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IMAGINING AN ETHICAL TAX SYSTEM IN SOUTH AFRICA

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Dissertation submitted to the School of Law, University of the Witwatersrand in fulfilment of the requirements of the degree of Doctor of Philosophy, 5 December 2003

ABSTRACT

The Constitution provides ethical and teleological information for the democratic South African political community, in addition to prescribing structures and behaviour expected of government. Identifying the objective of the Constitution as the realisation of full lives for all community members experienced in a just society, I argue that an experience of community existence can only be realised if the foundational, ethical values of the Constitution - respect for human dignity, freedom and equality – pervade community structures and rules.

Applying this proposition to taxation in the constitutional community, I critically examine traditional tax criteria and current tax arrangements by focusing on: fundamental values; constitutional characteristics, including rationalism and efficiency; and certain technical prescriptions.

I conclude that, while the current scheme of taxation shares many characteristics with an imagined constitutional scheme, it is inadequate in crucial regards. Although tax administration and legislation have been modernised in the constitutional era, constitutional values have not infused the South African fiscal system. Tax models of the advanced economies are adhered to, but without proper consideration of their appropriateness to the context of the constitutional community.

I argue that respect for human dignity may be upheld by the introduction of a state guaranteed minimum income as an element of income tax, and by the abolition of value-added tax. Freedom, appropriate for the constitutional community, will be reflected in tax laws that guarantee corporeal dignity or 'bio-liberty'. Equality may be pursued by tax schemes that include all members of the community, rather than focusing on the circumstances of a relatively narrow range of income taxpayers. Technically, equality requires the broadest practicable tax base; the elimination of privileges; and progression in tax rates. I conclude by sketching a scheme of taxation that is practicable and true to the Constitution.

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ACKNOWLEDGEMENTS

I owe a considerable debt of gratitude to numerous people with regard to this study but would particularly like to thank the following people:

- Iain Currie for his support, guidance, provision of material and unwavering patience;
- Support staff at the School of Law (notably Helen Frühauf, Helen Chemaly and Sharon Vergie) for facilitating long distance;
- William Barker for reviewing technical tax aspects;
- The internal and external examiners for their undertaking;
- Sean Archer and Simon Wigley for permission to use their unpublished work;
- Alex Butchart for provision of material relating to Michel Foucault; and
- Most of all my wife, Barina, without whom this study would not have been possible or worthwhile.

CHAPTER 1 INTRODUCTION

I PURPOSE AND OVERVIEW

The purpose of this study is to identify, describe and apply the principles that should inform an ethical scheme of taxation for the people of democratic South Africa ('the constitutional community').

In Part One, I derive the relevant qualities of the constitutional community and its expectations. To this end, I describe the Constitution[1] and its informing values of dignity, freedom and equality. Crucially, I look to the Constitution as the source of the ethical information for a scheme of taxation for the constitutional community, rather than a code of technical legal rules.

In Part Two, I consider the constitutional state, particularly the required norms of governance that may be relevant to a constitutional scheme of taxation.

Drawing on the principles so established, in Part Three, I construct a constitutional scheme of taxation. This process includes a comparison of fundamental constitutional values with traditional tax criteria; the use of a 'wealth narrative' to highlight issues of equity in taxation; and a justification of a progressive, comprehensive income tax, premised on constitutional principles.

In Part Four, I consider the role of consumption and behaviour modifying taxes under the constitutional dispensation. Here I focus on the rationality of behaviour modification methods.

I conclude the study by sketching a constitutional scheme of taxation, outlining the practical aspects of a national scheme of taxation informed by constitutional values.

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[1] Constitution of the Republic of South Africa Act 108 of 1996 (Constitution)

II THE ROLE OF IMAGINATION

Imagination is fundamental to the phenomena that make a scheme of taxation possible.

(a) Imagination and ethics

The breadth and quality of our sentiments for others and the degree to which we can sympathise with their condition, are set by our imaginations. This sentiment of sympathy, which is the 'universalising force in ethics',[2] enables us to contemplate the suffering of others. Once the suffering of others is imagined, we may be motivated to contribute to their welfare, whether through direct action, charitable giving or willing tax contribution. The basic ethics of taxpaying, thus, springs from the imagination. And, without a broadly held ethical compulsion to pay taxes, principally an urge to support others in the community, a functioning political community is impossible.

(b) Imagination and political communities

The extent of the national community is principally a matter of imagination.[3] The nation always remains imagined by its members who 'will never know most of their fellow-members, meet them, or even hear of them, yet in the minds of each lives the image of their community'.[4] An imagined duality of inclusion/exclusion is

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[2] B Russell *Power* (1938) (1975 reprint) 169

[3] A A Mazrui *The Africans: A Triple Heritage* (1986) 99 quotes Bernard Lewis who, in 1961, in part answered the question 'what is a Turk?' by suggesting a 'sentiment of Turkish identity'; simply thinking of oneself as a Turk.

[4] B Anderson *Imagined Communities* Revised ed (1991) 6

definitive of viable political communities,[5] so that all community members expect to be included in a consideration of comprehensive contribution and benefit but for all others to be excluded. This idea has particular resonance for taxation. Taxpayers must imagine an asymmetrical, impersonal and general duty of reciprocity owed to and by people whom they will never meet or even know exist. Crucially, the spatial reach of taxpaying is, in fact and from necessity, imaginatively coterminous with the territorial confines of the national community.

(c) Imagination and society

Third, within the taxpaying community, sentiments of solidarity, cooperation and sharing are affected by the ways in which the social product and property are imagined, indeed, how society itself is conceived.

One ostensibly plausible metaphor for contemporary society is that of passengers on a train, travelling together and yet apart.[6] However, this image, while indicating a common if 'oscillating' fate, fails to convey the complex web of cooperative achievement that marks political communities. When society is imagined in such a loose way, it becomes difficult to conceive of freedom,[7] or, indeed, any social expectations beyond the immediate. The evidence of cooperation and interdependence is everywhere, and yet a causative connection between cooperative labour and survival may no longer be obvious, so that an individual's need to participate in schemes of reciprocity may appear chimerical. A person in such a 'transparent' society may feel isolated and alienated from her fellow members of society, who are and will always remain mostly unknown to

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[5] M Waltzer 'Welfare, Membership and Need' in MJ Sandel (ed) *Liberalism and Its Critics* (1984) 200

[6] H Chang 'Postmodern Communities: the Politics of Oscillation' Vol 4 No 1 *Postmodern Culture* (1993) (no constant pagination)

[7] G Vattimo *The Transparent Society* (1989) (trans D Webb, 1992) 10

her, and yet she and they are inescapably dependant on each other. She may hold no ethical compulsion to cooperate productively and participate in schemes of reciprocity and mutual support, and yet, it seems, she must because of the situation in which she finds herself. It is what she must do if she wishes to remain alive.[8] Ultimately, an imaginative failure precedes her ethical crisis; a failure to recognise that productive cooperation and reciprocity make possible the society, which permits her to survive, and grants her rights and freedoms; that interdependence is an inevitable, basic fact of social existence and the laws which regulate that existence.[9] Imagination is, then, crucial to our ethical and human experiences. Government policies and programmes, such as taxation, must be recognised imaginatively, if they are to be plausible and effective.

(d) Imagination and an ethical scheme of taxation

Finally, as an image of freedom precedes liberation, so an ethical tax system must be imagined before it can be realised. It is my contention that policy planners have not sought to imagine an ethical scheme of taxation for the constitutional community, and, in this study, I seek to provide such an image.

Imagining, in a most human and hopeful manifestation, has led South Africans to reject historical injustice and establish the constitutional state. Informing this 'constitutional community' is the Constitution, which is, in essence, a record of the ethical imagination of that community. Nevertheless, the imagination is also constraining, and, perhaps, the most important consideration here lies in

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[8] OW Holmes 'Natural Law' *Harvard L R* 32 (1918) 40, 41

[9] E Ehrlich *Fundamental Principles of the Sociology of Law* (trans 1936) 42 observes that: 'All law is social law. Life knows not man as an utterly detached, individual, and isolated being, nor does the law know such a being. The law always sees in man solely a member of one of the countless associations in which life has placed him.'

recognising how our ability to conceive and resolve social problems is paradigmatically confined.

III PARADIGMATIC CONSTRAINTS

(a) Constraints on the imagination

Taking cognisance of Michel Foucault's conception of 'epistemes',[10] and Thomas Kuhn's proposition of 'paradigms',[11] our imaginations are constrained by factors, which include codes of culture, and the acceptance that well-established and workable techniques of governance exist for effecting social goals. Consequently, the space and options for any community to construct laws or ethical codes are not boundless but contained culturally, technologically and temporally.[12] From necessity, therefore, a credible scheme of taxation should be alert to paradigmatic expectations.

(b) Example of a paradigmatic conception of property

Alertness to paradigmatic expectations may be illuminated by a consideration of estate taxes.[13]

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[10] M Foucault *The Order of Things: An Archaeology of the Human Sciences* (1966) (trans1970) (1994 reprint) xx

[11] TS Kuhn *The Structure of Scientific Revolutions* 3 ed (1996) 10

[12] F Nietzsche *Beyond Good and Evil* (trans J Norman, 2002) 69

[13] An estate tax, provided for by the Estate Duty Act 45 of 1955 in South Africa, is levied on the taxable value of a person's property rights on death. Unlike an inheritance tax, estate tax is not normally borne by the beneficiary except in the case of default by the deceased estate.

A right to property, including the power to dispose of that property at will on death, may be no more than a juristic fiction,[14] but is 'real' inasmuch as, in most settled societies, it gives rise to predictable jural consequences. Furthermore, this legal convention has continued reception by the collective imagination and, to that extent, is broadly considered 'natural'. Therefore, while one may oppose the convention of inheritance on ideological grounds, it would be futile to ignore its juridical concretion and imaginative reception when constructing relevant social measures. Consequently, it is generally plausible to propose that a bequest should be taxable (in the hands of a transferor or, conversely, a beneficiary) but not to deny that there is a right to dispose of property on death,[15] or that the right of inheritance should be abolished.[16] The denial of the right of testacy is unworkable because it ignores a convention whose infraction gives rise to a cause of legal action. A proposal for the abolition of succession to property is futile because it runs counter to the sentiment for inheritance held in the collective imagination.

The way in which property, or any other manifestation of economic well-being, is taxed under a constitutional scheme of taxation should be consonant with the way in which it is imagined within that particular community. However, such a

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[14] Ehrlich (note 9 above) 101

[15] J-J Rousseau 'A Discourse on Political Economy' *The Social Contract* (trans GDH Cole, revised JH Brumfitt & JC Hall, 1973) (1992 reprint) 152, following Pufendorf.

[16] K Marx & F Engels 'Manifesto of the Communist Party' in K Marx & F Engels *Selected Works* (1968) (1977 reprint) 31, 52

view of property must be congruent with 'the constitutional society prefigured within the text' of the Constitution.[17]

(c) Paradigmatic awareness and modishness

In a pejorative sense, awareness of paradigmatic forces could imply a fatalistic acceptance of propositions that have regressive social consequences. (In taxation, the broad acceptance by many policymakers of the proposition underlying the Laffer curve, and the Tiebout hypothesis arguably indicates an irrational modishness.[18]) Constitutional government cannot follow a route of uncritical acceptance of trends. Ideas that are incompatible with the Constitution may not inform policies, even if they are popular and persuasive elsewhere. (The potential for conflict may be overstated, since the Constitution itself is a creature of the paradigm.) Furthermore, members of the constitutional community may hold values that are different from those of the Constitution. However, this simply means that constitutionally compliant measures will require proper communication, explanation and 'selling' in order to be effective.

(d) A constitutional scheme of taxation and plausibility

It is feasible to propose a scheme of taxation that is congruent with constitutional principles but is simply too novel to attract acceptance: that is not the purpose of this study. To promote plausibility, I employ the idea of coherence as a matter of

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[17] Davis J in *Oudekraal Estates (Pty) Ltd* v *City of Cape Town* 2002 (6) SA 573 (C) 595A

Although taxation can only function where property rights exist, my concern, in this study, lies principally with basic human rights, particularly those that relate directly to the human body. Concern for property interests, which could be pressing in an affluent society, is subsidiary in the context of the impoverished constitutional community.

[18] See Chapter 18, section VI below for a discussion of the Laffer curve and the Tiebout hypothesis.

fundamental principle, so that a constitutional scheme of taxation, as sketched, will cohere both with the general body of the constitutional community's laws but also the broad stream of paradigmatically bound social codes and techniques. Therefore, I do not present proposals that, in seeking to conform to some extraneous ethical or economic absolute, reach conclusions that are incompatible with conceptions of a tax held by the constitutional community. For instance, I seek to demonstrate that the broadly accepted principle of ability to pay, which underpins progressive income tax, is currently applied in an inchoate, even arbitrary manner. The policy proposals that arise from this conclusion may appear novel but are no more than logical extensions of a well-established principle.

IV IMPUISSANCE OF TAXATION

The capacity of taxation to provide a potent tool of directed social policy is frequently overestimated. I am sceptical of claims, for instance, that taxation is one of the most important 'weapons' the state has at its disposal to mitigate an individual's 'power to use property for private profit, and without regard to community purposes',[19] or that a tax system in a capitalist society may be used to diffuse anti-social concentrations of power.[20] Taxation, as currently imagined, has limited potential for bringing about radical social transformation for various reasons. These include:

- The crucial importance of distribution rather than collection;
- The conservative nature of taxation;
- The inability of taxation to curb power; and
- The restriction of taxation to economic phenomena.

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[19] W Friedman *Law in a Changing Society* 2 ed (1972) 114

[20] A Ryan 'Utility and Ownership' in R G Frey (ed) *Utility and Rights* (1984) 175, 191

I outline the limitations of taxation in effecting social change below:

(a) Just distribution is crucial

While they may be viewed as points along a single continuum, the collection of revenue and its subsequent distribution are separable. For instance, a state, rich in natural resources, may face a need to raise taxes in order to perform its functions. Conversely, a government may comply with traditional norms of equity with regard to contribution but may squander revenues, which may otherwise be used for social development, on, say, grandiose monuments or unnecessary arms purchases.

Crucially, it is the way in which government disburses revenues once collected, which holds the greatest potential for transforming society. Although progressive taxation is in itself indicative of redistribution, it is only as part of and within an overall structure of just government action and expenditure that it takes on meaning. There can be little doubt that well-directed government spending, augmented by foreign aid where necessary, can have a dramatic effect on people's lives, particularly the poor. As a prime example, increased expenditure on health care can have a multiplier effect throughout society: improved life expectancy and reduced disease burdens can stimulate economic growth through faster demographic transfer to lower fertility rates, higher investments in human capital, increased household savings, increased foreign investment and greater social and macroeconomic stability.[21] Taxation raises the revenue that makes such phenomena possible. Nevertheless, prudent allocation of resources makes social transformation probable.

[21] JD Sachs (Chair) *Macroeconomics and Health: Investing in Health for Economic Development* Report of the World Health Organization Commission on Macroeconomics and Health (2001)103

(b) Taxation is conservative

Even the most progressive schemes of taxation, and, it seems, schemes of redistribution,[22] paradoxically tend to reinforce existing structures of social relations rather than challenge them. By subjecting, for instance, an item of wealth to taxation, government effectively validates or authenticates the socio-economic structures from which it arose.[23] In this way, although a marginal income tax rate of 100 per cent would effectively confiscate any income that fell into the relevant tax band, it would, nevertheless, confirm the extant property rights and distribution of productive capital within society that gave rise to that income. Taxation, even if progressive within its own structure, is, in its nature, conservative.

Tax strategies, as currently imagined, simply do not seek to confront structural issues of social equity in the way that Marxism purports to, and so may be characterised as 'bourgeois-liberal' mechanisms. Such mechanisms 'rest on purely distributive concepts of justice' and 'do not consider the fundamental problem of social justice', which, for Marxist thought, 'lies in the problem of the control of the means of production by the working classes of society'.[24] Consequently, while a focus on issues of fairness in taxation is crucial, such an emphasis may promote a false impression of the deeper justice of the underlying

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[22] J Nash 'History and Power in the Study of Law' in JF Collier & J Starr (eds) *History and Power in the Study of Law: New Directions in Legal Anthropology* (1989), 108

[23] O Kirchheimer 'Political Justice' in CM Campbell & P Wiles (eds) *Law and Society* (1979) 276
Kirchheimer did not specifically refer to taxes but generally to the power of the law to 'authenticate'.

[24] W Lang 'Marxism, liberalism and justice' in E Kamenka & A Erh-Soon Tay (eds) *Justice* (1979) 116, 148
Lang did not specifically refer to taxes but generally to progressive, liberal strategies for social justice.

economic and social structures. Even a constitutionally reconfigured conception of tax equity cannot escape the confines of the taxation vehicle. This confinement and impuissance have resonance with the unexpected, pacifying effect of civil rights actions, since 'every time you bring a case and win a right, that right is integrated within an ideological framework that has as its ultimate aim the maintenance of collective passivity'.[25] The practical response to this paradox, as Peter Gabel and Duncan Kennedy counsel, is that it 'doesn't mean you don't bring the case - it means you keep your eye on power and not on rights'.[26] This approach is acutely relevant to an understanding of the role of a just scheme of taxation.

(c) Taxation cannot be levied on power

The distribution of income in the modern economy derives ultimately from the distribution of power.[27] Inequalities of wealth in society tend to be caused by inequalities of power and not vice versa.[28] Consequently, a radical tax system might seek to make power its subject. However, after Nietzsche in philosophy,[29] and, Weber in sociology,[30] power is understood to be ubiquitous,[31] and

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[25] P Gabel & D Kennedy 'Roll Over Beethoven' (1984) 36 *Stanford LR* 1, 36

[26] Ibid

[27] J K Galbraith *The Good Society: The Humane Agenda* (1996) 65

[28] R Norman *Free and Equal: A Philosophical Examination of Political Values* (1987) 111

[29] E Bodenheimer *Power, Law and Society* (1972) 5 provides a lucid and concise encapsulation of Nietzsche's conception of power.

[30] M Weber *Theory of Social and Economic Organization* (trans AR Henderson & T Parsons, 1947) 140

relational.[32] Although juridical theory may have traditionally conceived of power as being synonymous with a right that, analogous to a commodity or incorporeal property, could be transferred or alienated,[33] power does not have a tangible substance which might be curbed or otherwise dealt with by way of a tax in the way that wealth might be assessed, reduced, and redistributed. Strategies of containment, such as John Rawls's difference principle,[34] simply cannot operate in respect of power,[35] and other institutions and instruments must be used for assessment of and response to the consequences of unequal power distributions: taxation cannot play a direct role.

(d) Taxation relates only to economic phenomena

Finally, complex economic activity, of which taxation is a corollary, is but a part of human activity and existence. As Ivan Illich has observed, 'In none of the economic models serving as national guidelines is there a variable to account for non-marketable use-values any more than there is a variable for nature's perennial contribution' and yet, 'What people do or make but will or cannot put up for sale is as immeasurable and as invaluable for the economy as the oxygen we breathe'.[36] Indeed, the most worthwhile manifestations of human existence are

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[31] M Foucault 'Afterword: The Subject and Power' to HL Dreyfus & P Rabinow *Michel Foucault: Beyond Structuralism and Hermeneutics* (1982) 208, 223

[32] Norman (note 28 above) 129

[33] M Foucault *Power/ Knowledge: Selected Interviews and Other Writings 1972-1977* (trans and ed C Gordon, 1980) 88

[34] J Rawls 'Distributive Justice' in A Ryan (ed) *Justice* (1993) 73, 76

[35] Norman (note 28 above) 129

[36] I Illich *The Right to Useful Unemployment and its Professional Enemies* (1978) (1996 reprint) 68

not quantifiable in monetary terms. The United States' Bill of Rights[37] has, for instance, been memorably described as 'a series of definitions of things which could not be exchanged'.[38] Practical taxation can only consider events and phenomena that may be expressed in monetary terms, exemplified by the judicial ruling that an advantage to which a value cannot be placed cannot be taxed under the provisions of the Income Tax Act.[39] I do not propose that the scope of taxation should extend beyond a consideration of economic phenomena that have eventuated, but note its limitations, particularly with regard to equality. Notional endowment taxes to be levied on what one might or ought to have been earned or proposals for consumption taxes on leisure may provide fertile ground for philosophical speculation but, having no prospect of realisation, are beside the ambit of this study.[40]

In addition to practical taxation applying only to select human activities, the potential of taxation to do justice to different members of the community is limited by the unavoidable restriction of an assessment of economic well-being to monetary phenomena, predominantly income.

Two simple comparative examples may illustrate this point:

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[37] Amendments 1-10 of the United States Constitution

[38] Arthur Okun, cited by G Mulgan *Connexity: How to Live in a Connected World* (1997) 64

[39] See *CIR v Butcher Brothers* 1945 AD 301

[40] Charles Fried, for instance, questions whether leisure or working at a rate less than the highest reward might be considered to be a form of taxable consumption
See C Fried 'Is Liberty Possible?' *The Tanner Lectures on Human Values* 98, delivered at Stanford University, 14 & 18 May 1981.

Example 1

A is a Black professional, who currently enjoys a high income but has little accumulated wealth due to historical disadvantages.

B is an established White farmer, with a lower income than A, whose historical advantages have enabled the accumulation of vast, inherited, property and economic power (and other forms of power over others.)

A paradox of the current tax system is that it is A, the formerly disadvantaged person, without accumulated wealth, who will bear the greater tax burden on a year-to-year basis.

Although efforts are generally made to apply the principles of distributive justice to income tax – and these efforts must be extended under a constitutional scheme of taxation - it is unlikely that a politically acceptable tax system could be devised which would take full cognisance of differences in economic well-being.

Example 2

X is a casual gardener who, through good luck and hard work, is able to earn, from different employers, as much as Y, a low-earning, unionised worker in formal employment.

Compared in terms of income (the predominant determinant of economic well-being used to assess their potential for direct tax contribution) they are similarly situated. Yet, Y enjoys the benefits of formal employment, which may include: a degree of job security; the practical right to fair labour practices; the massed power of her co-workers; membership of a provident fund; insured benefits in the event of ill-health, disability or death; and, possibly, opportunities for her children to be granted educational bursaries. If the incomes of both X and Y are less than

R30 000 per annum,[41] neither will have crossed the threshold for paying income tax. They are, then, similarly situated for income tax purposes, even though a broader consideration of their circumstances shows that their respective economic and general well-beings are very different. Yet, both are excluded from any further consideration for equitable treatment by the tax system.

A tax system can and should incorporate the broadest, inclusive consideration of the circumstances of all community members. Nevertheless, the ambit of such a system will remain limited. For instance, assessing and redistributing the inestimable benefits of security and peace of mind between those in formal employment and the causally employed or unemployed generally lies beyond the realm of taxation. Traditional mechanisms of taxation tend to promote a convergence of economic outcomes by taking something away from the party who enjoys advantages relative to the one who does not. Here the policy concern lies in augmenting X's general well-being rather than decreasing that of Y. A comprehensive, progressive income tax can perform both functions (in relation to certain manifestations of economic well-being), principally, by combining graduated rates of tax with a guaranteed minimum income.

