilisation of green energy might be responded to slower probably because fuel duty is an available alternative.

3.5. Conclusion

South Africa's land ownership dynamics have not changed much since 1994 and the agricultural sector is still mainly white dominated, however despite the cost issues to accessing land, the tax measures and concession opportunities in our tax system is inclusive and available to anyone carrying on pastoral, agricultural and other farming operations. This is provided that one meets the requirement outlined in this study as per section 26(1); the applicable judicial interpretation and the clarity provided by the SARS Guide. Taxation can go a bit further in terms of concessions that enables access to land specifically by new entrants.

The case of *CSARS v Smith* has largely clarified the interpretation issues that existed regarding what it means to carry on farming operations. The SCA concluded that the phrase is capable of several meanings but that there is no doubt that section 26(1) was intended to apply to profit making activities as there is no reason why the legislature would have wanted those who farm as a hobby to benefit from the concessions provided. This further urged the legislative amendments that included part time farming as a tainted trade in terms of section 20A of the Act. This goes a long way in eradicating abuse of the concessions and ensuring that they are utilised where they are most needed.

Diversifying one's farming operations does not only provide farmers with additional income streams but is a much-needed risk management strategy considering the external factors such as weather, disease outbreaks, or price fluctuations that continually affect the sector. Farmers should however be aware of the potential tax implications and comply to maximize the benefits of diversification and prevent disputes.

4. TAXATION ON FARMING IN AUSTRALIA AND NEW ZEALAND- A COMPARISON BETWEEN THE TAXATION IN SOUTH AFRICA; NEW ZEALAND AND AUSTRALIA AND LESSONS LEARNT FROM OECD'S PUBLICATION ON TAXATION IN AGRICULTURE

4.1. Introduction

This chapter will attempt to establish whether South Africa's tax concessions go far enough to promote the agricultural industry. The literature and findings on taxation of farming operations by the Organisation for Economic Co-operation and Development (OECD) will be analysed in this regard. Furthermore, the farming operation related taxes in other countries (including Australia and New Zealand) will be analysed in comparison to those of South Africa.

4.2. Background

The OECD measures the level of subsidies or support that governments provide to farmers. Various indicators are employed for this including the producer support estimate (PSE) and a conclusion is then drawn from the analysis. (OECD, 2006b) According to the OECD, "'support' is understood as gross transfers to agriculture from consumers and taxpayers, arising from governments' policies that support agriculture." (OECD, 2016)

Though South Africa is merely an observer and not a member[9] of the OECD in terms of the OECD website, South Africa is "an Associate in 6 OECD Bodies and Projects, and a Participant in 15. It has also adhered to 19 OECD instruments." (OECD) The OECD's work is therefore important to South Africa's policy development processes and consideration.

The OECD's general view with regards to tax policies put in place by different countries to support agriculture has been that though these policies may come in different forms depending on the country they are basically similar. The policies generally provide for "taxes on income, profits and capital gains; social security contributions (which are a mixture of tax, duty and insurance); taxes on payroll and workforce which concern farm operators as employers; taxes on property (including taxes on property transfer); and taxes on goods and services (including sales tax and VAT)." (OECD, 2005)

Though affected by the levying of taxes the agriculture sector benefits from the concession provided to the taxpayers in general and the agricultural sector specifically. The OECD emphasise that tax concessions in agriculture are used as a vehicle to achieve a wide variety of objectives in the sector. In terms of the OECD, regardless of the form it takes, a "tax measure is considered to be a "tax concession" to agriculture if it results in differential treatment to the sector in such a way that agriculture is favoured, resulting in some foregone tax revenue, or tax expenditure". (OECD, 2005) So the aim would be to benefit the agricultural sector exclusively for OECD to consider it a concession. This view is however obscured as it focuses on the labelling issue rather than the objective of tax measures that a country may put in place to benefit amongst others, the agricultural sector.

Tax measures are being used to deliver policy objectives including promoting investment in the agricultural sector, increasing productivity of the land, encouraging succession and entry of new farmers specifically youth. (OECD, 2005) Food security would accompany a promotion of investment and productivity in the sector.

Amongst other indicators, the OECD uses the "Producer Support Estimate (PSE). The PSE is a measure of the total financial support provided to agricultural producers, quantified at the

[9] South Africa is not a member of the OECD but participates is various OECD studies and is a member of the OECD Base Erosion and Profit Shifting BEPS Committee which acknowledges the negative effect of domestic tax base erosion caused by multinational corporations that shift profits to avoid paying tax.

farm gate level. It encompasses all policy measures, regardless of their nature, objectives, or effects on farm production or income. The PSE calculates the support received by agricultural producers due to specific agricultural policies, compared to a hypothetical scenario where producers would only be subject to general policies of the country, which include economic, social, environmental, and tax policies. (OECD, 2006b)

As compared to other world players in the agricultural space, the OECD has found that South African Producers are offered support at the "same level as in China and Russia, and somewhat above that in Brazil, New Zealand and Australia". (OECD, 2006a) This is due to policy interventions targeted at agricultural producers including tax policies. In 2006, the percentage PSE in South Africa was however 5% which was found to be far less that the OECD average of 31%. A year-to-year analysis for the period 1994 to 2003 however demonstrated a fluctuation between 2% and 16%. This is said to be a result of change in policy, trade deregulation (which saw the shift from marketing boards etc.), reduced border protection and eradication of export subsidies. (OECD,2006a). Unfortunately there is a limitation in terms of empirical studies that compare support or concession between developing countries, specifically within the African continent.

Support to farmers come in various forms including "tax concessions, preferential lending, debt restructuring, and administered prices for inputs and services." (OECD, 2016). From the OECD's conclusion depicted in the figure below, "Australian farmers are some of the least subsidised in the world – second only to New Zealand in terms of countries where comparable information is available." (Greenville J, 2020). Australia is sitting at about 2% and New Zealand is the lowest at about 1% support. South Africa on the other hand is sitting at about 3% support. This is in contrast to approximately 19% OECD average and overall country average of about 12% (Greenville J, 2020)

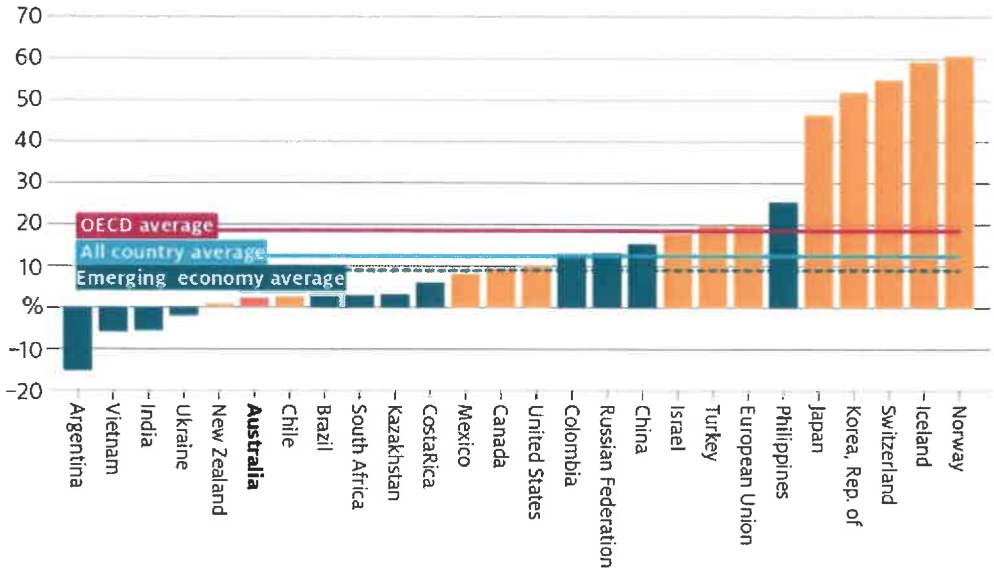

Figure 1: Source: OECD as depicted in Greenville J, 2020.

Australia and New Zealand are cited as leading examples of countries that prioritize open markets and redirect government support towards investments aimed at improving productivity in the agriculture sector. These strategies are believed to be instrumental in fostering sectoral growth and promoting global food security. (Greenville J, 2020) As noted by OECD (2019a) and Glauber et al. (2020), to t achieve the goals of global development, governments still need to invest in agriculture, but it is vital that such investments are not detrimental to farmers elsewhere. To support achieving this goal, trade rules will need to be set in future.