V POTENTIAL OF A CONSTITUTIONAL SCHEME OF TAXATION

If I have portrayed taxation as an impotent tool of social policy, what, if anything, do I propose that a scheme of taxation, reformulated to reflect the ethical imagination of the constitutional community, can achieve? Despite the reservations expressed, a re-imagined scheme of taxation can, indeed, achieve much and play a significant role in promoting radical social transformation in

[41] Calculated at 2003-04 income tax rates, taking into account the primary rebate of R5 400. See sections 5 and 6 of the Income Tax Act 58 of 1962, read with Schedule 1 to the Exchange Control Amnesty and Amendment of Taxation Laws Act 12 of 2003.

South Africa. The potential and positive effects of a just scheme of taxation include the following:

(a) Funding just government

Taxation provides the financial means for government to stimulate and manage a radical transformation of society. Effective socio-economic provision and other constitutionally prescribed initiatives will foster a just society, and enrich and bring fullness to the lives of community members.[42]

(b) Ensuring fair contribution

It is axiomatic that tax contribution should be fair.[43] A constitutional scheme of taxation will ensure fair contribution but will also ensure that the conceptions of fairness held by the constitutional community inform contribution arrangements.[44] All community members are expected to contribute to the commonwealth to the extent that they are able and benefit in accordance with their need. Under the transparent and reasonable scheme I envisage, contribution and benefits will be fair, rational and visible.[45]

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[42] I argue in Chapter 2, para II (c) below that the telos of the Constitution is the realisation of full lives, experienced in a just society.

[43] I discuss broadly accepted tax criteria in Chapter 11 below.

[44] I consider equity and various aspects of a tax system in Chapters 14-18 below.

[45] I discuss fiscal transparency and tax visibility in Chapter 10 below.

(c) Alleviating income poverty

An integrated scheme of taxation will fuse contribution with benefit.[46] A state guaranteed minimum income will be a crucial element of such a scheme.[47] The incorporation of a guaranteed minimum income into the tax system will be key to liberating the poor from the tyranny of income poverty and promoting the possibility of all community members enjoying opportunities to realise their human potential.

(d) Promoting fair distribution of wealth

A constitutional conception of equality requires a more even distribution of wealth in South Africa than currently prevails.[48] Progressive taxation, of the type I propose, is recognised as one of the most effective tools of achieving equitable wealth distribution.[49]

(e) Effecting desirable economic results

The collection and distribution of tax revenues may have considerable indirect economic effects.[50] The promotion of the free flow of money in the economy is an important consequence of a scheme of taxation (as I propose) that prefers the

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[46] I sketch such an integrated tax-benefits system in Chapter 21 below.

[47] I discuss how a state guaranteed minimum income manifests respect for human dignity in Chapter 12, section II below.

[48] I discuss an appropriate equality programme in Chapter 6 below.

[49] JK Galbraith *The Good Society: The Humane Agenda* (1996) 65

[50] I discuss the compatibility of equity and economic efficiency in Chapter 9, section V below.

progressive taxation of income to taxing consumption. This, in turn, prevents economic sclerosis and disrupts socially destructive wealth condensation.[51]

(f) Countering historical injustice in taxation

Grave injustice has been manifest in the ways in which taxes have been historically raised against Black people and women. A just scheme of taxation may contribute to a redress of the triple heritage of colonialism, apartheid, and patriarchy.[52]

(g) Complying with the Constitution and reflecting constitutional values

It I axiomatic that a constitutional scheme of taxation should reflect constitutional values, so meeting its own obligations in that regard. Furthermore, a comprehensive scheme of taxation that touches all community members' lives, will contribute to an inculcation of constitutional values throughout society. To employ an analogy to geometry, a truly constitutional scheme of taxation will be a fractal of the constitutional state.[53]

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[51] I discuss the benefits of a convergence of economic outcomes in Chapter 6, section VII below.

[52] The Preamble to the Promotion of Equality and Prevention of Unfair Discrimination Act 4 of 2000 recognises that: 'The consolidation of democracy in our country requires the eradication of social and economic equality, especially those that are systematic in nature, which were generated in our history by colonialism, apartheid and patriarchy, and which brought pain and suffering to the great majority of our people.'
I outline certain aspects of historical discrimination, relevant to a constitutional scheme of taxation, in Chapter 2, section II below.

[53] Fractal geometry developed from Benoit Mandelbrot's studies of complexity in the 1960s and 1970s. 'Fractals display self-similarity – that is, they have a similar appearance at any magnification. A small part of the structure looks very much like the whole.'
RP Taylor 'Order in Pollock's Chaos' *Scientific American* December 2002

PART ONE

CONSTITUTIONAL CONTEXT, PRINCIPLES AND EXPECTATIONS

INTRODUCTION TO PART ONE

In this part, I describe the broad characteristics of the contemporary, South African polity, 'the constitutional community'. My purpose, in this regard, is to adduce the factors that will inform a constitutional scheme of taxation.

The particular political community in hand is distinguished by the Constitution that its people have adopted as their legal, ethical and governmental bedrock.

Firstly, then, I seek to identify the fundamental message of the constitutional text. My purpose here is to derive fundamental ethical information, not to examine technical legal rules.

Secondly, I seek to outline the context in which the Constitution is to operate. Naturally, this context includes the contemporary paradigm. However, most relevant to the construction of a scheme of taxation, I emphasise the specific condition of the members of the constitutional community, their level of human development and particular experiences.

Finally, I describe community members' expectations with regard to the foundational values of the Constitution – human dignity, freedom and equality.

CHAPTER 2 THE CONSTITUTION AND THE CONSTITUTIONAL COMMUNITY

I INTRODUCTION

An ethical scheme of taxation must be informed by the settled ethical values of the community that it serves. In the context of the constitutional community, an ethical tax system will coincide precisely with the Constitution, since this records the ethical imagination of the constitutional community. The first step in developing an ethical scheme of taxation for South Africa, therefore, lies in distilling the fundamental constitutional message. Here, I refer to the core ethical information the Constitution conveys, not the technical rules of governance it prescribes. This message must then be contextualised so that its meaning can be fully understood and acted upon.

In this chapter, I establish the general will of the constitutional community. I seek to identify its core objectives and methods prescribed for achieving these objectives. In fixing the constitutional message in context, I outline the history of exclusion experienced by certain groups in the community. Finally, I consider the condition of contemporary South African society, since current socio-economic characteristics set the agenda for the community's scheme of taxation.

II DESCRIBING THE CONSTITUTION

(a) The general will of the constitutional community

A sustainable political community must have a 'general will' which, in establishing the 'rules of what is just or unjust' within that community, is the source of that

particular community's laws.[1] Whether the terms of this general will are themselves derived from rules which lay claim to an essential validity, such as those of 'natural law' or 'universal human rights',[2] they are taken to be self-evidently valid within the context of that particular community. The general will is taken to be immutable – in the short term, at least – and to transcend immediate concerns. The desire to distil and record, and abide by this record of the general will may be described as a will to constitutionalism.[3] The people of South Africa have demonstrated this will; so that the Constitution, distinguished by the Bill of Rights, encapsulates the general will of the contemporary South African polity and its citizens.

The Constitution is not, then, a memorandum of fundamental legal principles (at worst, a checklist against which Parliament's laws may be audited) rather it represents an attempt to capture and commit to text the general will or ethical

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[1] J-J Rousseau 'A Discourse on Political Economy' *The Social Contract* (trans GDH Cole, revised JH Brumfitt & JC Hall, 1973) (1992 reprint) 132. G Vattimo (see Chapter 1, para I (c) note 7) argued, in an interview in *Cape Times* 5 September 2000, that every country needs a unifying philosophy.

[2] LL Weinreb 'Natural Law and Rights' in RP George (ed) *Natural Law Theory: Contemporary Essays* (1992) 278, 279 argues that Rousseau substituted natural law with general will, and that more recently, natural rights have been superseded by the idea of human rights.

[3] John Rawls alluded to this tendency to constitutionalism in his conception of an 'original position'. His veiled actors, in eschewing the possibility of immediate, personal gain and opting for safeguards for all, typify the farsighted motivations of constitutionalists. (See J Rawls *A Theory of Justice* (1972) para 6.) Although the exact terms of his foundational principles have not been taken up in South Africa, a similar instinct has led to a prudent and farsighted Constitution.

imagination of the constitutional community.[4] A scheme of taxation for the constitutional community must seek a deep congruence with the general will of the community. The construction of tax laws that are not repugnant to constitutional values will be an insufficient response. To qualify as ethical, a scheme of taxation for the constitutional community must be thoroughly informed by constitutional values, it will, in short, be a 'constitutional scheme of taxation'.

The Constitution has been described as 'a document founded on deep civil morality',[5] but cannot plausibly be described as a codification of organic, time-honoured, endogenous community norms. Conversely, it does not represent the importation of alien ideas. At a fundamental level, the African social philosophy of ubuntu is eminently compatible with the Bill of Rights. A catholic gathering of interest groups within the South African national community (with considerable

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[4] C Taylor 'Hegel: History and Politics' in MJ Sandel (ed) *Liberalism and Its Critics* (1984) 177 explains that Hegel distinguished between *Sittlichkeit*, which refers 'to moral obligations I have to an ongoing community of which I am part...based on established norms and uses', and *Moralität*, which is 'an obligation to realise something which does not exist. What ought to be contrasts with what is'. (The German *Sitte* (custom) is believed to have etymological links with the Sanskrit *sva* (self) and *dhá* (to place), perhaps indicating the behavioural demands expected of the situated self.)

P Singer (ed) 'Introduction' in *Ethics* (1994) 4 argues that the term 'morality' implies 'a stern set of duties that require us to subordinate our natural desires – and our sexual desires get particular emphasis here – in order to obey moral law'. When using the terms 'ethics' and 'morality' and their correlatives, I intend no such pejorative implications. For convenience sake, and with deference to Hegel, I refer to 'morality' as the conventional conceptions of right and wrong held by members of a community, anthropologically observable customs and behavioural norms. Conversely, 'ethics' is taken to be a desirable, a yet-to-be achieved progress from conventional morality. 'Ethical', as used in used in this study, is, then, no more than what ought to be by virtue of reference to constitutional values and injunctions. The desired ideal will be a coincidence of morality, ethics, and law.

[5] Sachs and O'Regan JJ in *S* v *Jordan* 2002 (6) SA 642 (CC) [104]
Following the distinction made in note 4 above, this would be a 'deep civil ethics'.

external assistance), in seeking to concretise the ethical aspirations of that particular political community, has formulated a basic law, which incorporates principles of universal human rights from various sources but is distinguished by taking specific account of South African historical experience, and current socio-economic circumstances.[6]

Crucially, the Constitution seeks to redress past injustices, which traditional norms and laws have been powerless to prevent or have been complicit in their perpetration, and, in certain regards, aspires to values that may not be broadly held by community members.[7] Generally, the Bill or Rights is ethically

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[6] J van der Walt 'The Relation Between Law and Politics: A Communitarian Perspective' (Continued) (1994) 111 *SALJ* 152, 154 observes how Gadamer rejects 'Kant's attempt at founding a universalist conception of ethics as inconsistent with the hermeneutic regard for the cultural embeddedness of normative values, but nevertheless appreciates Kant's universalizability for moral deliberation as indispensable for modern for modern society'.
While there should be no pretence of having captured universal values in the Bill of Rights, there must be a lingering hope that this ideal has been approached. Although the Bill of Rights is derived from the tradition of liberal humanism, this does not imply that its strategies must be 'Eurocentric'. G Jordan & C Weedon *Cultural Politics: Class, Gender, Race and the Postmodern World* (1995) (1997 reprint) 29 comments that: 'While dominant forms of humanism, both liberal and socialist, have privileged European thought and values, they have also served strategically to legitimate movements for civil rights struggles for national liberation in non-Western countries.'
A Sen 'Democracy as a Universal Value' *J of Democracy* 10.3 (1999) 3, 12 argues that 'the claim of a universal value is that people anywhere may have reason to see it as valuable'. Since the principles and purposes of the Constitution are likely to found valuable by people everywhere, in Sen's conception, they may be described as 'universal'.

[7] For instance, despite the constitutional guarantee of sexual equality, homophobia remains common. In this regard, Sachs J implicitly recognised a deeply embedded prejudice against homosexuals in *National Coalition for Gay and Lesbian Equality* v *Minister of Justice* 1999 (1) SA 6 (CC) [23], when he observed that 'discriminatory prohibitions (sic) on sex between men reinforce already existing societal prejudices and severely increases the negative effects of such prejudices on their lives'. A constitutional goal must be a society where such prejudice does not exist, rather than one in which victims are protected from its effects.

progressive when many citizens have demonstrated moral conservatism; privileges tolerance when tolerance has not been historically shown; and prescribes inclusion when exclusion has been normal. In demanding redress of social exclusion and injustice, and, expressing an optative prospection, the Constitution seeks to transcend the introspective moral values historically generated by close communities.

While no sustainable claim can be made that the rules of the Constitution are 'natural' or 'universal',[8] no proof of any such claim is necessary in the pursuit of ethically informed action within the constitutional community. The constitutional rules, notionally at least, have been distilled from all possible social rules and selected by community members. The selection of the rules may be 'arbitrary' but adherence to such rules, once selected, absolves them of a charge of arbitrariness. The norms of the Constitution are not immanently good or virtuous beyond their context; simply they set the framework for what is good and virtuous within the constitutional community.

(b) Creature of the paradigm

Roberto Unger has argued that there was a 'Lycurgan moment' in the development of American society, implying that, at a particular juncture, certain forms of the federal polity and economic system were chosen above all other candidates for social organisation.[9] Similar considerations could be inferred to the substance of the Constitution. But Unger takes insufficient cognisance of the paradigmatic restrictions on the collective imagination and overstates the permutations open to the founders and shapers of American democracy. Comparable but different imaginative and contextual restrictions constrained the

[8] See note 6 above.

[9] RM Unger *The Critical Legal Studies Movement* (1986) 5 (Lycurgus was the Spartan lawgiver)

framers of the Constitution. Neither the broadly stated principles nor specific injunctions of the Constitution have been plucked from the aether, but are anchored in general and community-specific experiences and aspirations. The Constitution, its resultant strategies and practices may be specific to a particular South African context, but this, in turn, is situated in the realm of broadest human experience. Constitutional values generally reflect supra-national and supra-political ideals.

Consequently, there will be correspondence, both at a philosophical and policy level, between the norms of the constitutional community and those of other political communities which value social justice.[10] In rejecting those historical norms of the South African political community found to be odious within the country and almost universally vilified outside of it, the constitutional community draws closer to a broader human experience. The adoption of the Constitution implies a contemplation of the ideas and experiences of a particular community but also an opening of the imagination.

(c) Pursues a telos of fully realised lives

The telos of the Constitution may be characterised as the progressive enabling of every community member to participate in a good, rewarding,[11] or fulfilled life,[12]

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[10] Section 36 of the Constitution, the limitation provision, sets a benchmark of a restriction of rights being 'reasonable and justifiable in an open and democratic society based on human dignity, equality and freedom'. While that particular formulation of values may be unique to the Constitution, in practice, the Constitutional Court turns to restrictions imposed by other democracies, such as the United States, Canada and Australia.

[11] JK Galbraith *The Good Society: The Humane Agenda* (1996) 23 conceives of the good life as a 'rewarding' one.

[12] The Preamble to the Constitution includes the purpose – *'to...Improve the quality of life of all citizens and free the potential of each person...'*

within the context of a polity which privileges human dignity, freedom and equality.[13] Given the excluded condition of many members of the constitutional community, this purpose implies that a fundamental characteristic of the Constitution lies in a compassion for the plight of the excluded. In focusing its concerns on those who have been oppressed, not the erstwhile oppressor; on the dispossessed, not the propertied; on the weak and not the powerful, the Constitution unashamedly manifests, in Nietzsche's derisive terminology, a 'slave' rather than a 'master' morality.[14]

(d) Constitutional policies must be practicable and appropriate

The Constitution itself may be described as 'ideological',[15] inasmuch as it is a discourse, which sets the terms 'of practical communication between situated subjects' within the South African polity.[16] Nevertheless, the message of the Constitution has supra-political appeal and is, nominally at least, free of narrow allegiance to a particular philosophical or political view, beyond those that have created it. This is a classic 'chicken and egg' paradox: there had to be an ideology in place to enable the Constitution to be created in the first place. And so, it would be idle to argue that the Constitution is ideologically untainted when a

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[13] See, in particular, sections 1(a) and 7(1) of the Constitution

[14] F Nietzsche *Beyond Good and Evil* (trans J Norman, 2002) 156

[15] A Vincent *Modern Political Ideologies* (1992) 16 characterises 'ideologies' as being broader in scope than mere political allegiances but rather 'bodies of concepts, values and symbols which incorporate conceptions of human nature and thus indicate what is possible or impossible for humans to achieve; critical reflections on the nature of human interaction; the values which humans ought to reject or aspire to; and the correct technical arrangements for social, economic and political life which will meet the needs and interests of humans'.
Importantly, he concludes that ideologies 'claim both to *describe* and *prescribe* for humans'.

[16] T Eagleton (ed) 'Introduction' in *Ideology* (1994) 11

particular ideology caused it to come into being and informed its provisions. Nevertheless, I prefer to see the Constitution as paradigmatically moored rather than ideologically specific. It would have been unimaginable, for instance, for the original drafters of the American constitution to have enshrined sexual practice rights. If the Constitutional is seen as having sprung from a particular paradigm rather than an ideology, space for different worldviews within the constitutional community to exist and compete becomes available. The Constitution does not, for instance, prescribe how scarce economic resources should be allocated; whether this function should be performed through a free-market mechanism, a command system or a hybrid between these two poles. Ostensibly, this is a policy prerogative of the government of the day, subject to normal constitutional review, but, in reality, it is something that pre-exists, and lies beyond practicable government control.

The ways in which meaning is brought to constitutional values, injunctions and objectives; the practical policies employed; and the philosophies that underpin them cannot be abstractions. These methods must be acutely relevant to the circumstances of the particular society in which they operate. Such a need for relevance or appropriateness will be particularly important for a constitutional scheme of taxation.[17]

It is self-evident that certain outlying political ideas, such as those which animated apartheid, lie beyond the pale of constitutional action, but others, which are not generally considered to be abhorrent, may also be constitutionally incompatible because of their distance from the social realities of the constitutional community. A theory of possessive individualism, for instance, in proposing that the distinction of being human lies in freedom from dependence

[17] See Chapter 11, section V below for a discussion of appropriateness as a criterion by which a constitutional scheme of taxation should be measured.

on others, with engagement with others being wholly voluntary,[18] defies squaring not only with empirical sociological observation,[19] but also the text of the Constitution. Indeed, the Constitutional Court, like its German counterpart,[20] has stressed interdependence as a fundamental fact of social existence. In *Soobramoney*, using the example of health care, Sachs J demonstrated how the maintenance of individual, corporeal integrity only becomes possible through a complex web of interdependence. He described how:

> A healthy life depends upon social interdependence: the quality of air, water, and sanitation which the state maintains for the public good; the quality of one's caring relationships, which are highly correlated to health; as well as the quality of health care and support furnished officially by medical institutions and provided informally by family, friends, and the community.[21]

Interdependence is, then, 'not a social ideal but an inescapable fact',[22] and one that must be incorporated in an identification of the existential characteristics of the constitutional community.

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[18] As proposed by CB MacPherson and cited in B Richards *Images of Freud: Cultural Responses to Psychoanalysis* (1989) 44.

[19] Practicable liberal policies are not unconscious of the needs of others. Vincent (note 15 above) 51 observes that: 'Overall, it appears that liberals...though valuing individuals are not really prepared to take on board the full logic of individualism. Individualism in its most radical sense implies solipsism and relativism in all matters of morality and truth.'

[20] Investment Aid Case I of 1954 (1954) 4 *BVerfGE* 7, cited by Z Motala 'Socioeconomic Rights, Federalism and the Constitution: Comparative Lessons for South Africa' (1995) 112 *SALJ* 61, 75

[21] *Soobramoney v Minister of Health (KwaZulu)* 1998 (1) SA 765 (CC) [54]

[22] Martha Minow cited by Sachs J in *Soobramoney* (note 21 above) [54].

Recognition of interdependence 'helps us to come to terms with our vulnerability to and dependence on others as well as our commitment to and responsibility for others'.[23] Psychologically, it implies a curbing of egoistic instinct, preparing the ground for the acceptance that all desires cannot be satisfied; that the social product must be shared and rationed.[24] Recognition of situatedness and interdependence as basic existential facts suggests political maturity and a progression from a liberal ideal of independence.[25] Such recognition does not, however, necessarily infer communalism, either in explaining society or guiding constitutional interpretation.[26]

It is convenient to portray to an individualist's conception of society as 'one in which there is nothing especially bad about the weakest going to the wall'[27] but such a sentiment is unlikely to be transposed unmitigated into political strategies. Furthermore, it is feasible that the policies of a liberal political party may be more effective in delivering the outcomes the Constitution contemplates than the

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[23] AC Hutchinson 'The Last Emperor' in A Hunt (ed) *Reading Dworkin Critically* (1992) 45, 68

[24] This explanation is essentially the Freudian narrative of civilisation. See S Freud 'Civilization and Its Discontents' (1930) in *Civilization, Society and Religion* (1908-33) (trans J Strachey, 1961) (1991 reprint) 243, 284

[25] G Mulgan *Connexity: How to Live in a Connected World* (1997) 264

[26] The imaginatively confined distinction between *Gemeinschaft/Gesellschaft* has resonance in the similarly constraining binary opposition of liberalism/communitarianism. Hutchinson (note 23 above) 68, in contemplating a 'meaningful reconstruction of political morality', dismisses the extremes of both 'the personal indifference of liberal politics' in terms of which he characterises freedom as 'the freedom to be a conscript in a continual state of social war', and 'the public saturation of communitarianism', in terms of which 'virtue becomes an enforced solidarity in which failure to identify completely with others is an act of civic treason'.

[27] G Graham *Contemporary Social Philosophy* (1988) 16

policies of a communitarian political party. In line with Karl Llewelyn's proposal of the instrumentality of law, constitutional governance should be the 'means to practical ends'.[28] Instrumentalist and utilitarian perspectives must be relevant to constitutional governance whose success should ultimately be gauged by its delivering the broadest justice to the greatest number, and not its ideological claim to truth. (Provided, of course, that such policies are congruent with constitutional values.) Classical liberalism may privilege individual liberty, but is not unconscious of other social considerations,[29] or, of course, the liberty claims of others. Furthermore, the social liberalism of a type propounded by Thomas Hill Green and more recently John Rawls, which, although, by proposing the individual's antecedence to society may be problematic, is nevertheless highly alert to the cares and claims of others, and, therefore, seems eminently compatible with the strategies of the Constitution.

Nevertheless, it would be a dissemblance on my part to propose that the Constitution and its current context do not imply particular strategies that coincide with certain political ideas and not others: necessarily they must. But, just as the text of the American constitution has been interpreted differently as the socio-economic context in which it must operate has changed, so one may envisage a set of circumstances under which the Constitution will imply different emphases from those that apply currently.