Australia, New Zealand and South Africa are an interesting study in contrast to the OECD's average given the notion that in instances where there is a high level of support, the agricultural products change with those that are specifically subsidised dominating. The argument is that high support to farmers will lead to an increase in the price of food for consumers and may reduce the agricultural sector's growth and productivity in the longer term. (Greenville J, 2020) This view seems more in favour of the position taken by New Zealand and Australia which according to the OECD's analysis provide the lowest farmer support, South Africa does not fair too far too. South Africa's historically perspective which was highly adorned with government support for the minority white farming community could to a certain extent attest to this.

The following table presents a summary of the assessment made by the OECD and the results for Australia and New Zealand's agriculture related taxes. An addition has been made of how South Africa compares with the two countries:

	Income taxation		**Property taxation**		**Tax on goods and services**			**Environmental taxes**		**Tax incentives for R&D and innovation**	**Other**
	PIT	**CGT**	**CIT**	**Property and land tax**	**Transfers Acquisitions and Stamp Duties**	**Inheritance and gift taxes**	**Fuel**	**Outputs**	**Inputs**		
Australia	X			X			**X**	X		X	X
New Zealand	X						**X**			X	X
South Africa	**X**	**X**					**X**		**X**	**X**	**X**

4.3. Taxation of Farming Income in Australia

Australia's assistance to agricultural producers remains one of the lowest among the OECD countries and was estimated to be approximately 2% of gross farm receipts during the period of 2016-2018. The total support to agriculture (TSE) in Australia accounts for around 0.2% of GDP. The support provided to Australian agriculture is divided almost evenly between direct support to producers (PSE) and support for general services (GSSE). (OECD, 2019a) Australia is therefore second to New Zealand in terms of the level of support offered to farmers.

Each year, the Australian Government Treasury releases a report called the Tax Benchmarks and Variations Statement (TBVS), previously known as the Tax Expenditure Statement (TES). This report focuses on tax expenditures, which occur when there is a difference between the standard or "benchmark" tax treatment and the tax treatment applied to a specific activity or group of taxpayers. The TBVS categorizes tax expenditures into various broad groups, including concessional tax rates, exemptions, deferrals, accelerated write-offs, and rebates. One significant tax expenditure identified in the report is the provision of rebates through the Wine Equalisation Tax (WET), Farm Management Deposit scheme and the income tax averaging scheme. (OECD, 2019a)

The corporation tax rate in Australia is 30% for major corporate tax entities and 27.5% for incorporated enterprises with an annual turnover of less than AUD 50 million is. The tax rate for qualifying businesses was reduced from 27.5% to 26% in the 2020-21 financial year and further to 25% in 2021-22. Unincorporated small businesses with an annual revenue of less than AUD 5 million pay tax at a discounted rate. The discounted rate was however revised upward from 8% to 13% in 2020-21, and subsequently to 16% in 2021-22. (OECD, 2020)

Australia's agriculture sector operates with a strong focus on market dynamics, both domestically and internationally. The sector receives government support through a combination of direct budgetary allocations and tax benefits. Additionally, income support is available for farm households facing hardships. Direct assistance is also provided to improve on-farm infrastructure, aiming to promote better use of natural resources and environmental management. Tax concessions are part of the policy approach, enabling producers to manage production and market risks by smoothing their incomes and offering incentives for preparedness-related investments on farms. (OECD, 2019a)

Similar to New Zealand farmers in Australia can smooth out their tax liability by electing to pay tax on a rate based on their average income earned over the previous five income years. Though not immediate, the concession is brought about by the opportunity for farmers to offset higher taxes paid during less productive years from the savings that farmers can make from paying less tax in high-income years. Until July 2017, farmers that opted out from the income averaging scheme were not allowed back in. Recommencement is now allowed at least after expiry of ten years anniversary of having opted out. (OECD, 2020)

The Australian Taxation Office also provides assistance including extra time within which farmers pay tax debts to farmers affected by drought, natural disasters and other hardships can pay tax debts. The tax concession herein would apply to proceeds that farmers derive from advanced shearing/ double wool clips that had to be done due to drought, fire or floods; proceeds made from stock that farmers had to dispose of to counter the effects of droughts, fire or floods and any insurance paid out as a result of related claims. (OECD, 2020) "In special circumstances, the Commissioner for Taxation may release individuals from payment of income tax, fringe benefits taxes and some other taxes where it is shown that payment would cause serious hardship." (OECD, 2020)