(e) Embraces rationalism

The Constitution embraces rationalism, privileging rational processes and reason. Crucially, laws and policies, within the constitutional community, must be

[28] R Cotterrell *The Politics of Jurisprudence* (1989) 185

[29] I Berlin 'Two Concepts of Liberty' in Sandel (note 4 above) 15, 32, for instance, observes that freedom cannot be unlimited because it must be weighed against other claims, such as, equality, justice, happiness, and security.

rationally connected to a legitimate purpose and the Constitutional Court is empowered to review government action for such rational connection.[30] (It is, of course, the Constitution that imbues a government purpose with legitimacy.) However, the scope of judicial review, beyond testing for rational connection, is limited. 'Decisions as to the reasonableness of statutory provisions are ordinarily matters within the exclusive competence of Parliament',[31] and the power of the Constitutional Court to review government actions for reasonableness is proscribed.[32] Nevertheless, such limitation of the scope of judicial review does not imply that government action, falling outside the scope of judicial review, need not be reasonable, simply that judicial review may be an inappropriate means of oversight.

It is a plausible exercise to establish tests and procedures for ensuring rationality in government action that will be broadly accepted as objective. Assessing reasonableness is more problematic. Naturally, there are courses of action that are ideologically offensive to some but must nevertheless be recognised as reasonable.[33] A democratic polity must accommodate differing viewpoints within

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[30] Yacoob J in *New National Party of South Africa* v *Government of the Republic of South Africa* [24]

[31] Ibid

[32] Notably section 27(2) of the Constitution which provides that: 'The state must take reasonable and other measures, within its available resources, to achieve the progressive realisation of each of these rights [health care; sufficient food and water; and social security].'
Furthermore, as Yacoob J explained in *New National Party* (note 30 above) [24], reasonableness is relevant to judicial review if it is established that a scheme, though rational, affects citizens' rights.

[33] Yacoob J commented in *Government of the Republic of South Africa* v *Grootboom* 2001 (1) SA 46 (CC) [41] that 'It is necessary to recognise that a wide range of possible measures could be adopted by the state to meet its obligations. Many of these would meet the requirement of reasonableness'.

the scope of reasonableness. In such a context, 'unreasonable' cannot mean contrary to the prevailing ideology. However, the scope of reasonableness of constitutional government action is not open-ended. In addition to setting the fundamental ethical norms for the constitutional community, the Constitution and the context in which it operates also establish the framework for reasonableness. For instance, South Africa's history of exclusion and the corrective demand for comprehensive social inclusion contribute to shaping conceptions of reasonableness within the constitutional community. Thus, 'A [housing] programme that excludes a significant segment of society cannot be said to be reasonable'.[34]

Constitutional rationalism breaks from the exclusionary logic of colonialism, apartheid and patriarchy. Furthermore it rejects the irrationalities and prejudices that justified division and exclusion. South Africa 'has recently emerged from institutionalised prejudice',[35] which has been marked by a headless chauvinism masquerading as a scientistic 'truth'.

Postcolonial analysis, in particular, has demonstrated the fallacies of scientism, the cruel follies that have underpinned racism. These have been instantiated by a reductionist tendency to refer, for instance, to 'the Africans' or 'the African mind' with each phrase suggesting 'not only a whole culture but a specific mindset'.[36] Europeans have not, however, been alone in peddling reductionist stereotypes in order to establish African alterity. Léopold Senghor's aphorism 'Logic is Greek, emotion is African' echoes and entrenches Carl Linnaeus's famous taxonomy of the sub-types of homo sapiens, in which '*Afer Niger*' was condemned as 'crafty,

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[34] Ibid [43]

[35] Ncgobo J in *Hoffmann* v *South African Airways* 2001 (1) SA 1 (CC) [37]

[36] EW Said *Culture and Imperialism* (1994) 23

lazy, governed by caprice' in contradistinction to his elevation of '*Europaeus Albus*' to the level of 'gentle, ingenious, inventive, governed by law'.[37]

Constitutional rationalism privileges a logic that rejects these reductionist stereotypes,[38] whether they are adduced to infer the inferiority or alterity of any discernible group within the constitutional community. The obvious response is to engage with people as individuals, not as members of any particular group, to the extent that such an approach is just and feasible. Constitutional interpretation and governance must be free from the influence of prejudice and scientism, and must rather demonstrate a pragmatic and critical rationality. Action that, in the pursuit of rationality, employs the available cultural technology for the widest and deepest benefit of the constitutional community must supersede postmodern paralysis.

Constitutional rationalism should not be manifest simply in administrative and judicial procedures, but throughout society. In an holistic sense, the constitutional state will be rational if it 'expresses in its institutions and practices the most important ideas and norms which its citizens recognise, and by which they define their identity'.[39] Elements of constitutional society should, then, be fractals, resembling each other, informed by the same genetic code.

(f) Holds 'an eye on the future'

With the rejection of parliamentary supremacy, constitutional governance is, to a degree, freed from the concerns and whims of immediacy. As Chaskalson P

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[37] A Butchart *The Anatomy of Power: European Constructions of the African Body* (1998) 34

[38] Ngcobo J in *Hoffman* (note 35 above) [37]

[39] Taylor (note 4 above) 190 describing Hegel's conception of the state.

observed in *Makwanyane*, with regard to an alleged general public sentiment for capital punishment:

> If public opinion were to be decisive there would be no need for constitutional adjudication. The protection of rights could then be left to Parliament, which has a mandate from the public, and is answerable to the public for the way its mandate is exercised, but this would be a return to parliamentary sovereignty, and a retreat from the new legal order established by the 1993 Constitution.[40]

This new legal order does not imply that government, in implementing the Constitution, should concern itself only with long-term issues (the fact of the regular election of parliamentarians should see to that) but rather that policies and solutions proposed for current problems should be measured with a sense of history and a sensitivity to likely consequences. The Constitution, situated in the broad stream of human experience, requires maintenance of 'an eye to the future'.[41]

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[40] *S* v *Makwanyane* 1995 (3) SA 391 (CC) [88]

[41] McMurty CJO, MacPherson and Gillese JJA for the Court of Appeal of Ontario in *Halpern v Attorney General of Canada* (2002) 215 DLR (4th) 223 [42] observed that: 'A statute defines present rights and obligations. It is easily enacted and as easily repealed. A constitution, by contrast, is drafted with and eye to the future.'
B Russell *History of Western Philosophy and its Connection with Political and Social Circumstances from the Earliest Times to the Present* 2 ed (1961) (1991 reprint) 556 contemplating Spinoza's philosophy, explained: 'The wise man, so far as human finitude allows, endeavours to see the world as God sees it, *sub specie aeternitatis*, under the aspect of eternity'. Constitutional government should aspire to that ideal.

(g) Excludes minimal government

Given the conditions in which many members of the constitutional community live,[42] constitutional provisions do not permit state passivity and inert neutrality. The Bill of Rights, for instance, demands action and a particular partiality for those who have suffered in the past. This may disqualify certain strands of individualistic, *laissez faire* ideology from informing government policy but, as Galbraith observes, 'there is no substantive measure to relieve poverty or improve the lives and ensure the calming upward mobility of the underclass that does not require action by the state'.[43] An argument for minimal government is effectively a proposal for the minimal help of the needy, which is incompatible with the current needs of the constitutional community. And, it may be added, a state that is passive will almost certainly be conservative, buttressing the position of those with whom power and wealth currently reside. Indeed, it seems more likely that such passive governance would not simply conserve a particular state of affairs but would rather exacerbate inequalities and so is better described as 'regressive'.

The constitutional state cannot function in good faith at a minimalist level, and it would be fruitless, for instance, to propose that the role of the state should extend no further than that of a 'night watchman' when the Constitution

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[42] See section III below.

[43] JK Galbraith *The World Economy Since The Wars* (1994) (1995 reprint) 265 He continues: 'although there is both oratory and seemingly sophisticated argument to the contrary. The purpose of the latter is not to produce results but to relieve those who are most privileged of adverse conscience and cost.'

guarantees broad socio-economic provision, and, as a matter of incontrovertible fact, many citizens are unable to provide for themselves.[44]

II HISTORICAL CONTEXT OF EXCLUSION AND DENIAL OF HUMAN DIGNITY, FREEDOM AND EQUALITY

The provisions of the Constitution can only be understood in the context of current conditions and the historical forces that have shaped them. Experience of the denial of human dignity is the primary determinant of constitutional expectations. This denial is most conspicuously evident in the ways in which certain groups of people, notably those classified as 'Blacks' and women, have been excluded from the social mainstream. This exclusion has been effected through laws, but these laws were just one manifestation of a pervasive cultural domination.

(a) Exclusion of indigenous people

Europeans have typically engaged with other cultures by way of conquest (the predominant African experience) but also cultural pillage, exchange, or exoticism.[45] The colonists in Southern Africa sought to create unbridgeable

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[44] This classical, extreme liberal conception of the proper role of the state is, in any event, obsolescent. PW Singer of the Brookings Institution has studied the American outsourcing of military functions, and concluded that: 'The state is usually thought of as having a monopoly on the use of force. But it doesn't anymore.'
See ND Schwartz 'The Pentagon's Private Army' *Fortune* March 17, 2003

[45] U Eco *Serendipities: Language and Lunacy* (trans W Weaver, 2000) 69
The use of terms such as 'the West' or 'the European' is as implausible an exercise in reductionism as the stereotypes constructed of Africans in Western culture. Besides massive variance in *Weltanschauungen* at individual, group and ideological levels, some European countries have themselves recently experienced colonialism but as the subjects of colonisation not the perpetrators. However, this reservation does not detract from the plausibility of dominant traits being manifest in Western engagement with other peoples.

distinctions between themselves and the indigenes, principally by constructing stereotypes of Africans as counter images of themselves. These images, whether derived from high modernism or biblical myths,[46] acted as a method of domination, and an exercise in extractive power.[47] A binomial was created of 'Us/Them', an inclusive and, employing loosely the terminology of Antonio Gramsci,[48] hegemonic 'We', distinguished from an excluded and alienated 'Other'. Although the constructed characteristics of the Other may not always been pejorative and unsympathetic, invariably, colonisable peoples came to be imagined as inferior, retarded and less civilised. With the expansion of the imperial project in the nineteenth century, Africans often became demonised, an imagery which conveniently facilitated 'civilising strategies'.[49] Frequently these stereotypes were gross caricatures, amounting to no more than projections of the colonists' own neuroses,[50] strategies,[51] or imagines of Enlightened Man.[52] The purpose and effect lay in excluding Africans from the mainstream of society.

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[46] Pre-ordained labour roles and the colonial 'right' to extract labour from indigenes could be justified both from modernist and the biblical perspectives (Japhet/Ham binomial). See, for instance, Said (note 36 above) 296 regarding the European construction of the 'lazy native'. RL Rubenstein 'The elect and the preterite' in *Modernisation: The Humanist response to its promise and problems* (cited by Z Bauman 'The Fall of the Legislator' in T Docherty (ed) *Postmodernism: A Reader* (1993) 128, 136) observes that 'both Calvinism and Darwinism provide a cosmic justification for the felicity of the few and the misery of the many'.

[47] Said (note 36 above) 120

[48] A Gramsci *The Open Marxism of Antonio Gramsci* (trans C Marzani, 1957) 29

[49] See, for instance: N Bancel, P Blanchard & S Lemaire "Natives on show': Theme parks for colonialists' *Mail & Guardian* September 15, 2000 and O Peschel *The Races of Man and Their Geographical Distribution* 2 ed (1876) 463 who uncovers a strategy of exhibiting abnormal 'specimens' in Europe to promote ideas of monstrosity.

[50] J McCulloch *Colonial Psychiatry and 'The African Mind'* (1995) 142

In the field of taxation, the natives tax was payable only by native males.[53] Such a legal provision would have been impossible to conceive or implement if the European settlers had not held imagines of themselves distinct from 'the African Other'. While this distinction focused on comparative 'blackness',[54] it is more broadly derived from European assumptions as to African inferiority, laziness, predestined labour roles, de-individuation, and folklore relating to the colour black.[55] Crucially, these constructs may not be dismissed as the prejudices of the ignorant. They were and remain remarkably powerful tools of oppression, which have pervaded settler-indigene relations. Once established, cultural stereotypes are markedly durable, resilient to reason, and far reaching in effect. The commonly encountered prejudice that Africans cannot chart time in the way of Europeans,[56] for instance, continues to have real and tragic consequences for

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[51] See Said (note 36 above) 307 on colonial strategies for extracting labour. It is interesting to note that the Transvaal Indigency Commission Report, 1906-08, cited by DH Houghton & J Dagut *Source Material on the South African Economy: 1860-1970, Volume 2 1899-1919* (1972) 105, concluded that industrious Blacks were not a social problem, unlike free-riding bywoners and indolent 'poor whites', who, though incapable of performing skilled work, were unwilling to undertake unskilled work.

[52] According to R Dahrendorf *Law and Order* (1985) 42, Kant's conception of the Enlightenment was 'civilised' man's departure from self-imposed infancy.

[53] See 'Appendix' for an overview of the Natives Taxation and Development Act.

[54] The case law indicates that the 'blackness' of Africans was not used a point of comparison with the 'whiteness' of Europeans but rather against the 'yellowness' of the Khoisan. See, for instance, *Rex* v *Horn* 12 SATC 110 1942 CPD; *Rex* v *Makwena* 5 SATC 333 1932 EDL; *John Martin* v *Rex* 9 SATC 17 1936 EDL where the accused adduced evidence of their 'yellowness' to demonstrate that they were not liable for the natives tax.

[55] See F Fanon *Black Skin, White Masks* (1952) (trans C L Markmann, 1967) (1991 reprint) 189 on the relevance of the colour black in European culture.

[56] See *Rex* v *Willie Hannie* 7 SATC 281 1934 EDL.

individuals.[57] Just as the economic disparities that were fostered by the colonial and apartheid systems are not easily expunged,[58] so the hold of these myths over the group imagination is not broken when democratic governments are elected, racist laws are repealed, and fundamental human rights enshrined.[59] If the goals of the Constitution are to be realised, cultural stereotypes must be recognised, deconstructed and defused, and this urgency applies as equally to the tax system as to any other social arrangement.

The evolution of the mainstream or hegemonic system of taxation in South Africa corresponds with developments in the fiscal systems of the Commonwealth dominions: the notable distinction of South African taxation lies beyond the hegemonic in the separate and penumbral schemes of Black taxation. It is this denial of dignity through exclusion that a constitutional scheme of taxation must provide an antithetical model.

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[57] S Derbyshire 'AIDS in Africa: why the West is interested' *Sp!ked* 2 August 2001 reported that the head of the United States Agency for International Development, publicly reasoned that, since, in his estimation, and in accordance with persistent prejudice, Africans lack the disciplined conception of time necessary for a regime of retroviral drugs, money to combat HIV/AIDS should only be used in prevention not cure. Research has shown, however, that African AIDS patients demonstrate greater discipline in following their medication regimes than American patients, thus demonstrating the unfounded prejudice of the assumptions as to 'African time'. See DG McNeil Jr 'Africans Outdo Americans in Followings Aids Therapy' *New York Times* 3 September 2003.

[58] Taxation has played an important role in fostering economic disparities between settlers/ indigenes and empire/colony. AMM Hoogvelt *The Sociology of Developing Societies* 2 ed (1978) 72, for instance, characterises the colonial taxing of indigenes as an element of a process of '*under* development'.

[59] President Mbeki commented in an interview in *Guardian Weekly* 7 June 2001 that 'many whites, I wouldn't say all, have a particular stereotype of black people. They would deny it, but it's true. They see black people as lazy, basically dishonest, thieving, corrupt.'

(b) Exclusion of women

The current position of women in South African society appears to be similar to that of women in those of the major industrialised democracies, which have undertaken programmes to redress the disadvantages historically faced by women: unequal but not uniformly so.[60] Yet, despite ostensible manifestations of gender equality, women are generally over-represented amongst the poorest of society and particularly in South Africa.[61] Generally, then, in contemporary South Africa, there is gender equality before the law but, not only does the tradition of male economic and social dominance persist, foreign experience suggests that,

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[60] South African women are underrepresented as recipients of tertiary education, particularly at postgraduate level (See J Hofmeyr & A McLennan 'The challenge of equalizing education' in R Schrire (ed) *Wealth or Poverty: Critical Choices for South Africa* (1992) 174, 179. However, South Africa has a similar percentage of female university students to Canada and Australia, and a higher proportion than both the United Kingdom and the Netherlands (See J Seager *The State of Women in the World Atlas* Second Edition (1997) 86) - all countries generally recognised as having high levels of human development. Nowhere in the world are women represented in government in proportion to their population, and the South African proportion is on a par with that of New Zealand and Canada, but exceeds the proportions of Australia and the United Kingdom. (Seager (above) 90) (Women however, currently hold the highest offices of the three branches of government in New Zealand.) In the area of work, South African women hold 11 per cent to 25 per cent of administrative and managerial positions, on a par with the Netherlands and Germany, but significantly unequal in comparison to the more than 40 per cent in Australia, Canada and the United States (See Seager (above) 79).

[61] According to A Whiteford, D Posel & T Kelatwang *A Profile of Poverty, Inequality and Human Development in South Africa* (1995) 6, 48,3 per cent of all South African women live in poverty (compared to 43,5 per cent of men) and 63,2 per cent of rural women live in poverty (compared to 57,4 per cent of men).

even with comprehensive legislative and other interventions, this dominance is likely to continue.[62]

This phenomenon of economic inequality is consistent with Engels's prediction that 'the peculiar character of man's domination over woman in the modern family, and the necessity, as well as the manner, of establishing real social equality between the two, will be brought out into full relief only when both are completely equal before the law'.[63] Yet his attribution of the 'predominance of man in the marriage' simply to 'a consequence of his economic predominance' which 'will vanish with it automatically' is incomplete. Cultural forces are crucial to an understanding of social inequality, and these vary considerably between societies. Colin Bundy encapsulates an exceptional South African cultural factor well when he describes how:

> Women in all social classes, of all racial groups, whether urban or rural, are hugely at risk in South Africa... Sexual violence is an aspect of generalized subordination, and that subordination is cemented in a culture of taken-for-granted male dominance. On this platform are erected further levels of oppression and exploitation on the basis of race and class. (The 'triple oppression' of black working class women'.) [64]

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[62] J Carvel 'Figures show gender pay gap stays intact' *Guardian Weekly* 18 July 2002 reported that, according to research conducted by the United Kingdom's Department of Trade and Industry, notwithstanding long-term government efforts, the weekly median average total income for women in the United Kingdom is roughly half of that of men.

[63] F Engels 'Origin of The Family, Private Property and The State' in K Marx & F Engels *Selected Works* (1968) (1977 reprint) 500

[64] C Bundy 'Development and inequality in historical perspective' in Schrire (note 60 above) 24, 32

Various research projects on sexual violence in South Africa, which have seen Johannesburg, in particular, dubbed 'the rape capital of the world', have confirmed this idea that the causes and solutions to the country's rape pandemic, a brutal instantiation of sexual inequality and denial of human dignity, are primarily cultural.[65] The traditionally unequal position of women, particularly within marriage, is not unique to any particular society. Frances Olsen, considering general Western experience, observes that the state has traditionally conferred power in marriage, which might otherwise reserve for itself, on the husband.[66] This observation is borne out in South Africa, where, in the absence of an antenuptial agreement to the contrary, spouses are automatically married in community of property, and of profit and loss, with marital power traditionally having been conferred on the husband.[67] Prior to statutory intervention,[68] the primary legal consequence of such a marital arrangement was that the property of each spouse fell into a common stock over which the husband retained control, including the general right to dispose of the communal property without consulting his wife.

Comparably, TW Bennett has described how sex, age, and generation, the three criteria used in African societies to differentiate status, have led to a patriarchical family structure, in terms of which 'only senior males are accorded full powers

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[65] See the ongoing research conducted by CIET and Human Rights Watch.

[66] FE Olsen 'The Family and the Market: A Study of Ideology and Legal Reform' (1983) 96 *Harvard LR* 1497, 1510

[67] JF Coaker & WP Schultz *Wille and Millin's Mercantile Law of South Africa* 16 ed (1967) 48

[68] By virtue of the Matrimonial Affairs Act 37 of 1953 and Matrimonial Property Act 88 of 1984, a husband's marital control over the joint estate was curbed, so that, currently, marital property held in community is subject to joint and equal stewardship.

and authority; all women and junior males are subordinate'.[69] Similarly, Bundy, having noted women's insecure position and their comprising most of the poorest individuals in traditional African societies, observes that 'the most fundamental manifestation of inequality in precapitalist African societies was the sweeping control exercised over women by older men'.[70]

The income tax system has, for the greater part of its existence, reflected, and so perpetuated the cultural prejudices that underpin patriarchy. Ignoring the legal distinctions between different marital regimes and women's aspirations for equality, it simply deemed a married woman's income to have accrued to her husband.[71] Effectively, a cultural prejudice regarding the subordinate position of

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[69] TW Bennett *A Sourcebook of African Customary Law for Southern Africa* (1991) 147

[70] Bundy (note 64 above) 27

[71] For tax years ending on or before 28 February 1988, any income earned by a married woman was deemed to have been received by or accrued to her husband. (See AP De Koker & G Urquhart *Income Tax in South Africa* (1992) para 15-20). Following recommendations made by the Margo Commission (C Margo (Chair) *Report of the Commission of Inquiry into the Tax Structure of the Republic of South Africa* (1987)) separate taxation of spouses was gradually introduced, and, save for certain anti-avoidance measures, full separation of income was achieved in 1995. The Margo recommendations were informed primarily by administrative concerns, for instance, Margo Report para 7.159 noted that 'the application of the Income Tax Act to Blacks is a further reason for changing the unit, because Black spouses frequently live and work in different places'. The current system is essentially one of separate taxation, and is generally indifferent to the marital regime of taxpayers (Section 7(2) of the Income Tax Act 58 of 1962 includes anti avoidance measures relating to income arising from inter-spousal donations, and excess income arising from a trade carried on jointly. Section 7(2A) of the Income Tax Act provides that income from jointly held fixed property is taxable in equal shares, whereas other forms of income are generally taxed separately as trade income in the hands of the relevant spouse.)

married women triumphed over coherence in the legal system.[72]

Black women have been thoroughly excluded from consideration under the tax system, primarily because of their general economic exclusion. Such exclusion from the tax system, like exclusion from any other social arrangement, is not beneficial. Exclusion implies a lack of interest on the part of the state in the activities, indeed, very existence of those excluded. As Adam Smith recognised, taxpaying is a 'badge of liberty'.[73]

Despite their exclusion from taxation, Black women nevertheless suffered considerably from the operation of the tax system. They were, for instance, not subject to the natives tax, but, if one accepts the popular argument that the natives tax drove Black men into urbanised labour away from their rural homes,[74] then clearly their estranged partners would have suffered considerably as a result of the imposition of the tax. Cognisance of these histories of exclusion and domestic cleaving, and their current ramifications, must be taken into account in the construction of a constitutional scheme of taxation.

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[72] E Danziger 'Separate Taxation for Married Women: A Reappraisal' 1981 *De Rebus* 276 (cited by the Margo Report (note 71 above) para 7.23) represented this prejudice well when he argued that married women did not want, and, therefore, should not be granted separate taxation. They would, in his view, rather leave such inconvenient matters to their husbands. This demonstrates what Sachs and O'Regan JJ identified in *Jordan* (note 5 above) [65] as one of the 'archetypal presuppositions about male and female behaviour' that is offensive to the Constitution.

[73] A Smith *An Inquiry Into the Nature and Causes of the Wealth of Nations* (1776) (1952 reprint) 377

[74] See, for instance, L Callinicos *Working Life 1886 - 1940 Factories, Townships and Popular Culture on the Rand* (1987) 27.

III CONTEXT OF POVERTY AND INEQUALITY

The history of exclusion in South Africa has led to a society that is marked by poverty and pervasive inequality. More than any others, these features establish the context of the Constitution.

(a) Poverty

It is self-evident that widespread poverty is a distinguishing feature of the constitutional community. To put a statistic to this assertion, in 1995,[75] almost one in five South Africans lived below the poverty line.[76] More startling still, one third of South Africa's population is food insecure, that is, likely to have limited or no access to sufficient, safe and nutritious food: almost half of Eastern Cape and Free State citizens do not have access to sufficient food.[77]

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[75] Presidency *Towards a Ten Year Review: Complete Report* (2003) relied on 1995 statistics. Census 2001 data had not been processed as at 1 December 2003.

[76] According to EO Udjo, S Simelane & D Booysen 'Socio-Economic Indicator of Development Progress with the OECD Framework in South Africa' Paper presented at the Millennium Conference of Commonwealth Statisticians, Gaborone, Botswana, 1-5 May 2000, 18,2 per cent of the South African population lived below the World Bank's poverty line benchmark of $1 of income per day. Whether or not the World Bank's 'dollar a day' indicator of absolute poverty has universal cogency, the statistics adduced by Udjo et al are objectively appalling.

[77] Statement of Agriculture Minister, T Didiza, reported by D Pressly 'Third of South Africans "food insecure"' *Business Day* 4 November 2002.

Despite the context of widespread, extreme poverty, the Constitution does not make explicit reference to the eradication of poverty.[78] This omission is potentially problematic as poverty is the principal factor of exclusion in the constitutional community, and, notwithstanding the lack of a specific textual reference, widespread poverty is a direct consequence of the historical injustices the Constitution seeks to make good.[79] Simply, without the current, widespread poverty, and an understanding of the cultural exclusion that has contributed to it, the socio-economic guarantees of the Constitution would lack urgency. In the context of a comprehensively affluent society such basic promises could be mere abstractions, mementos of what once was or a simple abundance of caution on the part of the drafters.

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[78] Section 27 of the Constitution provides that:

(1) Everyone has the right to have access to –

(a) health care services, including reproductive care;

(b) sufficient food and water;

(c) social security, including, if they are unable to support themselves and their dependants, appropriate social assistance.

(2) The state must take reasonable legislative and other measures, within its available resources, to achieve the progressive realisation of these rights.

[79] If the text of the Constitution is not explicit with regard to the elimination of poverty, reference may be made to South Africa's international obligations, notably as a party to the United Nations Convention on Economic and Social Rights, and the Millennium Declaration, both of which require signatories to effect the progressive eradication of poverty. Signatories of the Millennium Declaration, for instance, undertook to 'spare no effort to free our fellow men, women and children from the abject and dehumanizing conditions of extreme poverty...to making the right to development a reality for everyone and to freeing the entire human race from want'. See the Eighth Plenary Meeting of the General Assembly of the United Nations (8 September 2000) that passed resolution 55/2, item 11.

Furthermore, since South Africa has ratified both the Convention on Economic and Social Rights, and the Millennium Declaration, the state is obliged to take appropriate action (under the doctrine of pacta sunt servanda) and such obligations must be considered by the courts when interpreting domestic law. See section 39(1)(b) of the Constitution.

Galbraith argues that human rights are an unavoidable consequence of economic development inasmuch as 'above a certain level of economic achievement, human rights become not only a right but an inevitability'; they are, in his view, 'extensively the product, not of original virtue but inescapable need'.[80] In South Africa, the degree of economic achievement attained by the majority is antecedent to the level that, in Galbraith's schema, renders the classic, civil and political rights inevitable. Consequently, for the economically dispossessed, it is likely that only once poverty has been eliminated and socio-economic expectations have been met, will other rights take on full meaning.[81]

It is most unlikely that a life of unwilled poverty can be a life experienced with a full realisation of dignity. Indeed, avoidable poverty may be described as the material manifestation of the denial of human dignity that the Constitution abhors. (A person in search of spiritual fulfilment may follow a life of indigence but the concern of constitutional government lies with those whose poverty has not been chosen.) And, attendant with this denial of human dignity is the denial of freedom and equality. Generally, then, human rights, and not simply socio-economic claims, lose cogency in a context of poverty, and so, for contemporary South Africa, more than any other development, the elimination of poverty would infuse

[80] Galbraith (1995) (note 43 above) 242

[81] Without the elimination of poverty, education is jeopardised. (For instance, S Chala 'Poverty is the reason' *The Teacher* 23 January 2003 reports that 56 per cent of children absent from school offer poverty as the explanation for their absence.) Without education, an expectation of 'higher' rights is improbable.

constitutional principles with practical possibility.[82] Furthermore, despite the remarkable human capacity for finding happiness in the direst of circumstances, the exclusionary effects of poverty make participation in a full life unlikely. It is incumbent on an individual to find happiness from her fair share of the social product,[83] but, first, she must be included in a consideration for distribution.

I use 'poverty', therefore, as shorthand for the socio-economic claims guaranteed by the Constitution.

(b) Poverty and property

If a fundamental constitutional concern is to eliminate poverty by granting everyone a minimum share in the social product, it may be asked whether such a concern implies a concomitant privileging of property in general. Furthermore, since a modern understanding of 'property' is wide enough to include various

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[82] Effective governance over a broad range of issues only becomes possible if widespread poverty is eliminated. Deleterious socio-economic ills, including the breakdown in the relationship between wages and income; non-delivery of key services because of the inability of the poor to pay for inclusion; and poverty-related crime and social instability, are crucially linked to income poverty. See V Taylor (Chair) *Report of the Committee of Inquiry into a Comprehensive System of Social Security for South Africa: Transforming the Present – Protecting the Future)* RP 53/2002 (2001) para 2.9.
World Bank *World Development Report 2003: Dynamic Development in a Sustainable World* (2002) 184 expressed the fundamental importance of eliminating extreme poverty: 'ending global poverty is much more than a moral imperative – it is the cornerstone of a sustainable world'.

[83] Charles Fried proposes a social minimum in the following terms: 'What is a man due? I would say these things: First, so much of the community's resources that he has a chance to live decently and to make a life for himself - by his own efforts if possible, by the community's aid if those efforts are insufficient. Beyond that he should demand nothing.' See C Fried 'Is Liberty Possible?' *The Tanner Lectures on Human Values* 100, delivered at Stanford University, 14 & 18 May 1981.

manifestations of wealth which are normally taxable,[84] it may be anticipated that a constitutional 'property guarantee' would be a crucial concern for an engagement with the Constitution and, in particular, a constitutional scheme of taxation. However, property is of little current relevance and an equation of poverty with the denial of basic human needs does not elevate property to the level of an inalienable right or the good in the constitutional context.

(i) Textual reticence

First, the text of the Constitution is reticent in guaranteeing property rights. Save for compensatory land requirements,[85] the Bill of Rights explicitly guarantees no more than fair procedures with regard to deprivation of property.[86] This implies

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[84] See, generally, C A Reich 'The New Property' (1964) 73 *Yale LJ* 733
C B MacPherson 'A Political Theory of Property' in his *Democratic Theory: Essays in Retrieval* (1973) 124 defined 'property' as 'a claim which the individual can count on having enforced in his favour by society or the state, by custom or convention of law'.
J De Waal & I Currie *The Bill of Rights Handbook* 5 ed (forthcoming) (non paginated extract) conclude that 'property' for purposes of section 25 'should therefore be seen as those resources that are generally taken to constitute a person's wealth, and that are recognised and protected by law'.

[85] Section 25(5) to (9) of the Constitution

[86] Section 25(1) of the Constitution provides that: 'No one may be deprived of property except in terms of law of general application, and no law may permit arbitrary deprivation of property'.
Ackerman J in *First National Bank of SA Ltd t/a Wesbank* v *Commissioner, South African Revenue Service* 2002 (4) 768 (CC) [48] observed that section 25 'does not expressly guarantee the right to acquire, hold and dispose of property'. However, the protection of extant property holdings is implied.

recognition of existing property holdings in a way reminiscent of Robert Nozick's entitlement principle,[87] and the general Lockean conception of property.[88] Nevertheless, a rational law of general application could extinguish all property holdings without offending the Constitution.[89] In other words, beyond access to land, as a basic socio-economic claim, there is no guarantee to property (or the inviolable maintenance of its integrity) in a way that might, say, obviate government's taxing income or any other manifestation of economic well-being.

Harksen v *Lane NO* 1998 (1) SA 300 (CC) [38] established that 'expropriation', a more specific form of deprivation, requires compensation. This rationale would prevent an optimistic plaintiff from seeking to rely on section 25(2) of the Constitution to oppose taxation. More plausibly, expropriation protections are not relevant to taxation, since the objective of tax laws is not 'solely or chiefly the acquisition' of an individual's property. (See Brennan J in *Mutual Pools & Staff Pty Ltd v The Commonwealth of Australia* (1994) 179 CLR 155 at 177-8, cited in *First National Bank* [83].)

[87] R Nozick *Anarchy, State and Utopia* (1974) (1993 reprint) 150

[88] T Nagel & L Murphy *The Myth of Ownership: Taxes and Justice* (2001) identify the problems of 'everyday libertarianism' that arise from the reception of the Lockean 'myth of property'. But their use of the word 'myth' suggests a mistake in fact; that there is a true, supra-ideological explanation of property, analogous to the way in which a Christian might describe a 'creation myth' of another religion. However, the utilitarian explanation of property, which they appear to espouse, is, in turn, a narrative, and, to that extent, 'mythical' itself. The significant difference between the Lockean and utilitarian conceptions of property is that the former has been well received, particularly in the hegemonic West. It is what Pierre Bourdieu has described as a 'strong discourse'; it is one which has taken hold in the imagination. See P Bourdieu 'Utopia of endless exploitation: the essence of neoliberalism' (trans JJ Shapiro) *Le Monde-Diplomatique* December 1998 (no constant pagination). This imaginative dominance of the Lockean view of property appears to be reflected in *First National Bank* (note 80 above).

[89] The crucial issue in *First National Bank* (note 86 above) [109] was that the deprivation had been arbitrary, not that the relevant property had been seized. De Waal & Currie (note 84 above) conclude that: 'A deprivation is substantially arbitrary if there is insufficient reason for it.'

(ii) Lack of horizontal conflict

Second, there is no conflict of rights under taxation in the way that, for instance, squatting may give rise to competing interests in immovable property. Under taxation, any dispute lies vertically between a property holder and the state; not horizontally, as between two bearers of competing interests in private, immovable property. (There may, of course, be a conflict of expectations held by different taxpayers, but not actionable rights.) Furthermore, there can be no doubt that the constitutional state retains the general prerogative of eminent domain, to use the property of its citizens for the common welfare.[90]

(iii) Property rights and others' interests

Third, although *First National Bank*[91] has strongly confirmed common law property rights, as Davis J observed in *Oudekraal Estates*, under the constitutional dispensation, 'the concept of property [must] be looked at afresh...as a connecting medium between the individual's needs and those of society'.[92] Furthermore, while the courts have not been consistent in their approach to property under the constitutional dispensation,[93] *Port Elizabeth Municipality* provides an indication of what a constitutionally realised judicial

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[90] T Bennett 'Aboriginal Title in South Africa' Paper presented at 'The International Conference on Land Tenure in the Developing World with a focus on Southern Africa' University of Cape Town, 27-29 January 1998 (No constant pagination)

[91] See note 86 above.

[92] *Oudekraal Estates (Pty) Ltd v City of Cape Town* 2002 (6) SA 573 (C) at 594J – 595A

[93] See AJ van der Walt 'Exclusivity of Ownership, Security of Tenure and Eviction Orders: A Critical Revaluation of Recent Case Law' 2002 (18) *SAJHR* 371 for a review of relevant cases.

approach to property might look like: in essence, it calls for a fusion of interests, with cognisance taken of 'realities and practicalities'.[94]

Secure property rights are crucial in a modern polity. However, the right not to be deprived of property arbitrarily is just one claim amongst many enshrined by the Bill of Rights. Crucially, the constitutional community is founded on the values of human dignity, equality and freedom, and none of these is likely to be achieved for the majority if the extant property holdings of a minority are considered inviolable. Provided tax laws are not arbitrary, a person may be deprived of property by way of taxation in whatever ways and to whatever extent the government of the day deems fit. Nevertheless, government which wishes to pursue the iustitia communis or ubuntu society will ensure that its scheme of taxation is thoroughly informed by constitutional values and will seek to fuse interests with needs.

(c) Inequality

It would be specious to compare the condition of the poor of the constitutional community with the condition of the wealthy of the Western world or the poorest of the developing world. Nevertheless, a widespread material lack (in absolute and relative terms) coexists in the constitutional community with significant wealth and abundance.

In 1995, the poorest 20 per cent of the South African population received only three per cent of the country's household income.[95] We can be confident that this poorest one fifth is comprised predominantly, if not wholly, of Blacks. But the

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[94] Horn AJ in *Port Elizabeth Municipality v Peoples Dialogue on Land and Shelter* 2000 (2) SA 1074 (E) 1083D

[95] Udjo et al (note 76 above) Appendix 1

wealth divide is not simply one of race. It has previously been noted that women are disproportionately represented amongst the poor, but there are also significant inequalities within identifiable racial groups. For instance, it is often assumed that the White population is an island of the West in Africa but the distribution of wealth amongst Whites is consistent with that of a developing, not an economically developed, country.[96]

IV CONCLUDING COMMENTS

The Constitution is fundamentally optimistic. It has mined the noblest, local and universal traditions and ideals to intimate a vision of a society that is just and governed by reason. However, this template applies to a society that is distinguished by poverty and inequality. The constitutional vision can only be entertained if this poverty and equality are made good. Thus, Chaskalson P observed in *Soobramoney* that it is the commitment to address poverty and inequality, 'and to transform our society into one in which there will be human dignity, freedom and equality' that 'lies at the heart of our new constitutional order'. He concluded that 'For as long as these conditions continue to exist that aspiration will have a hollow ring'.[97] Inequality and lack are not experienced solely in relation to wealth but are felt across the range of criteria by which human development and well-being may be gauged. Nevertheless, a constitutional scheme of taxation can have considerable impact on poverty and inequalities in the distribution of wealth, thereby contributing significantly to constitutional goals.

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[96] According to Whiteford et al (note 61 above) 21, the Gini coefficient for the White population in 1995 was 0,45, compared to the Western norm of less than 0,3.

[97] *Soobramoney* (note 21 above) [8]

CHAPTER 3 EXPECTATIONS OF THE CONSTITUTIONAL COMMUNITY

I INTRODUCTION

The fundamental goal of the Constitution[1] is the progressive realisation of full lives for everyone in the constitutional community.[2] This objective must be actualised in the context of poverty and inequality.[3] In this chapter, I consider what the socio-economic rights enshrined in the Constitution, situated in the context of poverty and inequality, might practically lead a member of the constitutional community to expect.

II USE OF 'EXPECTATION'

Members of the constitutional community expect that the values of human dignity, equality and freedom will be respected and manifest in every area of social life. Furthermore, these values, along with the expectation of prudent and honest governance, shape the underpinning principles of a constitutional scheme of taxation. I use the word 'expectation' (and not in a technical sense) rather than the usual 'right' for several reasons:

(a) Expectations and the broad constitutional message

By using 'expectation', I seek to distance this study from the precise, justiciable technicalities of the Constitution and ancillary legislation. I look to the Constitution for its fundamental ethical message, rather than the rules that a court might enforce. Unlike a right, an expectation corresponds with this broad approach.

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[1] Constitution of the Republic of South Africa Act 108 of 1996 (Constitution)

[2] See Chapter 2, para II (c) above.

[3] See Chapter 2, section III above for an outline of the context of poverty and inequality.

(b) Importance of duties

A member of the constitutional community not only holds rights but also owes obligations,[4] principally, the duty to comply with the community's laws.[5] Furthermore, duty is not bare, rather it is reflexive, since the community member expects those laws to conform to constitutional values (and for others to comply with the laws). Her duty to pay tax, for instance, will be understood within the context of what is imagined to be right and fair by the constitutional community.

(c) Indivisibility of right and duty

A bifurcation between right and duty is neither inevitable nor universal. In this regard, John Finnis argues that such a distinction was unknown to classical Roman law and observes that the Tswana word *tshwanelo*, translatable as 'due', serves to function both as the word for 'right' and 'duty' as 'it looks both ways along a juridical relationship'.[6] This is a particularly compelling idea for taxation, since the recognition of a specific tax duty within a broader scheme of potential claims should not be lost.

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[4] Section 3(2)(b) of the Constitution

[5] Langa DP in *City Council of Pretoria* v *Walker* 1998 (2) SA 363 (CC) [93] observed that 'The kind of society envisaged in the Constitution implies also the exercise of responsibility towards the systems and structures of society'.

[6] J Finnis *Natural Law and Natural Rights* (1980) 209. HR Hahlo & Ellison Kahn *The South African Legal System and Its Background* (1968) 76 note 1 illuminate the coincidence in meaning of 'law' and 'right' in one word in many languages.

(d) Expectations are open

The idea of a specific, actionable right may be unduly constraining and an insufficient indicator of an expectation of liberty. In this way, Ivan Illich distinguishes between liberties and rights in a modern state, identifying liberties as protecting 'use-values', and rights as protecting access to commodities. He concluded that 'just as commodities can extinguish the possibility of producing use-values and turn into impoverishing wealth, so the professional definition of rights can extinguish liberties and establish a tyranny that smothers people underneath their rights'.[7] This is a useful observation as it implies autonomy and open-ended potential. Adopting his instantiation: physical and psychological well-being should be fostered in the community (with an individual actively contributing to the maintenance of her own health) rather than the right being proclaimed for an ill person to demand specific treatments for maladies which have arisen, that is, to be the subject of medicalisation.

(e) Expectations and practicability

Finally, an expectation implies practicability. It sets a claim in the context of what is feasible under the relevant circumstances.[8] Unlike a right, which may be an abstraction, a reasonable expectation is something that is realisable; what a

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[7] I Illich *The Right to Useful Unemployment and its Professional Enemies* (1978) (1996 reprint) 79 While many will find Illich's views, particularly those relating to health professionals, to be intemperate and implausible, he plays the important dissident role of giving pause for thought, for prompting a reassessment of what strategies are most socially desirable and whether progressive policies really do improve the condition of purported beneficiaries.

[8] OW Holmes 'Natural Law' (1918) 32 *Harvard LR* 40, 42 observed that for legal purposes 'a right is only the hypostasis of a prophesy' and so, without the likelihood of actuation, a guarantee of socio economic provision is practically meaningless.

member of the constitutional community believes ought and can happen to her in her life.

III LEGAL AND PRACTICAL CONSTRAINTS

The fundamental determinants of the constraints on expectations are contained in the constitutional text. These include:

(a) Low material expectations

There can be no expectation of a guarantee of high material standards of living for all: the text of the Constitution consistently refers to 'basic' provision.[9]

(b) State as guarantor, not primary provider

A socio-economic claim is actionable against the state by default only.[10] If all community members' socio-economic needs were satisfied privately by familial, charitable or private social security arrangements, then, at first face, no further providential action would be required on the part of government. Under such circumstances, government's relevant concerns would lie mainly with regulation and combating unfair exclusion.[11] Nevertheless, in practice, private sources are unlikely to provide for the most needy members of society, and so inevitably

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[9] Z Motala 'Socioeconomic Rights, Federalism and the Courts: Comparative Lessons for South Africa' 112 (1995) *SALJ* 61, 70 argues that the constitutional state is obliged to 'intervene actively to provide high material standards of living for all, as opposed to leaving this function to be filled in the marketplace.' There are no obvious grounds for this assertion.

[10] Yacoob J in *Government of the Republic of South Africa* v *Grootboom* 2001 (1) SA 46 (CC) [81]

[11] V Taylor (Chair) *Report of the Committee of Inquiry into a Comprehensive System of Social Security for South Africa: Transforming the Present – Protecting the Future* RP 53/2002 (2001) para 4.5

government will be required to intervene actively to meet the socio-economic needs of many community members.[12]

The socio-economic claims contemplated in the Bill of Rights are indubitably justiciable,[13] but do not give rise to an open-ended right of action. For instance, there is no conferral of minimum core benefits as a self-standing right,[14] and an individual's demand for a specific benefit against a state agency will not be upheld where the relevant authority has prioritised needs within budgetary constraints.[15] However, if reasonable provision has not been made within the available budget, or the relevant policy is unreasonably inflexible,[16] a complainant may have grounds for action.

The rights of access to land,[17] housing,[18] health care, food, water and social services,[19] are explicitly subject to budgetary constraints and progressive realisation. Yet, as *Grootboom* has indicated, even with regard to children's unfettered rights to basic nutrition, shelter, basic health care services and social

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[12] See Chapter 4, section IV below for a discussion of the circumstances under which the state should intervene to ensure dignity, notwithstanding adequate socio-economic provision.

[13] *Minister of Health* v *Treatment Action Campaign* (2) 2002 (5) SA 721 (CC) [25]

[14] *Treatment Action Campaign* (note 13 above) [34]
However, the proposal of minimum core benefits may be relevant to a query of reasonableness.

[15] Chaskalson P in *Soobramoney* v *Minister of Health (KwaZulu)* 1998 (1) SA 765 (CC) [11]

[16] *Treatment Action Campaign* (note 13 above) [80]

[17] Section 25(5) of the Constitution

[18] Section 26 of the Constitution

[19] Section 27 of the Constitution

services,[20] and the right to basic education,[21] there cannot be an expectation of delivery on demand.

IV CONCLUDING COMMENTS

It is possible and expectable that the state will act reasonably to provide access to the socio-economic rights guaranteed in the Bill of Rights on a progressive basis.[22] In particular, since poverty may be equated with socio-economic need, the constitutional state is expected to eliminate poverty on a progressive basis. Indeed, the fundamental expectation of the constitutional community is that extreme poverty will be eliminated. A scheme of taxation that is true to the Constitution will be instrumental in achieving this goal.

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[20] Section 28(1)(c) of the Constitution

[21] Section 29(1) of the Constitution

[22] *Treatment Action Campaign* (note 13 above) [35]

CHAPTER 4 HUMAN DIGNITY

I INTRODUCTION

In this chapter, I consider human dignity, the most important of the foundational values of the Constitution.[1] I describe dignity in these terms as the other foundational values, freedom and equality, can both be seen as manifestations of dignity.[2] To bring full meaning to dignity in the constitutional context, it is necessary to turn to the African concept of ubuntu since this unequivocal relates to the innate 'humanness' of people rather than any socially constructed status. Yet, as I seek to demonstrate, the informing principles of ubuntu and its consequences for social policy are not uniquely African, rather ubuntu speaks a 'universal' truth.[3]

II UBUNTU

(a) The primary ethical benchmark of dignity

A respect for human dignity is the root value of the Constitution,[4] and the wellspring of each community member's expectations. She expects her fellow

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[1] Constitution of the Republic of South Africa Act 108 of 1996 (Constitution)

[2] See para (c) below.

[3] A Sen 'Democracy as a Universal Value' *J of Democracy* 10.3 (1999) 3, 12 argues that 'the claim of a universal value is that people anywhere may have reason to see it as valuable'. Since the message of ubuntu is likely to found valuable by people everywhere, in Sen's conception, it may be described as 'universal'.