In terms of code B38 of 2018 TBVS which provides for valuation of livestock from natural increase allows farmers to utilise different methods to determine the value of income acquired by natural increase of livestock. In this case the methods may produce a lower value than what it actually costed the farmer to produce the livestock, this result in a tax concession for the farmer. (OECD, 2020)

Australia has a range of small business Capital Gains Tax (CGT) concessions which may also apply to farmers. CGT is however not payable when a taxpayer dies. Unless the item has been passed to an exempt entity, gains or losses accrued during the life of the deceased are deferred until the person inheriting the CGT asset disposes of it. (OECD, 2020)

Australia levies a broad-based goods and services tax of 10% on most common goods and services consumed in Australia. Basic foods such as eggs, fruit and vegetables are exempt from goods and services tax. As per TBVS code H21, this exemption extends under certain conditions to supplies of farmland. This include where "farmland supplied for farming on which a farming business has been carried on for at least five years immediately before the sale; continuity of the farming businesses is intended to be carried out on the land; and subdivided farmland that is potential residential land and supplied to associates for nil or for less than market value." (OECD, 2020) On the other hand Land tax in general varies between states which may in terms of their policies impose e.g. stamp duty on transfers etc. (OECD, 2020)

Similar to New Zealand and South Africa, "specified fuels used in off-road business activity are eligible" Vehicles used in the agricultural sector such as tractors and harvesters that don't use the road could benefit from this. This incentive is available to most businesses and are not only limited to farmers." (OECD, 2020)

In order to encourage all economic sectors including farmers to invest in research and development activities, the Australian Tax Office in conjunction with the Department of Industry, Innovation and Science administer an tax incentive for research and development. Registration of the research and development activity with the applicable authority is a prerequisite for eligibility to the tax incentive. (OECD 2020) Given the limited direct assistance provided by the government to agricultural producers and the absence of a permanent farm subsidy program, Australia places significant reliance on research and development (R&D) initiatives as a key form of support for the agriculture sector. The primary avenue through which the Australian Government fosters innovation in rural areas and facilitates increased agricultural productivity is through rural research and development corporations. (OECD, 2019a)

Australian wine producers who own at least 85% of the grapes used to make the wine throughout the winemaking process and whose wine is branded and packaged in a container not exceeding five litres (51 litres for cider and perry) are eligible to a tax rebate of the 29% Wine Equalisation Tax. (OECD, 2020)

"Other tax preferences are to facilitate structural adjustment including exemptions from capital gains tax for exiting small businesses (also available to farmers operating as a small business) and to incentivise investments in specific activities. Another group of tax preferences is linked to encouraging environmental improvements, sustainable water use and soil conservation." (OECD, 2019a)

In Australia, the payroll tax is a state-based tax and is payable across sectors. However, the specific rate, scope, and implementation of this tax can differ across different states. Small businesses, including farmers, are often exempt from this tax due to the application of a size threshold. It's important to note that the federal government does not have any influence over the individual policy decisions made by the states regarding payroll tax since it falls under their jurisdiction. (OECD, 2020) "Other tax deductions available to primary producers include exemptions from Fringe Benefit Tax for meals provided to employees who are carrying on business in a remote area and exemptions from primary industry levies. (OECD, 2020)

Australia has adapted its approach to agricultural support over time to adhere to national competition policy, pro-competitive reforms, and its commitments under the World Trade Organization (WTO). Currently, the government's main focus in supporting the agricultural sector lies in boosting its capabilities, mainly through investments in research and development (R&D). When providing direct assistance to farmers, particular attention is given to risk management tools that help mitigate the challenges posed by Australia's uniquely unpredictable climate. Notable examples of such tools include Farm Management Deposits and income tax smoothing. (Greenville, 2020)

4.4. Taxation of Farming Income in New Zealand

New Zealand's tax system is broad and encompasses most areas without many exceptions. The same normal income and corporation taxes that are imposed on businesses throughout the economy also apply to farmers and agro-food businesses. (OECD, 2020) "The level of support to farmers has been the lowest among OECD countries, accounting for less than 1% of farm receipts." (OECD, 2019a)