[4] O'Regan J in *Dawood* v *Minister of Home Affairs* 2000 (3) SA 936 (CC) [35] concluded that 'Human dignity therefore informs constitutional adjudication and interpretation at a range of levels. It is a value that informs the interpretation of many, possibly, all other rights'. [Footnotes omitted]

community members to respect her dignity and she expects government to protect and nurture her dignity.[5]

(b) Dignity and the common law

A conception of human dignity generating justiciable expectations is recognised in the South African law of delict. However, the relevant actio iniuriarum, although it may be a starting point for a consideration of justiciable dignity,[6] since such an action requires subjective impairment of the complaint's self-esteem,[7] must be an insufficient basis for a constitutional conception of dignity. In its Roman law origins, dignitas seems closer to a conception of an individual's reputation,[8] whose infraction is an actionable tort under the Anglo common law. A conception of dignity suitable for the constitutional context should spring from the 'universal' or permanent human condition, and, untainted, to the extent feasible, by subjectivity and concerns of status, must relate to the immanent 'value and worth' of every person.[9] This dignity is the primary ethical benchmark. It

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[5] Section 10 of the Constitution provides that 'Everyone has inherent dignity and the right to have their dignity respected and protected'. Sections 7(1), 36(1) and 39(1) of the Constitution also confirm the importance of dignity.

[6] D Leibowitz & D Spitz 'Human Dignity' in M Chaskalson et al (eds) *Constitutional Law of South Africa* (1996, 5 rev 1999) 17-i generally see the common law as a starting point for an examination of dignity.

[7] J Burchell *Principles of Delict* (1993) 198

[8] JAC Thomas *Textbook of Roman Law* (1976) (1986 reprint) 369 describes iniuria as 'any deliberate affront, insult or contumely to another'.

[9] Skweyiya AJ in *Du Toit* v *Minister of Welfare and Population Development* 2003 (2) SA 198 (CC) [29]

encapsulates the 'intrinsic humanity divested of all socially imposed roles or norms' and 'pertains to the self as such, to the individual regardless of his position in society.'[10] It is crucial here to distil dignified personhood from the power and wealth a person may command at a particular point in time.[11] This is why, in pursuing the idea of an intrinsic human dignity, I emphasise dignified corporeality, a fundamental respect for each person's body and mind, not their temporal possessions or arbitrary status.

(c) Dignity and ubuntu

While the common law does not provide an adequate enunciation of a community member's expectation of respect for her dignity, the indigenous idea of ubuntu, 'the recognition of human worth and respect for the dignity of every person',[12] does express the idea. The importance of human dignity for the constitutional community cannot be underestimated in the light of the physical and psychological humiliation of colonialism, apartheid and patriarchy, whereby people have been 'culturally undervalued, socially segregated and psychologically demeaned'.[13] It is appropriate, then, when colonial institutions have failed to recognise the immanent humanity in all people that the constitutional community should turn to African values for guidance.

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[10] P Berger 'On the Obsolescence of the Concept of Honour' in MJ Sandel (ed) *Liberalism and Its Critics* (1984) 149, 153

[11] Hegel's 'imperative of right' was 'Be a person and respect others as persons', cited by EB Pashukanis *Law and Marxism: A General Theory* (1929) (trans B Einhorn, 1978) (1989 reprint) 111.

[12] Ngcobo J in *Hoffmann* v *South African Airways* 2001 (1) SA 1 (CC) [38] note 31

[13] AA Mazrui *The African Condition* (1980) (1982 reprint) 28

Ubuntu is commonly illuminated by reference to the Xhosa proverb *umuntu ngumuntu ngabantu*, rendered *mothe ke botho babang* in Sesotho,[14] which 'describes the significance of group solidarity on survival issues so central to the survival of communities'.[15] Although different translations are offered which indicate ideological nuances, this saying is generally taken to mean 'a person is a person through other human beings'.[16]

(d) Ubuntu and situation

A second aspect of ubuntu, then, is its expression of the fundamental fact of human or social existence. Necessarily and fruitfully, an individual possessed of immanent dignity lives amongst dignified others. (It appears that, traditionally, southern African conceptions of situated personhood have incorporated transcendental elements of location within a specific geographical place and the realm of ever-present ancestors.[17] Nevertheless, ubuntu, like the East African

[14] Used, for instance, by Ronnie Kasrils, then Deputy Defence Minister, in an interview in *Sunday Independent* 13 April 1997 to sum up the meaning of ubuntu.

[15] Mokgoro J in *S* v *Makwanyane* 1995 (3) SA 391 (CC) [308]

[16] HC Ngambi 'Community leadership: The cases of an African village and an American firm' *SA Business R* 1999 3(2) 27. M Battle 'The Ubuntu Theology of Desmond Tutu' in L Hulley, L Kretzschmar & LL Pato (eds) *Archbishop Tutu: Prophetic Witness in South Africa* (1996) 93, 100 cites with approval Augustine Shutte's version of 'a person depends on other persons to be a person'. DJ Louw 'Ubuntu: An African Assessment of the Religious Other' a paper presented at *Paideia*: Twentieth World Conference of Philosophy, Boston, MA 10-16 August 1998 opts for Willie van der Merwe's 'to be human is to affirm one's humanity by recognizing the humanity of others in its infinite variety of content and form'. MJ Bhengu *Ubuntu: The Essence of Democracy* (1996) 6 offers 'a person realises his Ubuntu by listening to and taking advice and criticism from other human beings'.

[17] K Brown 'Globalization and Cultural Conflict in Developing Countries: The South African Example' *Indiana J of Global Legal Studies* Fall 1999 Vol 7:225, 232

concept of *muntu* - meaning 'man' or 'mankind' - is generally presented in secular humanist terms, and does not require acceptance of a particular cosmology.[18] The precepts of ubuntu are derived from a specific cosmology that developed within cultural codes and techniques that are rightly dismissible as inadequate or superstitious relative to contemporary requirements. However, these origins cannot preclude the tenets of ubuntu being applied in a contemporary secular polity any more than the roots of universal human rights, being in Christian theology, should preclude their modern employment.[19])

(e) Ubuntu and values of other cultures

There is a tendency to obfuscate rather than illuminate similarities between African and European social ideas. However, arguments on these lines are unpersuasive and frequently reliant on implausible cultural stereotypes to distinguish organic, African group sensibilities from theorised, European, individuated sensibilities.[20] Recognition of an individual's community situatedness is deep-rooted in European folkways and philosophy,[21] and, of course, those of other cultures. For instance, Heidegger's highly influential proposition of *Dasein* or being-in-the-world is that we become human inasmuch as we relate to and are

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[18] AA Mazrui *The Africans: A Triple Heritage* (1986) 295

[19] LL Weinreb 'Natural Law and Rights' in RP George (ed) *Natural Law Theory: Contemporary Essays* (1992) 278, 279 observes that Aquinas, arguably the font of universal human rights, 'likewise did not, in the first instance, uphold rights of the individual; rather, it confirmed his personal responsibility while still within and still subject to the Providence of an omnipotent God'.

[20] See, for instance, Battle 100, and Louw (note 16 above).

[21] Makgoro J observed in *Makwanyane* (note 15 above) [308] that 'In the Western cultural heritage, respect and the value of life, manifested in the all-embracing concepts of 'humanity' and 'menswaardigheid', are also highly priced'.

bound up with others within the material world.[22] This proposition corresponds directly with the basic existential fact that animates ubuntu. At a level of constitutional law, the German Constitutional Court has held that 'the image of man in the Basic Law is not that of an isolated, sovereign individual. On the contrary, the Basic Law has resolved the tension between the individual and society in favour of coordination and interdependence with the community without touching the intrinsic value of the person.'[23] This statement encapsulates the fundamental proposition of the Constitution and, with it, ubuntu.[24] Generally, traditional African sensibilities seem to imply comparable cultural solutions to the existential problems of discrete, human beings existing in community with others as, say, natural law or Islamist theory.[25]

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[22] P Schank 'Understanding Postmodern Thought and its Implications for Statutory Interpretation' (1992) *Southern California LR* 65/6 2505, 2519

[23] Investment Aid Case I of 1954 (1954) 4 *BVerfGE* 7, cited by Z Motala 'Socioeconomic Rights, Federalism and the Constitution: Comparative Lessons for South Africa' (1995) 112 *SALJ* 61, 75

[24] J Sindane 'Ubuntu and nationbuilding' *Newsletter of Human Sciences Research Council Centre for Constitutional Analysis* Year 6 No 3 1995 has suggested further correlation, such that ubuntu may play a similar role to *Bundestreu* (federal trust) under the German *Grundgesetz* (Basic Law). However, *Bundestreu* appears to relate specifically to the relationship between the German Federation and its constitutive *Länder*, and not directly to relations between the State and citizens, or between citizens themselves.

[25] See, for instance, M Al-Jamri 'Human Rights: An Islamist Perspective' International Forum for Islamic Dialogue (1998) for the similarities between Islamist thought on human rights and natural law, and, I would add, ubuntu.
See Chapter 20 below for a discussion of reparation as a 'natural' legal principle and the role of reparation in indirect taxation.

Ubuntu is distinguished, then, not by its difference from many Western and other ideologies, but by its consonance with them.[26] A practical distinction may, lie in the fact that, for many Western people who are inclined to communalist ideals, having been immersed in the mythologies of liberal ideology, communalism represents a political vision to be attained. Yet, for many African people, personal or family memory presents communalism as a lived experience. In broad terms, ubuntu, like Islam and Thomist natural law, has a fundamental telos of a just, social harmony, and immanent within it 'the ideas of humaneness, social justice and fairness.'[27] Social injustice must be considered inimical to social harmony - 'harmony', it is stressed, not 'status quo'. In a comparable way, Aquinas and later social natural law theorists emphasised a concern 'with the creation and maintenance of a harmonious social whole, bringing about a synthesis between society and the individual'.[28]

Naturally, caution must be exercised in seeking to amplify and apply the cultural solutions of close, supposedly homogeneous communities onto an infinitely diverse, national community. Such an exercise may engender simple disbelief or

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[26] In *Makwanyane* (note 15 above) [309], Makgoro J, having asserted that inherent human dignity is the source of all human rights, notably those enshrined in the International Covenant on Civil and Political Rights, concluded that this idea 'is not different from what the spirit of ubuntu embraces'.

[27] Madala J in *Makwanyane* (note 15 above) [237]

[28] E Kamenka 'What is justice?' in E Kamenka & A Erh-Soon Tay (Editors) *Justice* (1979) 1, 3 He adds that this is achieved by 'putting emphasis not on subjective rights but upon an objective social equilibrium'. The challenge for constitutional government, as for any just government, lies in promoting social equilibrium without sacrificing subject rights.

suggest the prospect of some form of totalitarianism.[29] Nevertheless, the vision suggested by ubuntu of dignified individuals living in a community distinguished by organic, social harmony, represents the telos of the Constitution realised.

III INTERRELATION OF DIGNITY, FREEDOM AND EQUALITY

Under the constitutional dispensation, freedom and equality must be considered together and through the prism of the core value of dignity.[30] Rather than mutually exclusive choices, they must be recognised as mutually complementary elements of human dignity and a reflexive respect for the humanity immanent in every person. Four aspects of human dignity or ubuntu may generate expectations of a member of the constitutional community relevant to a constitutional scheme of taxation.[31]

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[29] F Fanon *Black Skin, White Masks* (1952) (trans CL Markmann, 1967) (1991 reprint) 34 was acutely aware of Négritude's over zealous desire to disprove the colonial conception of there being no African 'culture, no civilization, no 'long' historical past', and Mazrui (1986) 74 (note 18 above) identifies a Romantic gloriana, particularly in Nkrumah's post-independence Ghana, in which it was sought to attribute 'almost all the ingredients of literate culture and written science' to African origins.

[30] DM Davis 'The Underlying Theory that Informs the Wording of Our Bill of Rights' (1996) 113 *SALJ* 385, 393 characterised 'the harmonization of liberty and equality within the particular African context of ubuntu' as the 'fundamental underpinnings of the [Interim] Constitution'.
The text of the Constitution does not explicitly refer to ubuntu as the 'Postamble' to the Constitutional of the Republic of South Africa Act 200 of 1993 (Interim Constitution). Nevertheless, the Constitutional Court has turned to ubuntu to enunciate the idea of human dignity in the Constitution, particularly where the matter touches human existence at a fundamental level, as was the case in *Hoffmann* (note 12 above).

[31] Naturally, this approach is not the only one that may be adopted or complete but captures the fundamental message of the Constitution.

(a) Inherent corporeal dignity

The first aspect relates to recognition of the discrete corporeality of a person, her unique and independent body and mind.[32] This gives rise to an expectation, on the one hand, of freedom from corporeal want, expressed positively, the expectation that bodily needs, such as food, shelter and health,[33] will be met, and, on the other hand, of freedom from unjustified infractions against the physical or psychological self, such as unapproved restrictions or violence.[34]

(b) Bio-liberty

The second aspect relates to autonomy, and a resultant expectation of being free to realise an identity which is not decreed by others, and the space to investigate and live out one's own take on a fulfilled existence. I will refer to these together as an expectation of 'bio-liberty' as their fundamental concern lies with the

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[32] Sachs and O'Regan JJ observed in *S* v *Jordan* 2002 (6) SA 642 (CC) [81] that 'the constitutional commitment to human dignity invests a significant value in the inviolability and worth of the human body'.
J Finnis *Natural Law and Natural Rights* (1980) 83, in finding commonalities in different cultures, claims that all societies value the human body through the following practices: demonstrating a concern for human life; permitting self-preservation as a proper motive for action; prohibiting the taking of life without definite justification; seeing procreation of new human life as 'good'; restriction of socially harmful sexual activity; and respectful disposal of the dead.

[33] Notably the socio-economic needs considered in section 27 of the Constitution.

[34] Examples include: provisions of the criminal law which punish, and so protect against, assault and rape; comparable tenets of the law of delict; but especially constitutional guarantees with regard to freedom and security of the person, freedom from slavery, and just treatment on being arrested.

freedom of the dignified human body and mind.[35] (The recognition of every person as a discrete body, incorporating a unique cognitive system, as opposed to, say, part of a social organism, does not imply an atomistic existence. A conception of a discrete body and mind is not incompatible, for instance, with propositions that society operates in a way comparable to an organism or that knowledge is socially constructed. Discrete corporeality is a basic fact of biological existence but implies little about how society might be arranged.)

(c) Dignity in relation to dignified others

A third aspect of human dignity relates to the situation of an individual community member in relation to other community members - in essence, the constitutional equality guarantee. I do not suggest that the particular ideals of equality expressed in the text of the Constitution are manifest in traditional African societal arrangements. The treatment of women, in particular, has been markedly unequal from a constitutional perspective. Ubuntu, as it may inform the Constitution, is a developing philosophy, not a rigid code of conduct.

(c) Metaphysical dignity

A fourth aspect, which beyond recognising I will not pursue, also relates to the realisation of a full life, but transcends corporeality and takes cognisance of the common tendency in people to hold a metaphysical yearning or religious faith which is only realisable with and amongst others.[36] The ethical scheme I have

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[35] M Foucault 'Right of Death and Power over Life' in P Rabinow (ed) *The Foucault Reader* (1984) (1991 reprint) 258, 262 describes the development of techniques for 'achieving the subjugation of bodies and the control of populations' as the beginning of the era of 'bio-power'. It will become evident that certain of these techniques of social control are the key to liberating the dispossessed – hence my use of the derivative term 'bio-liberty'.

[36] Finnis (note 32 above) 83, for instance, makes a plausible claim for the universality of religion.

presented may be a wholly secular one, but is not incompatible in practice with ethical values which are derived from a metaphysical foundation.[37] I see similarities, at a foundational level, between a secular constitutionalism and traditional African social philosophy (which incorporates animism), Islam and Thomist natural law.

IV DIGNITY AND POLICY

(a) Respect for dignity and policy

Following *Grootboom*,[38] it might be inferred that, beyond ensuring fairness, government has no role to play in socio-economic provision if such needs are met privately, for instance, through familial or charitable arrangements.[39] Yet, besides issues relating to the justice of a system that might allocate an unwilled dependency to some and to others a superfluity of wealth sufficient to permit charitable donations, it would be incongruous if the members of the constitutional community, having been characterised as dignified members of a society which seeks social harmony and fully realised lives, were to be dependant on the uncertain generosity of others to survive. Consequently, the ways in which socio-

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[37] In this regard, U Eco *Five Moral Pieces* (trans A McEwen, 2001) 26 proposes that a schema of secular ethics may be founded on natural reality, that is, the human body and the instinct of a metaphysicality that only has meaning in the presence of others. He considers this proposal to be eminently compatible with Christian doctrine.

[38] Yacoob J in *Government of the Republic of South Africa* v *Grootboom* 2001 (1) SA 46 (CC) [81] held that the state's obligations with regard to the amelioration of socio-economic lack 'is to provide access to housing, health-care, sufficient food and water, and social security *to those unable to support themselves and their dependants*'. (Emphasis added.)

[39] V Taylor (Chair) *Report of the Committee of Inquiry into a Comprehensive System of Social Security for South Africa: Transforming the Present – Protecting the Future* RP 53/2002 (2001) para 4.5

economic claims are met, particularly how government ensures them, must be informed by constitutional values, notably a respect for dignity. Methods of provision that, in either design or practice, lead, for instance, to humiliation, even if instrumentally effective, cannot be congruent with the Constitution.

(b) Urgency of inclusion

Returning to the idea of corporeality, which considers dignity in terms of physical and psychological well-being, programmes which are characterised by 'inclusion' rather than 'charity' can have significant positive impact on corporeal dignity. Children, in particular, are likely to suffer when policies do not seek inclusion.[40] This implies that policies based on the principles and practices of social solidarity and inclusion are likely to be most appropriate for constitutional governance, provided, of course, that they are effective.

There is, then, a fundamental expectation of 'living as a human being, being part of a broader community, and sharing in the experience of humanity.'[41] If this expectation is to be met, there must be a comprehensive programme of inclusion.

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[40] S Phipps 'An International Comparison of Policies and Outcomes for Young Children' Canadian Policy Research Networks Study No F/OS (1999) studied and compared the tax policies with regard to children of five industrialised countries and the general well-being of children in those countries. Phipps 131 discovered that generally Norwegian children were physically and psychologically most healthy, with children in the United States faring worst. This could not be attributed to a parsimonious expenditure on children's health by the United States but rather a failure to include all children, particularly the most vulnerable. Significantly, in this regard, she characterised the general United States approach to programmes for children in terms of 'charity' rather than 'inclusion', compared to Norway's broad policy objective of achieving social solidarity, 'providing at least some support for all children in acknowledgement of shared social and private responsibility for the well-being of children'.

[41] Chaskalson P in *Soobramoney* v *Minister of Health (KwaZulu)* 1998 (1) SA 765 (CC) [17]

will serve as the platform for the delivery of other constitutional guarantees:[42] freedom, since freedom cannot be enjoyed until threshold human needs have been met, and equality, since 'Equality includes the full and equal enjoyment of all rights and benefits.'[43] If due consideration is not paid to the opportunities (absolute and relative) of every member of the community to participate in the activities and share in the benefits which community living makes possible, then, dignity is denied and promises of freedom and equality simply cannot be fulfilled.

(c) Contextual relevance

A conception of dignity, as it may inform policy, must be relevant to and conscious of the circumstances of the context in which it is to operate. All people are possessed of immanent dignity and so are worthy of equal respect by the state and their fellow community members, yet different members of the constitutional community are simply endowed with differing capacities,

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[42] An expectation of inclusion by the community on the part of an individual is met with an expectation on the part of the community as a whole that an individual will fulfil certain obligations, such as, paying her taxes and refraining from free-riding. A less obvious expectation with regard to an individual's 'includability', which arises from extra-legal social pressures, is that she should behave in a way that invites inclusion by the community. Certainly, the proposal that an individual bears a burden of includability is problematic but does not create the potential for individual oppression. Rather, it recognises the tension and potential for stifling individuality, which are always present in society. In its mildest forms, society's expectation of includability on the part of an individual produces pressures to conform in mundane ways; in its severest manifestations, it assists the most oppressive of totalitarian control. Nevertheless, an individualist declaration of autonomy does nothing to change social reality, which is why Henry David Thoreau's proposition of polite anarchism (in effect that he might refrain from paying taxes but otherwise remain undisturbed in the community) is untenable in any sustainable society. The result, as Thoreau discovered, will be prosecution by the state and quotidian exclusion by the members of his community. See HD Thoreau *The Variorum Civil Disobedience* (1849) (1969 reprint).

[43] Section 9(2) of the Constitution

characteristics and motivations. By virtue of no repugnant forces, these differing endowments will give rise to differing economic outcomes in a market influenced economic system. Even extreme variance in economic outcomes cannot alone represent a breach of the constitutional dignity imperative. Nevertheless, extreme poverty is the material manifestation of the denial of human dignity that the Constitution abhors. Furthermore, intuitively, there must arrive a point in a market-based society at which inequalities in economic outcomes become humiliating and so offend human dignity. A crucial lesson to be learnt from South African history is that there can be no respect for dignity when certain elements of the community are excluded. Furthermore, a corrective inclusion must be comprehensive and meaningful, incorporating a share in all manifestations of the social product. Practicability and political ideology may proscribe the extent to which equality may be pursued but it must be recognised that those who are excluded and extremely poor, relative to their fellow community members, are also likely to be dispossessed of dignity.

V CONCLUDING COMMENTS

Enshrining human dignity as the cornerstone of the Constitution will amount to little more than a hollow gesture without concrete effect. As the denial of human dignity under apartheid, manifest in humiliation and repudiation of equal humanness, was a real and lived experience, so, under the constitutional dispensation, members of the constitutional community must recognise in their lives the state's respect for human dignity. A primary objective of a constitutional scheme of taxation will lie in promoting that recognition.

CHAPTER 5 FREEDOM

I INTRODUCTION

Freedom is the most problematic foundational value in relation to a constitutional scheme of taxation. For instance, although the Bill of Rights[1] springs from the liberal humanist tradition,[2] the classical liberal conception of freedom,[3] can have little influence on a constitutional scheme of taxation. Simply, freedom conceived in that way is unhelpful in promoting constitutional goals. My purpose in this chapter is, then, to identify a conception of freedom that is apposite to the constitutional community and its scheme of taxation. The freedom I describe may appear unduly restrictive. It emphasises liberation in a very basic sense, that is, freedom from corporeal need. Yet, this is the manifestation of freedom most appropriate for current circumstances, and whose realisation will go furthest to liberate the majority of the constitutional community.

II A CONCEPTION OF FREEDOM RELEVANT TO THE CONSTITUTIONAL COMMUNITY

(a) Negative liberty

If everyone were to claim a right of untrammelled liberty and, consequently, exercised unrestrained will, interminable and polycentric conflict would be the likely consequence.[4] The classical liberal project, in seeking to privilege individual

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[1] Chapter 2 of the Constitution of the Republic of South Africa Act 108 of 1996 (Constitution)

[2] See Chapter 2, para II (a) note 6

[3] I take Richard Epstein's enunciation of 'taxation in a Lockean world' as representative of a liberal theory of taxation. See RA Epstein 'Taxation in a Lockean World' in J Coleman & E Frankel Paul (eds) *Philosophy and Law* (1987) 39.

[4] I have in mind here a break down of existing societal constraints, rather than a pessimistic 'natural condition' of man as imagined by Thomas Hobbes. (See T Hobbes *Leviathan* (1651) (1973 reprint) 64.)

liberty,[5] yet take cognisance of this potential for social chaos, has sought 'to draw a line in the sand' around a person's freedom beyond which no other may trespass. In *Ferreira*, Ackermann J expressed broad support for Isaiah Berlin's enunciation of such a 'negative liberty', that is, a freedom from extraneous interference, 'the right of individuals not to have "obstacles to possible choices and activities" placed in their way by...the State'.[6] Although his argument was opposed on technical grounds,[7] the overall tenor of the Constitution does not justify an outright rejection of this classical liberal conception of liberty.[8] By establishing rights and freedoms and then setting the conditions under which they may be limited, many provisions of the Bill of Rights seem to be wholly compatible with the general conception of negative liberty. Besides, Berlin's principal aim appears to have been to champion negative liberty over positive liberty, in his words, 'being one's own master',[9] or rather the way in which

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[5] There is a tendency to assume that liberty is something inherently good and desirable. R Dahrendorf presents a more pessimistic view his essay 'Seeking Rousseau, Finding Hobbes' in *Law and Order* (1985) 43, arguing that 'Liberty always tends to anarchy, and we have seen that there may be a strain towards anomy in modern societies. But this strain is self-destructive. Anarchy and anomy do not strengthen liberty...Freedom to choose means almost by definition the absence of normative constraints on our actions'.
The Constitution includes freedom as a foundational value and so an appropriate manifestation of freedom must be considered good in the constitutional context.

[6] *Ferreira* v *Levin NO* 1996 (1) SA 984 (CC) [54]

[7] It was not relevant to the specific provision under consideration. See Chaskalson P in *Ferreira* (note 6 above) [169].

[8] Section 7(1) of the Constitution affirms 'the democratic values of human dignity, equality and freedom'. While it would be incorrect to seek to apply a general concept of freedom to a specific right, as was the case in *Ferreira* (note 6 above), freedom is a value on which the constitutional community is founded, and should not be conceived in a restrictive way.

[9] I Berlin 'Two Concepts of Liberty' in MJ Sandel (ed) *Liberalism and Its Critics* (1984) 15, 23

positive liberty has developed historically, and been abused, particularly in totalitarian states.[10]

(b) Positive liberty

The Constitution also manifests a positive liberty. It could not be otherwise, given South Africa's history and current circumstances, but acceptance of this necessity does not imply that it has coincidentally imported the historical baggage that Berlin deplored. No choice has been or should be made between a negative and positive freedom and whether any other conception of freedom has or should be selected to guide constitutional interpretation. A moral concept of liberty, 'The liberty to do not what we like but what we ought',[11] for instance, should have a strong appeal in the *Rechtstaat.* There is, in short, no good reason why the Constitution should contemplate uniquely one of the two concepts of liberty that Berlin discusses out of the 'two hundred senses of this protean word recorded by historians of ideas'.[12] Indeed, to do so seems to fall for a rhetorical trap.[13]

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[10] Berlin (note 9 above) 22

[11] Lord Acton's words, cited by R Harries *Is there a Gospel for the rich? The Christian in a capitalist world* (1992) 99 to illustrate Michael Novak's conception of moral liberty.

[12] Berlin (note 9 above) 15

Constitutional engagement should be conducted with an open idea of freedom, one to which, as circumstances require, negative or positive freedom will be relevant or, indeed, many other takes on liberty. Nevertheless, freedom has no special claim to independent consideration but must rather be considered with and in the light of other constitutional imperatives.

(c) Contextually appropriate liberty

A member of the constitutional community expects to be free from certain actions or denials, which are generally considered to represent a constriction of human freedom: this has been guaranteed by the Bill of Rights.[14] This set of particular freedoms and rights corresponds with the individuated guarantees, prominent in the liberal tradition, and seeks to safeguard an individual (and groups) against the predations of sovereign power. Furthermore, they reflect a particular experience of oppression that has been lived by many members of the

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[13] DM Davis 'The Underlying Theory that Informs the Wording of Our Bill of Rights' (1996) 113 *SALJ* 385, 392 argues that 'For Berlin, positive freedom was the equivalent of the principle of equality which is enshrined in the Constitution'. It is not immediately obvious why he should have come to this conclusion. Berlin (note 9 above) 23 does not equate positive freedom with equality (which he refers to elsewhere) but rather characterises positive freedom as 'being one's own master'. Furthermore, while this may have some relevance to equality, there is no exact correspondence with the constitutional conception of equality. Negative freedom is clearly insufficient to describe a constitutional conception of liberty but positive freedom is better seen in threshold terms, a guarantee of enabling, which makes an undefined freedom possible, but does not prescribe its terms. Logically also, if it is accepted that constitutional equality is equivalent to positive freedom, then, 'freedom' under the Constitution must mean something other than positive freedom. The obvious, if unpalatable, candidate is negative freedom.

[14] Notably the following provisions of the Constitution: freedom and security of the person (section 12), freedom from slavery, servitude and forced labour (section 13), the right to privacy (section 14); freedom of movement and residence (section 22), and provisions relating to arrest, detention, arraignment and trial (section 35).

constitutional community. Responses to these experiences must be similarly contextually specific and paradigmatically alert.[15]

Therefore, the urgent concern does not lie with disputing the classical configuration of liberty but in considering whether, in the context of the constitutional community, it provides sufficient and concrete guidance for the formulation of social policy. In addition, certain assumptions and implications that relate to the formulation of negative liberty do detract from its social relevance and hence current usefulness:

(i) Individuated freedom is moot

First, negative liberty assumes that a comprehensive individuation of a person and a distillation of her interests from those of her fellows and the community as a whole are possible and desirable. However, social existence is marked by cooperative production, mutuality and the rationing of scarce resources. These characteristics similarly distinguish certain rights and freedoms of the Constitution: as Sachs J reasoned in *Soobramoney* :

> When rights by their very nature are shared and inter-dependent, striking appropriate balances between the equally valid entitlements or expectations of a multitude of claimants should not be seen as imposing limits on those rights... but as defining the circumstances in which the rights may most fairly and effectively be enjoyed.[16]

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[15] These idea of contextual specificity and paradigmatic awareness may be demonstrated by a comparison of, say, the American Bill of Rights (Amendments one to 10 of the Constitution of the United States) and the Freedom Charter (adopted at the Congress of the People, Kliptown, on 26 June 1955).

[16] *Soobramoney* v *Minister of Health (KwaZulu)* 1998 (1) SA 765 (CC) [54]

Under the Constitution, as in any modern polity, government is the guarantor and final arbiter of these distributions.

(ii) Government intervention can liberate

Second, without the operation of laws and other mechanisms of governance, and the potential restrictions they imply, it would be impossible to exercise freedom in any meaningful sense. The influential liberal philosopher Thomas Hill Green recognised the need for massive involvement on the part of government before freedom could be contemplated generally. This idea that more law, for instance, in regulating the sale of alcohol; housing; employment; public health; and education could create more general freedom, animated the interventionist social policies of British liberal governments of the early twentieth century,[17] setting the template for effective, modern governance.[18]

(c) General absence of freedom

Third, a demand to be left alone implies that rights worthy of protection have already been actuated; that a valuable freedom is already enjoyed; that a full life

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[17] A Vincent *Modern Political Ideologies* (1992) 44

[18] M Waltzer 'Welfare, Membership and Need' in Sandel (note 9 above) 200, 204 argues that no government worthy of the name can stand passively by and allow its subjects to starve when food is available to feed them. The distribution of food to the hungry is a stark example, but the principle must apply to other human necessities, so that government, in theory and practice, must concern itself with the lives of its citizens. In this regard, R Nozick *Anarchy, State and Utopia* (1974) (1993 reprint) 26, who proposed an 'ultraminimal' state, which would do no more than 'maintain a monopoly over all use of force except that necessary in immediate self-defence', is credited with influencing neo liberal government policies. Yet, modern government remains massively interventionist. The neo liberal challenge to government intervention lies, it seems, not so much at a level of workable government policy but at an 'everyday' level of moral disbelief. See, generally, T Nagel & L Murphy *Myth of Property* (2001).

has already been realised, and so forth. However, in reality, many people, trapped in a harsh struggle for survival, have never had the opportunity to contemplate fully or participate meaningfully in human activity beyond precarious existence. In short, the guarantee of a freedom, which does not practically exist, is futile.

Therefore, a constitutional conception of freedom must be alert to social realities. The constitutional community is principally distinguished by widespread poverty and inequality, and freedom must be given meaning in this context. Certainly, constitutional freedom must accommodate the interests of those community members whose liberties have been attained but, crucially, its concerns will lie with those for whom such liberties have been denied by law or circumstance, and, therefore, require assistance in realising freedom.[19]

III FREEDOM, EQUALITY AND THE GOOD

(a) The problem

Although the proposition that there is no fundamental incongruence between the principles of freedom and equality is generally plausible,[20] where the matter in hand does not relate to freedom as 'a scarce resource', as was the case in *Soobramoney*,[21] conflict is indeed possible and real. In principle, there cannot be

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[19] Sachs J in *Ferreira* (note 6 above) [251]

[20] G Mulgan *Connexity: How to Live in a Connected World* (1997) 181 suggests that, 'If we think of freedom not as the possession of a separate individual, living in one lifespan, but rather as the exercise of consciousness of larger wholes - the group, the society, the species, the biosphere – then some of the tension is resolved'.
Once more, this idea has correspondence with the condition of a dignified human being situated in a harmonious social whole that is the ideal of ubuntu, social natural law and Islam.

[21] See Sachs J in *Soobramoney* (note 16 above) [54]

any 'rationing' of negative freedom: for instance, everyone must be free from slavery without limitation. Nevertheless, when freedoms must be protected, such as through a judicial process, the allocation of scarce resources, and how these should be distributed justly may remain relevant. An important and pertinent liberal concern, therefore, lies in a consideration of whether government policies, particularly those that pursue equality, may unduly interfere with a person's freedom to lead a full or good life. If government holds a different conception of the good from mine and prohibits or hinders my pursuit of a good life, my liberty will be limited and I will be treated unequally in relation to a person whose idea of the good coincides with that of government.

The multiplicity and fluidity of community members' interests and associative allegiances render a comprehensive preconception of a good life for all a practical impossibility. Government that seeks to enforce its own preconceptions of the good will inevitably exclude and obviate some community members from realising their own versions of a good life.

(b) The liberal solution

To overcome this potential conflict, the classical liberal view holds that government should not maintain and pursue any particular preconception of the good.[22] (Conversely, in the tradition of civic or republican humanism, 'no distinction between the ethical and political was imaginable'.[23]) Yet, in practice, the government of the day will always hold a particular conception of the good,

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[22] R Dworkin 'Liberalism' in Sandel (note 9 above) 60, 64

[23] T Eagleton *The Illusions of Postmodernism* (1996) (1997 reprint) 77
However, as the fate of Socrates indicated, countenancing dissent, rather than distinguishing the ethical and the political, appears to have been the more fundamentally unimaginable activity in the polis.

however hazy it may be.[24] Indeed, it seems that the very purpose of pursuing political goals lies in the hope of shaping society and the lives of its members in a particular way. Consequently, rational policies are not abstractions but are conceived within a particular vision of how society ought to be and how lives ought to be led. Nevertheless, the potential for conflict between a government that holds a well-defined conception of the good and a citizen who holds a contrary view may be overstated in contemporary practice.

(c) The example of religious tolerance

Experience of religious intolerance has played an important role in fostering the idea that the state should not pursue a particular conception of the good (in ways extending far beyond religious belief). Yet, once freedom of religion has been guaranteed, in word and deed, fears of its infraction can no longer motivate government neutrality. Modern states are typically, on the one hand, secular and, on the other hand, tolerant of different religious beliefs. In such a way, the Constitution guarantees freedom from government interference in the areas in which people's pursuit of the good has been interrupted in the past, particularly the practice of religion, belief and opinion.[25] Generally, the Bill of Rights anticipates and incorporates traditional liberal concerns and remedies with regard to civil rights and, therefore, the good.

(d) Bio-liberty and the good

For the contemporary constitutional community the practical concern regarding freedom and the good does not lie with negative liberty but once more with bio-

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[24] As Eagleton (note 23 above) argues, the liberal conception of the good requires holding no conception of the good.

[25] Section 15 of the Constitution

liberty and enabling freedoms. If government were to apply a bare impartiality, which is an appropriate starting point for civil rights, to socio-economic provision, it is unlikely that the socio-economic expectations of many, particularly the most needy, would ever be met.[26]

(i) The example of education

Using the example of education: the classical liberal standpoint of negative liberty would leave parents alone to educate, or fail to educate their children, as they saw fit. In this scenario, some children would receive extensive education and some would receive none, creating serious inequalities, since education is recognised as being a significant advantage in modern society. This is unacceptable and the principle of equality demands that a parent who dismisses the value of education (and it must be recognised that she may do so in good faith) should not be free to prejudice her child's opportunities relative to those of a child whose parent does value education.[27]

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[26] It is, perhaps, a failing of the textual structure of the Bill of Rights to integrate civil liberties with socio-economic claims, since the former are frequently impinged by government intervention, whereas the latter are often meaningless without it.

[27] Examining the claim for certain Christian schools to employ corporal punishment, Sachs J concluded in *Christian Education South Africa* v *Minister of Justice* 1999 (1) SA 6 (CC) [51] – [52] that 'their schools of necessity function in the public domain so as to prepare their learners for life in the broader society...so is it not unreasonable to expect them to make suitable adaptations to non-discriminatory laws that impact on their codes of discipline...When all these factors are weighed together, the scales come down firmly in favour of upholding the generality of the law'. This approach may be compared with that of the United States Supreme Court in *Wisconsin v Yoder* 406 US 205 (1972) that, put simply, permitted parents' rights to freedom of religion to trump children's rights to a modern education.

(e) Benchmarking the good

If, from the preceding discussion, it may be concluded that negative liberty does not have a significant role to play when engaging with socio-economic guarantees, it still must be asked whether, in a heterogeneous society, government can set a justifiable benchmark for what is good and respectful of dignity, freedom and equality.

(i) Pluralism and specific moral perspectives

The Constitution does not prohibit the government's pursuit of a specific idea of the good, as Sachs and O'Regan JJ observed in *Jordan*:

> A pluralist constitutional democracy does not banish concepts of right and wrong, nor envisages a world without good and evil. It is impartial in its dealing with people and groups, but is not neutral in its value system. Our Constitution certainly does not debar the state from enforcing morality.[28]

Community members, who do not share the incumbent government's conception of the good, cannot expect to impede its actions unless there is some unjustifiable coercion or denial.

(ii) Common law analogies

Under South African common law, specifically the law of trusts (which is a plausible analogue for constitutional government), the concept of bonus et diligens paterfamilias (an honest and prudent head of a household) is crucial in establishing expected behavioural norms. Similarly, the Anglophone common law frequently employs a 'reasonable person' test in subjective situations because

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[28] *S* v *Jordan* 2002 (6) SA 642 (CC) [104]

society expects normal behaviour by individuals when others may be affected. The law is able to determine norms of behaviour in various situations that may impact significantly on a person's freedom of action. It would be unusual if society should expect objective norms of honest and prudent behaviour on the part of an actor in a private arrangement but not of the state, performing its ultimate 'fiduciary' role. It seems plausible, therefore, that a similar ratiocination process to that used in ascertaining objectivity in the common law may be applied to discerning what is good and equal in relation to government's guarantee of socio-economic claims.

(iii) The example of education

Returning to the example of education, the Fabian socialist Richard Tawney argued that 'What a wise parent would desire for his own children, that a nation, in so far as it is wise, must desire for all children. Educational equality consists in securing it for them'.[29] We can discern what Tawney's 'wise parent' would desire across a broad range of circumstances which might impact on children, and this is likely to coincide with empirical observations of the actuated desires of informed parents possessed of the means to give effect to their concerns for their children. The extreme liberal argument that government should not give effect to those aspirations for all children in the community because such action would breach the principles of liberty and equality (in respect of the parents) disguises the fact that, without government intervention, the benefits of 'wise parenthood' will be denied to children whose parents are contrarian, ill-informed or lack the means to actuate their desires.

[29] RH Tawney *Equality* (1931), cited by R Norman *Free and Equal: A Philosophical Examination of Political Values* (1987) 122

(iv) Rationalism and the good

In additional to rationalism,[30] the Constitution requires transparent and accountable (honest), and effective and coherent (prudent) governance.[31] While these are ostensibly behavioural norms, it seems inconceivable that a government could behave in the way required by the Constitution if it does not hold a conception of the good which is actuated through its policies and which invests those policies with coherence.

(g) Taxation and the good

There are two issues relating to the pursuit of a good life that are pertinent to taxation itself.

(i) Freedom to acquire wealth

While government must be vigilant for anti-social exercises of wealth and power, and should act against their causes, not merely their effects, interference in an individual's legitimate acquisition of wealth should not be pursued without justifiable reasons.[32]

(ii) Concerned impartiality

A further issue relates to how taxation may assist community members to investigate a good life. Currently the principal concern for equal treatment and

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[30] See Chapter 2, para II (e) for a discussion of the constitutional embrace of rationalism.

[31] Section 41(1)(c) of the Constitution

[32] Section 22 of the Constitution provides that: 'Every citizen has the right to choose their trade, occupation or profession freely. The practice of a trade, occupation or profession may be regulated by law'.

the good lies in enabling people to investigate ways of realising their potential. By instituting a negative income tax in order to eradicate extreme poverty and meet basic corporeal needs, government may ensure that the prerequisites for an investigation of a good life are in place. But, given the history of exclusion and denial, this will be insufficient. Government must go further and actively assist people who would not otherwise realise a good life to find it. What may described as a policy of 'concerned impartiality' would see government cultivating community members' awareness and participation in potentially fulfilling activities. If, for instance, art is generally considered a component of a good life, government that does not consider the promotion of art in the public sphere is indifferent to the good, not impartial. Furthermore, it would be insufficient to grant a person, who has been socially and educationally excluded, the price of entry to an art gallery: much greater involvement – and, of course, expenditure – will be needed.

The issue of a good life is not central to the structural aspects of a constitutional scheme of taxation but will affect the amount of tax that must be collected to fund government programmes. This must be so, since, under a constitutional scheme of taxation, government's revenue requirements will be set by expenditure requirements, rather than its ability to spend being set by revenues raised. Consequently, the extent to which government programmes are interventionist will be crucial to taxation. If, for instance, government applies a 'wise parent' criterion in establishing children's educational needs, it will be required to raise considerably more revenues in an unequal society than if it were to adopt a bare impartial approach.

IV BIO-LIBERTY AND BIO-POWER

(a) Bio-liberty

Pursuing a fundamental constitutional conception of liberty that demonstrates ubuntu,[33] I have proposed that the primary expectation with regard to freedom will be one which relates to the human body and mind, what may be described as 'bio-liberty'. This is, in a positive sense, freedom from corporeal need, and, in a negative sense, freedom from infractions against the physical and psychological self. In making this proposal, I have in mind Michel Foucault's identification of 'bio' or 'disciplinary power', a phenomenon, which he characterised as a technique or form of power, which subjugates and makes individuals subjects,[34] 'a mechanism of power which permits time and labour, rather than wealth and commodities, to be extracted from bodies'.[35] Crucially, then, the human body is the subject of these techniques of power. This being so, inevitably many Foucaultian studies have focused on the practice of medicine.[36] But modern

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[33] See Chapter 3 above for a discussion of ubuntu.

[34] M Foucault 'Afterword: The Subject and Power' in HL Dreyfus & P Rabinow *Michel Foucault: Beyond Structuralism and Hermeneutics* (1982) 208, 212

[35] M Foucault *Power/ Knowledge: Selected Interviews and Other Writings 1972-1977* (trans and ed C Gordon) (1980) 104 describes the phenomenon in the following terms:
'It is a type of power which is constantly exercised by means of surveillance rather than in a discontinuous manner by means of a system of levies or obligations distributed over time. It presupposes a tightly knit grid of material coercions rather than the physical existence of a sovereign. It is ultimately dependent upon the principle, which introduces a genuinely new economy of power, that one must be able simultaneously both to increase the subjected forces and to improve the force and efficacy of that which subjects them'.

[36] For convenience sake, in this brief discussion of disciplinary power, I have included references to the opinions of Ivan Illich and Thomas Szasz, who have demonstrated a comparable scepticism towards the effects on freedom of the modern state. I do not imply that Foucault has influenced Illich or Szasz or that their views share similar premises.

governance in general is comprehensively 'disciplinary' in this view, and Foucault's considerable influence is greatly attributable to the broad recognition and resentment of extensions and intrusions of mechanisms of power.[37]

(b) The state and disciplinary power

Although the state is not the sole repository of bio-power,[38] and is not uniquely responsible for satisfying all community members' corporeal needs, it is inevitable that the state, with its comprehensive interventions and its burden of the ultimate responsibility for provision should be the prime focus of disciplinary concerns. Indeed, the purposes for which this bio-power are employed, including the promotion of the health, well-being and security of the general public, are the very stuff of the socio-economic promise of the Bill of Rights.[39] Furthermore, the bio-liberty I have portrayed as the essence of constitutional freedom is only realisable if mechanisms of bio-power operate.[40] A concern must lie, therefore,

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[37] A Hunt & G Wickham *Foucault and Law: Towards a Sociology of Law as Governance* (1994) 69

[38] I Illich *The Right to Useful Unemployment and its Professional Enemies* (1978) (1996 reprint) 48, for instance, in an intemperate polemic, attacks 'bodies of specialists', and describes a 'new cartel', which dominates 'the creation, adjudication, and satisfaction of needs'. However, his barbs are aimed primarily at therapeutic professionals, not the state.

[39] Notably sections 24 and 27 of the Constitution.

[40] My concern here lies with disciplinary power exercised in good faith by a democratic government with an aim of benefiting its citizens; what may be described as an 'innocent' or unwitting denial of freedom. There is broad acceptance that government intervention to promote human development is desirable. See S Anand & A Sen 'Sustainable Human Development: Concepts and Priorities' (1994) United Nations Human Development Report Office Development Programme Occasional Paper for a discussion of universal human rights from a human development perspective.

with whether, in the light of the revelation of bio-power, the progressive assumption that more government leads to more freedom might be obsolescent and that these programmes may lead to a stifling of the very freedom they seek to promote.

(b) Can bio-power liberate?

(i) Relevance to the constitutional community

As a preliminary point, since Foucault did not claim to explain the experiences of the developing world, it would be convenient to dismiss the concerns for freedom raised by the revelation of bio-power as 'Eurocentric' and inapposite to contemporary South Africa.[41] And, certainly, the critique of Thomas Szasz, who presents a comparable condemnation of the 'therapeutic state',[42] is unlikely to be recognised by the majority of the South African population, whose experience of the state until recently is more likely to have been one marked by indifference or malign neglect rather than suffocating concern. However, Illich, who expresses similar concerns regarding government policy, particularly where developing countries have followed Western models, cannot plausibly be described as being indifferent to the plight of the dispossessed or unfamiliar with the conditions of economically undeveloped countries. And so, assuming that such scepticism toward established methods of interventionist governance is relevant to

[41] A Butchart *The Anatomy of Power: European Constructions of the African Body* (1998), for instance, has applied Foucaultian theory to European engagement with Africans. The natives tax also lends itself to this type of analysis. See 'Appendix' for an outline of the Natives Taxation and Development Act 41 of 1925.