Over the past ten years, there haven't been any significant revisions, although as of October 1, 2010, the top income tax rate was lowered from 39% to 33%, and the corporate tax rate was lowered from 33% to 28%. A Tax Working Group formed the previous year analysed the tax system and presented its final recommendations to the government in the early months of 2019, changes were to be implemented in 2021. Changes to the tax laws governing capital income and the imposition of environmental taxes, both of which are likely to have an effect on farmers, are suggested. A capital gains tax has already been ruled out. (OECD, 2020)

The government relies on tax revenue from the agriculture sector as a significant part of its income. Agriculture and related industries are treated like all other regular businesses and are subject to standard tax regulations. In New Zealand the agricultural sector is not given any exemptions from paying social security taxes, property taxes, transfer taxes, or value-added taxes. (OECD, 2020)

However, there is a special provision for certain land improvements in farming, which can be fully deducted from taxable income immediately, rather than being considered as capital and spread out over time. Vehicles used in the agricultural sector such as tractors and harvesters that don't use the road receive refunds for fuel excise duty (with the exception of diesel), and they are also exempt from paying road user fees. (OECD, 2020)

New Zealand farmers and those tax payers engaged in forestry and/ fisheries can also benefit from an income equalisation scheme, which can result in them paying lower taxes. However this delays farmers from accessing the income. The income equalisation scheme that evens out revenue over time. Typically, funds are kept for a minimum of 12 months and a maximum of 5 years. After 12 months, pre-tax interest is added to the funds at a rate of 3% per annum. (OECD, 2020)

Additionally, the New Zealand Inland Revenue Department has a number of tax relief for farmers who have been affected by unfavourable weather occurrences or natural catastrophes. Farmers may be permitted to make late tax payments including late re-estimates of provisional tax, filing delays, instalment plans, and penalty reductions or allowed early withdrawal from the income equalisation scheme to mitigate the effects of bad weather on their crop. (OECD, 2020)

In terms of section DO 1 of the Income Tax Act, 2007, enhancements such as expenses for control of weeds, plants, animal pests, the restoration of flood or erosion damage to the land, the removal of scrub, the erection of fences, the re-grassing and fertilizing of pasture can be written off as tax deductions. Section DO 2 of the Income Tax Act, 2007 allows for costs associated with planting or maintaining trees for erosion, land shelter and water protection purposes on farms to can be deducted immediately from income tax. Though the financial benefit may be insignificant, the above concessions can save taxpayers money on compliance costs. (OECD, 2020)

Other tax relief measures available include deductions for farm losses when certain improvements are destroyed or irreparably damaged; livestock or materials donated because of an adverse event may be treated as zero-value rated; payments or donations from charities are not taxable or liable for GST; tax treatment of insurance payments may depending on the circumstances e.g. loss of capital assets be non-taxable and interest on money borrowed to keep the farm going may be deductible. (OECD, 2020)

With regard to incentives for research and development, New Zealand has since 2019, "introduced a 15% tax credit granted for eligible R&D expenditure over NZD 50 000 per annum with an expenditure cap of NZD 120 million per company." This important incentive is available to all sectors including the agricultural sector. (OECD, 2020)

Section EC 7 of the Income Tax Act, 2007 makes provision for two ways in which livestock can be taxed. The natural standard cost scheme and the herd scheme are the two methods used to value livestock for income tax purposes. While the herd scheme treats animals as capital assets and only considers changes in livestock numbers as taxable income, not changes in stock values, the natural standard cost scheme concentrates on production costs. The choice of valuation method may have both tax benefits and drawbacks. (OECD, 2020)

There are no environmental taxes or national land taxes in New Zealand. Local governments instead levy rates based on capital or land values to deliver local services. Since 2010, there have been no taxes on the sale of rural property, including no stamp duty, inheritance tax, capital gains tax, or gift duty. Agriculture has no special provisions or geographical distinctions. It is unclear what effect property taxation has on investment and agricultural structures. However, international institutions like as the IMF and the OECD have emphasized in their studies of the New Zealand economy that the lack of a capital gains tax may have resulted in excessive land investment relative to other types of investment. (OECD, 2020)

In conclusion New Zealand does not provide any tax concessions to the agriculture sector through its social security system and the labour income of those employed in the sector is processed through the pay as you earn system in the same as any other labour related income for tax purposes. Similar to South Africa, New Zealand has an across-the-board levy in place to cover for work related accidents. (OECD, 2020)