[42] TS Szasz 'The Therapeutic State: The Tyranny of Pharmacracy' *Independent R* Vol 5 No 4 Spring 2001 485, 516 concludes that: 'Formerly, people rushed to embrace totalitarian states. Now they rush to embrace the therapeutic state. By the time they discover that the therapeutic state is about tyranny, not therapy, it will be too late'.

contemporary South Africa, it must be asked what this may imply for policy formulation, particularly whether a *laissez faire* approach becomes preferable.

(ii) Is there an alternative to state action?

It is particularly problematic that Foucault's musings on the deleterious effects of social security mechanisms on individual autonomy could be summoned in support of the neo liberal argument that welfare provisions should be done away with.[43] Yet, autonomy and the discovery of a full life can only become possible when people are freed from a mundane and ceaseless struggle for survival. Using poverty once more as the emblem of socio-economic need, social security in the form of a guaranteed minimum income is the most obvious way to achieve a degree of concrete independence.[44] The principle of social security cannot, therefore, be challenged and it may be concluded that Foucault's critique of social security goes no deeper than a distaste with the methods employed in assessing need – means-testing, for instance.

(iii) Disciplinary analyses and neo liberalism

The anti-progressive aim of dismantling the state and privatising the public sphere, would, if achieved, shift more power to those who already 'dominate economic relationships'.[45] In other words, if power is ubiquitous,[46] a rolling back

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[43] M Foucault *Politics Philosophy Culture: interviews and other writings 1977-1984* (trans and ed LD Kritzman, 1988) 161

[44] See, for instance, the V Taylor (Chair) *Report of the Committee of Inquiry into a Comprehensive System of Social Security for South Africa: Transforming the Present – Protecting the Future)* RP 53/2002 (2001) para 5.6.2 for an indication of the potential for a flowering of autonomy made likely by a modest social grant.

[45] P Bourdieu 'Utopia of endless exploitation: the essence of neoliberalism' (trans JJ Shapiro) *Le Monde-Diplomatique* December 1998

of the state's ability to interrupt and regulate hegemonic forces will not assuage bio-power concerns and is unlikely to benefit the community in general. Rather, as power will increasingly subsist outside of democratically accountable institutions, it may be assumed that the general community will be considerably worse off without comprehensive state intervention.

Using the example of public health: even if public health programmes may cause people to become dependant on medical interventions, rather than becoming healthy (and it is plausible that, in economically advanced countries, the medicalisation of certain phenomena has been over zealous), there can be no withdrawal of government intervention in public health. It takes little imagination to envisage the harm which would be done if government were to withdraw, not only at an individual level to those cannot afford health care but to the community in general.

(iii) Importance of critique

Rather than anti-governmentalism, these critiques of 'disciplinary mechanisms', 'the therapeutic state' or 'bodies of specialists', may be interpreted as implying no more than, firstly, the techniques of achieving stated goals should be subject to continuous, critical review and, secondly, that the nexus between desired results and policies should be rigorously assessed. These imperatives coincide with the

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[46] According to Foucault (1980) (note 35 above) 102, traditionally, jurisprudence has considered social justice in relation to power by considering the exercise of authority in a state, with the aim of balancing the power of the sovereign with the rights of the individual. However, after Nietzsche in philosophy and Weber in sociology, there has been a broad reception of the idea that power is a ubiquitous phenomenon. This being so, a consideration of power which focuses solely on the behaviour of the sovereign must be too narrow. Perhaps Foucault's lasting contribution to social justice will prove to be his excavation of techniques that practically demonstrate the operation of dispersed power. Whether or not this would have met his approval, concerned policymakers may then tackle the techniques so exposed.

constitutional requirement of rationality in governance. If a particular programme does not lead to the results intended, then another approach should be tried. But there can be no retreat from the principle of government promoting the general welfare.

In short, these ostensibly anti-government arguments tells us no more than the Constitution does – that we should engage rationally and critically with government programmes which are designed to benefit the general community. Indeed, the kernel of one of Illich's recurring arguments is that developing countries should construct their programmes appropriate for their needs and not simply seek to follow those of the West.[47] Yet, once the critical analyses of Western models have been performed (to the extent that such an exercise is feasible in a developing country), it is likely to be found that the programmes of intervention which have been developed in Western countries and have provided immeasurable benefit to their citizens, are, in fact, appropriate, amended as necessary, for a developing country such as South Africa.

(b) Governance that is conscious of disciplinary power

Generally, the revelation of bio-power does not lead to an anti-government conclusion but alerts us to the possibility that certain practices (often, but not uniquely performed by government) may, deliberately or otherwise, suppress certain manifestations of freedom. This being so, valid concerns lie not in denouncing the state's use of any particular technique of power as such, but in identifying and proscribing those manifestations which are unjustifiable in a particular context, and ensuring that those which are found to be justifiable are, nevertheless, appropriate for an open democracy which privileges human dignity, freedom and equality. This proposal is anathema to Foucaultian dogma.

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[47] See, for instance, I Illich 'Outwitting the "Developed" Countries' in CK Wilber (ed) *The Political Economy of Development and Underdevelopment* 2 ed (1979) 436.

(i) Distinguishing the legitimate

Despite his important excavations of techniques of power, Foucault, following Nietzsche,[48] demands that the 'juridico-discursive' or liberal idea that power can be distinguished as legitimate or illegitimate should be rejected.[49] But, in a *Rechtstaat*, it is imperative that acts can and should be so distinguished. Certainly, Nietzsche valuably indicates the fallacy of an over reliance on criteria, such as intention, in differentiating actions,[50] nevertheless, workable systems of ethics and laws must provide a basis for differentiating between approved and unapproved actions, even if they have no claim to external validity.[51] Since the Constitution provides the basic ethical information for judging actions within the constitutional community, it is a plausible and necessary exercise to differentiate between justifiable and unjustifiable manifestations of bio-power using those criteria in that context. It is greatly irrelevant whether the nature or effect of an action or practice, or whether the intention informing it can be classified as 'disciplinary', the pertinent issue is whether it stands up to constitutional scrutiny.

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[48] F Nietzsche *Beyond Good and Evil* (trans J Norman, 2002) 153 claimed that exploitation 'belongs to the essence of being alive as a fundamental organic function'. Nevertheless, an earthquake and a heart attack are also natural occurrences. Simply because a phenomenon is considered 'organic', it would be unnaturally fatalistic to refrain from seeking to avoid it or temper its effects.

[49] Hunt & Wickham (note 37 above) 16

[50] Nietzsche (note 48 above) 33

[51] J van der Walt 'The Relation Between Law and Politics: A Communitarian Perspective' (1993) 110 *SALJ* 768 and (1994) 111 *SALJ* 152, 157 discussing J Habermas *The Philosophical Discourse of Modernity* comments: 'the struggle against power relations only makes sense if one can distinguish between legitimate and illegitimate power with reference to a normative criterion'. Whether one supports the conception of reason propounded by Foucault or Habermas, practical governance must have benchmarks of reason and right. See D Hoy 'Foucault versus Habermas' in DC Hoy & T McCarthy *Critical Theory* (1994) 148 for a discussion of their differing views.

(ii) Bio-liberty

Despite his apparent indifference, Foucault provides an intimation of a way out of the dilemma he has promoted:

> If one wants to look for a non-disciplinary form of power, or rather, to struggle against disciplines and disciplinary power, it is not toward the ancient right of sovereignty that one should turn, but towards the possibility of a new form of right, one which must indeed be anti-disciplinarian, but at the same time liberated from the principle of sovereignty.[52]

By identifying a bio-liberty that respects, promotes and protects the inherent dignity of the human body and mind, I have sought to indicate how such a right might be championed in the context of the constitutional community, this done with the limited purpose of constructing a constitutional scheme of taxation which is both ethical and cognisant of real societal forces.

V AUTONOMY

(a) Practical autonomy

An aspiration to autonomy is fundamental to freedom, and yet this imperative must have limited practical reach. Generally, there can be no independence from the web of cooperation and reciprocity which makes survival possible nor can there be autonomy from the laws of the community.[53] (I will return to the possibility of 'private taxes' later.[54])

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[52] Foucault (1980) (note 35 above) 108

[53] See Sachs J in *Ferreira* (note 6 above) [250] for a discussion of autonomy and interdependence.

[54] See Chapter 13, section III below for a discussion of 'private taxes'.

(b) Autonomy and identity

(i) Identity and postmodernity

Autonomy within the community is fundamentally realised in a person's freedom to construct or imagine her own identity. Although identity is widely considered a social construction,[55] and one frequently derived from distinctions drawn by hegemonic groups to distinguish themselves from others,[56] people are not powerless in the face of socially constructed identities. Indeed, arguably in the postmodern condition such alterity cannot be sustained, it 'disappears in the infinite free-associating hospitality of mediaspace'.[57] While this appears to be an overstatement, identity is capable of being imagined anew, loosened from the bonds of historical impositions. Frances Olsen, for instance, has envisaged, in relation to gender-based identity 'a new referential system for relating men and women to the world, a systematic departure from the ordinary image of male and female as correlatives'.[58] More generally, Unger has argued that 'the life chances and life experiences of the individual should be increasingly freed from the tyranny of abstract social categories', and no one should remain 'the puppet of his place in the contrast of classes, sexes, and nations'.[59]

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[55] DJ Greenwood 'Cultural Identities and Global Political Economy from an Anthropological Vantage Point' *Indiana J of Global Legal Studies* 1993 vol1-1 (no constant pagination)

[56] EW Said *Orientalism* (1977/1995) 332

[57] D Cupitt *After God: the future of religion* (1997) 100

[58] FE Olsen 'The Family and the Market: A Study of Ideology and Legal Reform' (1983) 96 *Harvard LR* 1497, 1578

[59] RM Unger *The Critical Legal Studies Movement* (1986) 23

(ii) Strategic identities

If prejudice in the pre-constitutional state was reliant on imprisoning cultural constructions,[60] then, in the constitutional state, identity must be liberated from reductionist ghettoes and be open for re-imagining. Members of the constitutional community should imagine themselves primarily as members of that community (and the multiplicity of fluid and often impermanent, social relations that implies), not as members of a particular group, identifiable by, say, language, religious belief or gender. Certainly, the assertion of such specific qualities for particular purposes may have strategic political value. Furthermore, it is plausible that a call for the liberation of identity from traditional classifications might be a prescription rather than a description of postmodernity that benefits the ideologues of the 'anarchic liberalism of the new right'.[61] In this way, a rejection of rigid classifications must be balanced against the needs of compensatory justice. If people have in the past been comprehensively discriminated against on the grounds of constructed difference, notably race, then it would be idle to argue that such past injustice may be rectified through a scrupulously equal treatment now of (de-grouped) individuals. Nevertheless, invariably a strategy of single quality identification leads to confinement. Rather than a human being, possessed of complex and variable qualities, one may become nothing but a woman, Black, gay, disabled. A progressive vision of society, which seeks to engage, not only with historical experience, but also with contemporary conditions and future consequences, must recognise the fluidity of interests and avoid the confinements of single quality groupings.

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[60] See Ngcobo J in *Hoffmann v South African Airways* 2001 (1) SA 1 (CC) [37] note 30 for remarkable examples of prejudice operating in the South African judicial system.

[61] P Collier & H Geyer-Ryan (eds) 'Introduction: Beyond Postmodernism' *Literary Theory Today* (1990) 1

(iii) Liberated identity

Edward Said proposed a strategy of juxtaposing and playing-off of different views and experiences so that they become 'concurrent' and 'ideologically and culturally' open.[62] Hopes for identities, which are deconstructed and re-imagined, are dependant on shedding prejudices and cultural myths. Crucially, community members, who have been the subject of alterity, should not become 'trapped in the emotional self-indulgence of celebrating one's own identity'.[63]

This plan for liberating identity from historical social construction seems to contradict a communitarian conception of society. However, a communitarian view does not inevitably imply that a person, in the context of a particular community, is set for life in the mono-characteristic role that hegemonic powers in close communities have traditionally allocated.[64]

VI CONCLUDING COMMENTS

When an ethics and practice of inclusive yet autonomous identity is fostered that celebrates common humanity rather than ethnic, cultural, gender or any other politically convenient distinction, recognition will be given to the '*humanitas* of the

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[62] EW Said *Culture and Imperialism* (1994) 37

[63] Said (1994) (note 62 above) 227

[64] SE Fish 'Anti-Foundationalism, Theory Hope, and the Teaching of Composition' in *Doing What Comes Naturally: Change, Rhetoric, and the Practice of Theory in Literature and Legal Studies* (1989) 346 persuasively argues that 'the subject' is 'always and already tethered by the local or community norms and standards that constitute it and enable its rational acts'. While this is plausible, the ligatures that bind one to a community - or communities - seem to be more elastic than he implies.

homo humanus'.[65] A manifestation of freedom animated by ubuntu would then be realised.

In the material realm of a constitutional scheme of taxation, such a situated autonomy implies individuation of contribution and benefit, and the promotion of financial independence and dignity.

Although the imagining of freedom the Constitutional promises should not be constrained by ideologically inspired preference or aversion, generally the freedom needed currently in the constitutional community is liberation. People do not expect to be left alone by the state. They expect the state, firstly, to free them from the tyranny of corporeal need.

[65] R Kearney *The Wake of Imagination: Ideas of Creativity in Western Culture* (1988) 28, following Heidegger.

CHAPTER 6 EQUALITY

I INTRODUCTION

Equality, the third foundational value of the Constitution,[1] alternatively the relational aspect of ubuntu, concerns the situation of a dignified person amongst others in the constitutional community. Leading toward a constitutional scheme of taxation, the particular concern here relates to the way in which democratic government engages with the differences between people.

Democracy and equality are reflexive implications and it is inconceivable that a modern polity should not be founded on both of these ideals. Yet, as democracy takes many forms and demonstrates varying degrees of effectiveness, so there is no generally accepted meaning of equality.[2] Consequently, seeking a plausible meaning for equality will be a crucial task in constructing a constitutional scheme of taxation. Here, I wish to do no more than outline the terms of the constitutional equality guarantee; note the problems of implementation; and to sketch the equality expectations of the constitutional community.

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[1] Constitution of the Republic of South Africa Act 108 of 1996 (Constitution)

[2] Indicating some of the ideological possibilities for a meaning of equality, J Griffin 'Towards a Substantive Theory of Rights' in RG Frey (ed) *Utility and Rights* (1984) 137, 143 identifies eight candidates for the idea of equal regard, namely: a utilitarian equal weight; a minimum level of welfare, above which obligations cease; an equal start with equal prospects, after which inequalities resulting from just transactions, are themselves to be regarded as just; equal goods, except when inequalities work to the advantage of the worst off; equal goods with equal prospects; equal welfare; or equal opportunity. Each of these configurations is likely to lead to different ethical schemes of taxation but current consideration requires a meaning to be placed on equality in a constitutional context.

II CONSTITUTIONAL EQUALITY GUARANTEE

(a) Equality before the law

The first aspect of the constitutional equality guarantee is 'the classic liberal desire' of equality before the law,[3] which may be characterised as an equal opportunity to a proper judicial consideration of a legal matter or event.[4] Therefore, litigants presenting similar suits may expect to receive equal consideration by the courts but not necessarily equal outcomes.[5] Certain inequalities of treatment under the law, typically procedural in nature, practised before the establishment of the constitutional state, are unproblematic and require rectification as soon as is practicable. For instance, on the one hand, there can be no justification for the continued administration of the estates of Black decedents under a different and probably inferior system from that of White decedents but, on the other hand, it is understood that assimilation of the two systems cannot be achieved immediately.[6]

(b) Prohibition on unfair discrimination

The second aspect of the equality guarantee is a general prohibition of any unfair discrimination,[7] particularly, any distinction that offends human dignity.[8] An

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[3] A Vincent *Modern Political Ideologies* (1992) 41

[4] Section 9(1) of the Constitution provides that 'Everyone is equal before the law and has the right to equal protection and benefit of the law'.

[5] See, for instance, *Van der Walt* v *Metcash Trading Ltd* 2002 (4) SA 317 (CC).

[6] See, for instance, *Moseneke* v *The Master* 2001 (2) SA 18 (CC).

[7] Section 9(3) of the Constitution provides that 'the state may not unfairly discriminate directly or indirectly against anyone one on or more grounds' which includes traditional bases for discrimination.

individual expects to be free from discrimination practised against her but also expects that other community members will not benefit from arbitrary or irrational differentiation, manifest in naked preferences.[9] The Constitutional Court explained in *Prinsloo*:

> In regard to mere differentiation the constitutional state is expected to act in a rational manner. It should not regulate in any arbitrary manner or manifest "naked preferences" that serve no legitimate purpose, for that would be inconsistent with the rule of law and the fundamental premises of the constitutional state.[10]

III SUBSTANTIVE EQUALITY

(a) Aristotelian conception of justice

The most pertinent equality concern for the purposes of this study is the fundamental aspect of a guarantee of comprehensive equal regard in the substance of laws, 'the full and equal enjoyment of all rights and freedoms.'[11] Equality in this sense is not synonymous with justice.[12] Nevertheless, the popular

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[8] Ackermann, O'Regan and Sachs JJ in *Prinsloo* v *Van der Linde* 1997 (3) SA 1012 (CC) [31]

[9] Section 9 (3) and (4) of the Constitution
Unfair discrimination will play an important role in assessing the acceptability of certain current tax arrangements.

[10] *Prinsloo* (note 8 above) [25]

[11] Section 9(2) of the Constitution

[12] RWM Dias *Jurisprudence* 4 ed (1976) 67

notion of equality, and a starting point for its consideration under the Constitution,[13] is provided by the Aristotelian conception of distributive justice.[14]

(ii) Distributive justice

Distributive justice requires equal distribution amongst equals and, by implication, unequal distribution amongst unequals.[15] This may be characterised as a 'geometric' equality, which ensures that distribution is made according to community members' varying merit or desert.[16]

(ii) Compensatory justice

The realisation of distributive justice may require the righting of historical wrongs. Reparative, restorative or compensatory justice that informs affirmative action

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[13] See, for instance, J Kentridge 'Equality' in M Chaskalson et al (eds) *Constitutional Law of South Africa* (1996, 5 rev 1999) 14-i, 14-5

[14] Dias (note 12 above) 66 describes how, in terms of the Aristotelian schema, particular justice, as opposed to universal justice, is distinguished between distributive and corrective or commutative forms.
From a political perspective, Vincent (note 3 above) 41 characterises commutative justice as being concerned with the conditions under which individuals express their preferences (not the outcomes of those preferences), whereas distributive justice concerns itself with the amelioration of social suffering and distress.

[15] Dias (note 12 above) 66 suggests that 'Equal distribution among equals does not carry the corollary of unequal distribution among unequals'. Nevertheless, in the popular conception, especially with regard to taxation, equality certainly does imply that unequals should be treated differently.

[16] E Kamenka 'What is justice?' in E Kamenka & A Erh-Soon Tay (eds) *Justice* (1979) 1, 3

measures may, therefore, be seen as a specific manifestation of distributive justice.[17]

(iii) Commutative justice

Commutative justice seeks to restore equilibrium where it has been disturbed, and may be characterised as relating to an 'arithmetical' equality, seen, for instance, in the conferral of punishments and compensation in terms of judicial processes.[18] While this may imply an assumption that the status quo ante was just, in a further sense, Aristotelian justice is a moving equilibrium, which constantly seeks to reconcile the conflicting demands of distributive and commutative justice.[19]

(b) Taxation and justice

Taxation necessarily focuses on issues of distributive justice, how contribution and benefit should have similar effects on those similarly situated, and different

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[17] Dias (note 12 above) 67 classifies compensatory justice as a form of 'corrective' justice. Aristotle *Ethics* (trans JAK Thomson, 1953) (1963 reprint) 145 describes corrective justice as having two parts, namely 'voluntary' and 'involuntary', with the latter being further distinguished between 'secret' and 'violent'. Commutative justice is not and never has been a purely private matter. The community sets the norms of justice and community institutions permit the actuation of correction. Analogous to establishing the border between private and public law, it is debatable which matters are properly classified as manifestations of distributive justice and which as manifestations of commutative justice.

[18] Kamenka (note 16 above) 3

[19] Ibid

effects on those situated differently.[20] Nevertheless, commutative justice is indirectly relevant to taxation, in the sense that taxpayers may consider the justice of their own situations relative to the situations of others – the motivation for the complainant in *Walker*.[21]

(c) What should be distributed?

A fundamental flaw in the Aristotelian conception of justice is supposed to be revealed by the question 'distribution of what?', since Aristotle's reference to the distribution of 'honour or money or such other possessions of the community as can be divided among its members',[22] may be considered to be 'imprecise and unsuited to the present day.'[23] However, the scope of application of the principles of distributive justice is not problematic under the constitutional dispensation, and certainly not for a constitutional scheme of taxation. Equality is a foundational

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[20] Tax literature tends to distinguish between 'vertical equity', that is, the treatment of those differently situated and 'horizontal equity'; used to refer to the treatment of those similarly situated. (See, for instance, BP Herber *Modern Public Finance* (1983) 119.) Both forms of equity consider treatment of citizens by the state and are, therefore, 'vertical' in the sense used in constitutional law literature. (See, for instance, S Liebenberg 'Socio-economic Rights' in M Chaskalson et al (note 13 above) (3 rev 1998) 41-i, 41-45.)

The other form of equality that features in taxation is 'intergenerational equity' (also known as the 'benefiter-pays' principle). This principle requires some matching of costs and benefits over time. For instance, the costs of a community facility that is expected to last 50 years should be spread over the generations that will benefit and not born immediately or, conversely, solely later. (See J Thompson 'Intergenerational Equity: Issues of Principle in the Allocation of Social Resources Between this Generation and the Next' (2003) Research Paper No 7 2003-03 Information and Research Services, Australian Parliament 5.)

[21] *City Council of Pretoria* v *Walker* 1998 (2) SA 363 (CC)

[22] Aristotle (note 17 above) 145

[23] Dias (note 12 above) 66

value of the Constitution, and, if distributive justice is an element of that equality, must apply, to the extent feasible, to all distributive arrangements within the constitutional community. The text of the Constitution is unambiguous in establishing that all citizens are 'equally entitled to the rights, privileges and benefits of citizenship' but are also 'equally subject to the duties and responsibilities of citizenship.'[24] Consequently, if members of the constitutional community are to be treated equally, there must be an equal distribution of benefits and burdens. Marx's version of distributive justice – 'From each according to his ability, to each according to his need!'[25] – usefully links burden and benefit. This implies an holistic and integrated consideration of the condition of all members of the community, since it is inconceivable that there can be a rational programme of distributing benefits and burdens equally, if abilities and needs of all community members have not been properly considered.