5. CONCLUSION

Overall "South Africa reduced its support to agriculture during the reforms of the mid-1990s and support to farms has remained below 5% of gross farm receipts since 2010. In 2016-18, support to agriculture was around 3% of gross farm receipts. "(OECD, 2019a)

From the comparison done one can conclude that there is not much of a gap between the incentives that South African farmers have access to as compared to their counterparts in Australia and New Zealand. Given that Australia and specifically New Zealand offer their farmers lesser incentives than those available to South Africans and still achieve production and food security, the argument that less is more when it comes to agricultural concession seem to hold water after all. In fact it seems that the impact does not lie on the sizable number of incentives but on the quality and benefit the incentive derives.

The argument is that high support to farmers will lead to an increase in the price of food for consumers and may reduce the agricultural sector's growth and productivity in the longer term. (Greenville J, 2020) Lower level of support in Australia has apparently led to, participation in global markets which in turn has supported sector development leading to over 70% of agricultural exports approximately 50% of employment in the sector derived from trade. (Greenville J, 2020) This is yet to be realised by South Africa.

It would seem that South Africa could benefit from employing less costly income tax smoothing mechanisms which are said to be more efficient ways to deal with farm income instability. (OECD, 2005) Tax concessions connected to transfers of farming land are said to be more beneficial mechanism to support the farming sector. In the immediate term, specific measures like income tax concessions or reductions in annual business property taxes are not expected to have a substantial influence on production. These measures do not disturb the connection between the marginal factor cost and the marginal value product of variable inputs, nor do they disrupt the relationship between marginal costs and marginal revenues of output. However, there could be indirect and lasting consequences. For example, tax concessions that enhance the attractiveness of agricultural rewards might encourage the retention of entrepreneurial labour or land within the industry, which can ultimately impact overall output.
(OECD, 2005)

The issue of understanding the context of existing tax concessions is valid. The observation made by the OECD with regard to lowered fuel duty whose history dates back to the Second World War but is still employed today by most countries including South Africa; Australia and New Zealand is important. (OECD, 2005) According to the OECD, in the United Kingdom, fuel duty was apparently introduced to stimulate farm output during the Second World War and seems to have lingered on since then. Continued existence of lower fuel duty is said to clash with other government policies that are aimed at reducing subsidised use of energy in order to meet environmental goals.

The OECD also argues that there could be unintended consequences where lowering fuel duty result in an the rise in fuel consumption and the production of agricultural goods and services, which includes both market output and non-market environmental goods and negative externalities, can be influenced by various factors. These factors encompass the marginal physical product of fuel when applied to fixed production factors, the proportion of fuel costs in the total expenses, the potential for substituting different factors of production, the elasticity of fuel supply and complementary inputs, and the impact of increased output on market prices, among others. (OECD, 2020)

The shedding of employment by the South African economy and specifically the agricultural sector is concerning and requires concerted effort by all economic sectors to resolve. The fact that the commercial agricultural sector, more so of recent has not been the much-needed saviour in resolving the unemployment crisis does not make it any less important. In fact, it is much more important in an economy with a marginalised subsistence sector that has no ability to sustain livelihoods.

The tax measures provided by South Africa's tax system and specifically concessions provided in terms of section 26(1) are a step towards realising South Africa's international obligations to the right to adequate food in terms of the International Covenant on Economic, Social and Cultural Rights of 1966 and also South Africa's constitutional obligations to the same right. As indicated above the obligation is not explicit and instead implicitly requires the state to make food accessible, an investment including by way of granting favourable tax measures and concessions in agriculture which is the means through which food is produced contributes to making food available and discharging this obligation. Unlike pre-1994, the tax system can play a positive role in providing for South Africa's people.

It would appear that tax incentives in the agricultural sector are mainly aimed at improving the farmers' income and are not necessarily focused on the consumers and the right to access to food. The study presents an opportunity for an impact study to be done to assess whether the concessions available to the commercial agricultural sector trickle down to the consumers and whether they get to experience the indirect benefit of the tax concessions in terms of access to food. On the other hand the tax concessions and measures tend to benefit those that are already in the sector and dose little for transformation and new entrants. So to a certain extent the current tax policy still encourage the exclusive system previously closely guarded and made to thrive by the state.

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