Distributive justice is problematic not in its consideration of what is to be distributed but, because it is so widely entrenched in human arrangements, across time and cultures, so as to have no essential message. Claude Lévi-Strauss, for instance, described the operation of distributive justice amongst the Khoi-San, observing how different parts of hunted animals were invariably allocated to different status holders within the group.[26] The resultant distribution may not be something we would immediately recognise as being 'equal' but is likely to be strictly compliant with the norms of justice of that community. No

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[24] Section 3(2) of the Constitution

[25] 'Critique of the Gotha Programme' in K Marx & F Engels *Selected Works* (1968) (1977 reprint) 311, 321

[26] C Lévi-Strauss *The Elementary Structures of Kinship* (1969) 35

doubt, from a structuralist perspective,[27] it could be argued that a mechanism of distributive justice is essential to all human societies.[28] Indeed, from an untheorised perspective, it seems that every society must find a way of distributing scarce resources, with empirical evidence suggesting that this requirement never results in an equalisation of outcomes. (Although Christian texts do provide some support for equalised outcomes,[29] there is strong counter support for the justice of differentiated outcomes,[30] and no Christian-influenced government has instituted equalised outcomes.[31])

The Aristotelian formulation may be the most enduring prescription for distributive justice but even that amounts to little more than respecting what is due or the 'natural' fit. The earlier Platonic identification of justice as being 'when each of three classes...does its own job and minds its own business, that...is justice and makes our city just',[32] demonstrates this clearly, as does Justinian's

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[27] A Podgorecki & CJ Wheelan (eds) 'Conclusions' in *Sociological Approaches to the Law* (1981) 228 describe the underpinning proposition of structuralist theory as holding that social reality consists of abstract networks of interrelationships and cultural phenomena. Structuralism seeks to explain cultural phenomena by interpreting information of the entire system and act as a guide to understanding the different observable data of social existence.

[28] F De Waal *Good Natured: The Origins of Right and Wrong in Humans and Other Animals* (1996) argues that the processes of reciprocity and 'just' dessert that underpin distributive justice in human societies are reflected, in a rudimentary way, in the societal practices of other anthropoids.

[29] See, for instance, the parable of the vineyard owner given in Matthew 20:1–16.

[30] See, for instance, the parable of the talents given in Matthew 25:14-30.

[31] The radical Levellers did seek this goal. See JFC Harrison *The Common People: A History from the Norman Conquest to the Present* (1984) 195.

[32] Plato *The Republic* (trans HDP Lee, 1955) (1973 reprint) 183

characterisation of the 'just person' as manifesting 'a constant and perpetual will to assign others their own due'.[33] Therefore, distributive justice, in effect, is a truism that provides no prescriptions for justice other than to reinforce pre-existing allocations of merit and desert, at a structural level, within a society. The justice of the allocation of 'class', 'status' or 'what is due' has no constancy across time and culture. In the context of the constitutional community, the Constitution provides the ethical information that allows us to consider the justice of these underpinning mechanisms and structures. Yet, even armed with this information, the proposition of equal treatment of those equally situated remains problematic in several regards.

(d) Practical problems in distributive justice

(i) Limited scope of equal situation

In practice, equality of situation can only plausibly apply to a narrow range of pertinent facts in a particular context or for a specific purpose. For instance, the courts may accept that two plaintiffs pursuing 'identical pieces of litigation' are equally situated.[34] Yet, the circumstances of the plaintiffs in such an 'identical litigation' case might otherwise be distinguishable in numerous other ways.[35] This possibility of countless distinctions being drawn between the circumstances of different individuals has a particular pertinence for taxation. There is an expectation of just contribution and benefit, and yet no contributor or beneficiary

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[33] Constans et perpetua voluntas ius suum cuique tribuere. See R Harries *Is there a Gospel for the rich? The Christian in a capitalist world* (1992) 109. Ulpian provided similarly. See HR Hahlo & E Kahn *The South African Legal System and Its Background* (1968) 9.

[34] Sachs J in *Van der Walt* v *Metcash Trading Ltd* (note 5 above) [81]

[35] As Peter Hogg observes, 'Laws never provide the same treatment for everyone'. Cited by Ackerman, O'Regan and Sachs JJ in *Prinsloo* (note 8 above) [17].

is ever truly equally situated to another. To overcome this potential for arbitrariness, Carl Shoup proposed a principle of relevance with regard to the circumstances selected in ascertaining whether certain persons are equally circumstanced for tax purposes,[36] suggesting that the criteria used for deciding similarity or difference should include only those which accord with the community's ideas on relevance. Due deliberation by the community of the factors of relevance is assumed, but such deliberation is improbable, and, in practice, very few criteria are taken into account in assessing similarity or difference for tax contribution.[37] This approach is the only practicable response, but removes taxation from plausible claims for equality of treatment.

(ii) Power to ascribe similarity or difference

The capacity to construct and act upon differential criteria is a privilege of the hegemonic group, class or culture in a society.[38] In this way, Hahlo and Kahn, expressing the traditional view of differentiated justice, argue that treating alike 'the raw savage and the civilized man' 'would be the height of injustice', and speculate that 'There may be nothing unjust in withholding the franchise from persons below a certain age or without a certain standard of education or

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[36] CS Shoup *Public Finance* (1969) 24

[37] Unlike South Africa, many jurisdictions take into account the number of children a taxpayer must maintain. Adopting a more focused approach, the Income Tax Act No 58 of 1962 only takes into account the exceptional medical costs likely to be incurred by the parent of a disabled child.

[38] Edward Said has amply demonstrated the techniques of cultural domination in relation to the construction of differences between settlers and indigenes. (See, generally, EW *Orientalism* Revised ed (1977/1995) and *Culture and Imperialism* (1994). Antonio Gramsci has shown that, even within ethnically homogenous communities, hegemonic groups control the means of constructing difference. (See, generally, A Gramsci *Selections from the Prison Notebooks of Antonio Gramsci* (trans and ed Q Hoare & G Nowell Smith, 1971) (1978 reprint).)

civilization.'[39] By focusing on cultural differences, as defined by the hegemonic group, and denying the undifferentiated equality of human beings at a level of immanent dignity, this approach clearly permits a justification for open-ended separate development. In this way, Apartheid could be justified on the unimpeachable grounds of Aristotelian justice: policies of constructed difference, brute and unrepentant, could lay the grounds for the perpetuation of subjugation and preference for a hegemonic group and yet still claim a mooring in equality.[40] Yet, recognition of equal human dignity offers little guidance to distributive justice in a complex polity with vastly different circumstanced citizens. Once intrinsic humanity has been recognised and served, we must still engage with the unavoidable fact that human individuals, from nature and nurture, are never equal in capacities and 'higher' needs.[41] Nevertheless, repugnant consequences of the application of distributive justice in the past or its perennial openness to

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[39] Hahlo & Kahn (note 33 above) 35

[40] CR Swart, the Minister of Justice under JG Strydom's government, expressed the equality issue as it really lay under Apartheid, when he cautioned that 'The white man cannot survive if the black man is allowed equality of opportunity'. Cited by J Gunther *Inside Africa* (1955) (1957 reprint) 468.

[41] A H Maslow *Motivation and Personality* 3 ed (1970) 16, incorporating ideas of structural anthropology into behavioural psychology, constructed a hierarchy of universal human needs, of which physiological needs form the base. The second level of needs are those relating to safety: 'security; stability; dependency; protection; freedom from fear, anxiety and chaos; need for structure, order, law and limits; strength in the protector and so on' (ibid 18). Then follows a stratum of belongingness and love needs (ibid 20); then esteem (ibid 21); and, at the apex, the need of self-actualisation (ibid). Maslow's general proposition is that as each stratum of needs is satisfied, so the needs of the next level become paramount. He does, however, recognise that people's motivations differ, and an individual's concerns change with different contexts.

The basic needs Maslow identifies are generally mirrored in the Bill of Rights, (see, for instance section 27 of the Constitution) although without explicit hierarchical ranking.

sophistry should not alone preclude its being employed positively now.[42] The fundamental requirement of describing difference (or conversely finding similarities between certain members of the community and so implying difference from others) continues to hold the potential for domination of one group over another. The power to ascribe difference or similarity is an immensely potent one.

(iii) Masked conservatism

Even an ostensibly progressive strategy to treat differently those differently situated may be markedly conservative in its effect. In identifying differences between the members of two groups in society and treating them differently because of these distinctions, difference may become concretised and entrenched. This presents particular challenges for affirmative action measures, especially when historical distinctions are employed to correct the wrongs those distinctions previously permitted. In righting past injustices, compensatory justice must not establish a platform for future injustice.

It is axiomatic that people similarly situated should be treated similarly but, in practice, claims for reliable methods of assessing similarity must be approached sceptically. The difficulties faced in demonstrating similarity imply that everyone is differently situated and so are worthy of differential treatment: a practical impossibility for many areas of public policy and certainly for taxation. Therefore, where reasonable, government policy should refrain from identifying similarity or difference. Consequently, under a constitutional scheme of taxation, the only

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[42] W Lang 'Marxism, liberalism and justice' in Kamenka & Erh-Soon Tay (note 16 above) 116, 148 records, for instance, that Robert Nozick considered progressive taxation to be unfair on the grounds that it ignores different and incomparable needs of individuals, audaciously claiming that 'People with higher incomes simply work more in order to satisfy their more sophisticated and expensive needs. People with lower incomes do not have such needs, but having more free time, they achieve some pleasures easily without extra labour'.

relevant similarity would be the objective fact that two taxpayers enjoy a similar, measurable increase in economic well-being during a period of assessment.

IV EXPECTATIONS OF A PROGRAMME OF EQUALITY

When constitutional government pursues equality, the following principal characteristics may be expected to be manifest in its programmes:

- contextual appropriateness;
- cognisance of paradigmatic constraints; and
- rationality, practicability and effectiveness.

I consider these criteria below:

(a) Contextual appropriateness

A programme of equality must be relevant to the context in which it operates. In a hunter-gatherer community, for instance, the acute concern might lie with the distribution amongst all community members of the food hunted and gathered and, in a capitalist society that has a fundamental function of producing consumer goods and services, a conception of equality might relate to the share of the particular product of that society. Recognition of the context in which distribution is to take place does not, however, lead to inescapable policy conclusions.[43] Viewing a modern economy, one person may reasonably argue that the unimpeded market mechanism allocates the social product fairly and another that extensive, extraneous state intervention is required to attain fairness.

[43] As Marx & Engels (note 25 above) 320 observed, 'Right can never be higher than the economic structure of society and its cultural development conditioned thereby'.

A primary concern for a constitutional equality programme is, then, to identify the content of the distributable 'social product' of the constitutional community, and then to consider the extent to which the Constitution prescribes or implies a method of distribution of that social product.

(i) Consumer goods and services

I do not suggest that the dominant purpose of the constitutional community is the production of consumer goods and services, nevertheless, such production and distribution is a significant function. Consequently, the constitutional principle of equality is a mere abstraction if consideration is not given to some manifestation of equality in the distribution of those goods and services. There may be a temptation to relegate material desires, particularly those for consumer goods, to a level of unworthy frivolousness, subordinate to 'virtuous' goals such as fellowship and personal discovery.[44] Nevertheless, government would be ill-advised to adopt such an idealistic approach. For instance, it is plausible that the economic model of the Soviet Union collapsed because of its failure to provide consumer goods: 'Frivolous or not, varied, workable, well-styled and abundant consumer products and the companion services are what people want.'[45]

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[44] J Locke *Two Treatises of Government* (1690) (Everyman ed 1924) (1990 reprint) 180 was not so tempted, declaring that: 'The great and chief end, therefore, of men uniting into commonwealths, and putting themselves under government, is the preservation of their property.' We may find the effective equation of property with human life repugnant, but in elevating property expectations in this way and coupling them with natural law's sanctity of the individual, Lockean theory usefully recognises the pre-eminent significance of economic goods in a mercantile society.

[45] JK Galbraith *The World Economy Since The Wars* (1994) (1995 reprint) 240

(ii) Distribution of necessities

By enshrining rights to basic socio-economic provision, the Constitution effectively makes reciprocal security and welfare a legal fact,[46] and, to that extent, requires a share of the scarce resources necessary to satisfy these claims to be distributed fairly to everyone and in a particular way. When government requisitions scarce resources and provides goods and services to meet basic socio-economic claims, allocation is principally based on need. (This must be so, since a right to socio-economic provision can only be actuated against the state when there is a need. A person who enjoys adequate housing, for instance, only has a notional or potential right to housing and cannot expect to be included in a distribution of resources aimed at providing adequate housing.)

(iii) Distribution of non-necessities

Beyond a needs-based distribution of basic goods and services, the manner in which the Constitution expects other socially produced goods and services to be distributed is not obvious. Indeed, although the Constitution requires pervasive equality and hence appropriate forms of distributive justice to apply to all arrangements within the constitutional community, by refraining from guaranteeing rights to all manifestations of the social product, a needs-based distribution mechanism cannot be inferred beyond basic socio-economic claims. Government is not, therefore, required to provide goods and services to those who need them beyond the modest socio-economic guarantees. However, if government does provide additional goods and services, it is not bound to

[46] Representing the communitarian viewpoint, M Waltzer 'Welfare, Membership and Need' in MJ Sandel (ed) *Liberalism and Its Critics* (1984) 200, argues that a foundational premise of a political community is that its members owe one another an inclusive and exclusive obligation of communal provision of security and welfare.

distribute them according to need but may mimic the market, for instance, by levying user charges.[47]

A programme of equality should be grounded in the lived experience of the members of the constitutional community. A fair allocation of all manifestations of the social product, including consumer goods and services is, therefore, a valid equality concern. Furthermore, compensatory justice must take cognisance of the historical denial of full participation in the capitalist economy to certain groups. Conversely, if, as is widely believed, Blacks were unfairly coerced into the cash economy by, amongst other methods, the natives tax,[48] then, this injustice must be made right. Yet, although there is an expectation that government will distribute social goods in a way that addresses need, there is no similar expectation that government should produce and distribute consumer goods. The most practical and efficacious way of starting on the road to equality in relation to consumer goods and services lies in granting everyone the means to participate in the consumer economy by alleviating income poverty. Once more, the guaranteed income element of a constitutional scheme of taxation will satisfy this goal.

(b) Awareness of paradigmatic constraints

Beyond cognisance of the specific context in which it operates, an effective programme of equality should also be aware of broader paradigmatic constraints.

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[47] JK Galbraith *The Affluent Society* (1958) (1968 reprint) 209 argues for social balance, the idea that 'a satisfactory relationship between the supply of privately produced goods and services and those of the state': this, he proposes, is a more socially desirable goal than material equality.
See Chapter 20 below for a consideration of the acceptability of user charges under a constitutional scheme of taxation.

[48] L Callinicos *Working Life 1886 - 1940 Factories, Townships and Popular Culture on the Rand* (1987) 27

For instance, Marx's prescription of collective ownership of the means of production as a prerequisite for equality[49] is not currently plausible and it would be unreasonable for government to seek to implement such a prescription.[50]

(i) Difference principle as an anachronism

In the early 1970s, Richard and Peggy Musgrave observed that traditional concerns with 'relative income positions, the overall state of equality and excessive income at the top of the scale',[51] had been supplanted by concerns with the 'adequacy of income at the lower end' and the 'prevention of poverty', in short, 'setting what is considered a tolerable cutoff line or floor at the lower end, rather than putting a ceiling at the upper end as was once the more popular view'. Given Richard Musgrave's influence on Rawls,[52] the significance of the Musgraves' later observation lies in the indication, that, however ethically attractive Rawls's difference principle might be,[53] it never gained a foothold in the

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[49] Marx & Engels (note 25 above)

[50] I do not suggest that the Constitution prohibits radical socialism, rather that current geo-political and economic conditions (including: the demise of the Soviet bloc; uninhibited cross-border movements of capital; multilateral free trade agreements; the dominance of neo liberal ideology in international agencies) render national governance founded on Marxist prescription untenable.

[51] RA & PB Musgrave *Public Finance in Theory and Practice* (1973) 13
While their contention is plausible in respect of economic outcomes, it is not necessarily applicable to all facets of production that give rise to unequal outcomes. For instance, modern governments are alert to the issues of control and ownership of socially important institutions and commonly restrict these, particularly through anti-monopoly measures. To this limited extent, government may effectively cap the potential of powerful individual enterprises.

[52] See, for instance, J Rawls *A Theory of Justice* (1972) para 43

[53] Outlining the difference principles, Rawls (note 52 above) 302 prescribed that social and economic inequalities should be arranged so that they are to the greatest benefit of the least advantaged.

formulation of practical tax policy, and is unlikely to do so under contemporary conditions.[54] At a time when the Platonic ideal (that no one should be worth more than four times any other) has been supplanted by the common practice of chief executive officers earning more than 400 times the wages of their lowest-paid workers,[55] the difference principle appears quaint or, optimistically, 'the radicalism that currently dare not speak its name'.[56]

(ii) Quality or quantity of wealth

A programme of equality that is cognisant of paradigmatic forces would not focus on the quantity of a person's income or wealth, but rather its quality. Galbraith makes the important distinction between socially permissible enrichment and wealth obtained at an unacceptable social cost. He identifies income earned through 'insider trading, corporate raiding, junk bonds and the earnings of many corporate heads who are neither constrained by fiduciary sentiments or the practical intervention of shareholders' as wealth obtained at a great social cost.[57] This is a more practicable and justifiable approach to the curtailing of excessive wealth than Rawls' difference principle.

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[54] Vincent (note 3 above) 54 indicates that the current manifestation of the British Labour Party has been influenced by Rawls. However, while the Blair government is evidently committed to fighting poverty, particularly amongst children and the elderly (see T Clark, M Myck & Z Smith *Fiscal Reform Affecting Households, 1997 – 2001* (2001) Institute for Fiscal Studies Briefing Note) to the casual observer, there is no concern evident in its policies of an application of the difference principle to economic outcomes.

[55] C Handy 'What's Business For?' *Harvard Business R* December 2002

[56] W Hutton *The World We're In* (2002) 76

[57] JK Galbraith *The Good Society: The Humane Agenda* (1996) 29

However, income tax systems operate on a quantitative basis and seem incapable of accommodating the qualitative nuances Galbraith implies.[58]

Cognisance of paradigmatic expectations does not imply subservience to them, but policies running counter to them necessarily swim against an imaginative tide. Generally, government that is cognisant of paradigmatic expectations will focus its equality concerns on enabling the poor and weak of society and not on hobbling the legitimate acquisition of wealth. However, a *laissez faire* approach to the accumulation of wealth is not sufficient.[59]

(c) Rationality, practicability and effectiveness

A starting point for the construction of a rational programme of equality in relation to wealth lies with a consideration of why there should be different economic outcomes amongst community members.[60] Furthermore, since wealth is acquired in different ways, it is pertinent to consider the differentiating factors in relation to different sources of wealth.

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[58] The Income Tax Act does, undesirably, differentiate between certain forms of income. See, for instance, the exemption of dividends under section 10(1)(k). Section 5(9) of the Income Tax Act allows preferential treatment of 'special remuneration' paid to a mineworker engaged in hazardous emergency or rescue work in a mine. This represents an unusual desert-based tax privilege. Since the community holds a particular sentiment toward miners risking their own lives to save others, their reward is qualitatively distinguished from other remuneration.

[59] See para VII (c) below for a discussion of the risks to society posed by wealth condensation.

[60] WJ Baumol & AS Blinder *Economics: Principles and Policy* 5 ed (1991) 800 suggest eight possible causes for different levels of income, namely: differences in ability; difference in intensity of work; risk taking, compensating wage differentials; schooling and other types of training; work experience; inherited wealth; and luck.

(i) Sources of difference

(aa) Reward for labour

Earnings from labour are a primary determinant of economic outcomes. Modern society tends to privilege certain natural abilities and skills more than others: for instance, the egregious skills of a soccer player may be valued far more highly than the commonplace skills of a nurse. While such privileging may offend sentiments of desert and may not stand up to logical scrutiny (why, for instance, a particular scarce skill should be highly valued), it seems to be unavoidable. In free market economies such preferences often lead to exceptional incomes accruing to people possessed of arguably frivolous skills but, at a more mundane level, differentiation applies to all occupations and jobs. Within the same occupation, the incomes of two workers of similar ability performing similar jobs are likely to be distinguished on the grounds of differences, such as, effort and work experience.[61] If one worker is expected to work anti-social hours, she is likely to be paid additional compensation, and if one studies for a vocational qualification, she is likely to be rewarded accordingly.

(bb) Risk taking

In a capitalist economy, risk taking is an important differentiating factor in determining economic outcomes. Successful entrepreneurs are frequently the wealthiest members of free market communities but risk-taking is also an

[61] In-depth processes of job grading with concomitant remuneration differentials are normal in modern organisations. For instance, Edward Hay's commonly used system awards points for various criteria, such as, responsibility. While such criteria may disguise bias, their general purpose is objective assessment.

important way for the very poor to improve their outcomes.[62] Inherited wealth is a further important determinant of different economic positions in a society, as is the social class one is born into.

(cc) Saving and consuming

People have different propensities for saving and consuming.[63] While starting positions will obviously be crucial, even two people earning similar remuneration may have different final incomes because, year-by-year, one is inclined to save more than the other, and so, with compounding effect, produces further income. Numerous factors may inform a person's propensity to save. Beyond the immediate economic explanations, cultural, psychological and experiential factors are likely to be relevant. Yet, even of those similarly situated in all relevant regards, one person may be simply inclined to consume more than another.

(dd) Luck

These factors that contribute to different economic outcomes generally lend themselves to government intervention, particularly through the operation of taxes. However, simple good fortune, an important additional factor in differentiating outcomes does not lend itself to government intervention, although its fruits may be apt for redistribution.

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[62] V Taylor (Chair) *Report of the Committee of Inquiry into a Comprehensive System of Social Security for South Africa: Transforming the Present – Protecting the Future* RP 53/2002 (2001) para 5.4.2

[63] See Chapter 19, para III (a) for a discussion of the distinction between saving and consuming.

(ee) Power

Finally, the crucial factor in determining differentiated economic outcomes is power. It is the unequal distribution of power across all fields of economic activity and relationships, which dictates differences in wealth: the unionised worker who enjoys the negotiating power of her massed co-workers over a casually employed individual; the managing director in relation to a clerk; the licence-holder over the person without the wherewithal to apply for a trading licence; the educated over the illiterate. However, power is not a tangible thing that can be corralled and distributed in the way that money can. Paradoxically then, the most important factor in determining the distribution of wealth is the one which tax policy can influence least.

(ii) Legitimacy of difference

Broadly speaking, save for inheritances,[64] the factors outlined above which distinguish people's different levels of wealth are rational and legitimate. Generally, society values hard work, enterprise and thrift, and it would be counter productive for private or government initiatives to interrupt the economic incentives that accrue to these efforts. There is little obvious justification for government interference with those distinguishing factors that are 'natural' and arise from the exercise of free choice, rather there are compelling arguments in favour of *laissez faire*.

[64] I suggested in Chapter 1, para III (b) above that there is strong, strong general sentiment for the convention of inheritance. However, there is a strong counter sentiment that unlimited inheritance is socially damaging. (See, for instance, the Responsible Wealth website.)

(iii) Arguments for *laissez faire*

(aa) Freedom

A policy of *laissez faire* maximises the freedom of those capable of exercising choice and pursuing a goal of wealth accumulation.[65]

(bb) Economic efficiency

There are areas where it is self-evidently, economically inefficient to enforce equality: for instance, rewarding a diligent worker equally to a dilatory worker. Similarly, the driving force of an entrepreneur may be a desire to distinguish herself from others through the achievement of exceptional wealth. Interrupting her achievement may effectively quash her entrepreneurial drive and that is unlikely to be beneficial for the community as a whole, since a successful entrepreneur may create jobs and earn foreign earnings through exports.

(cc) Aggregate utility

Government interference in the legitimate accumulation of wealth interrupts citizens' pursuit of the good. In utilitarian terms, this must detract from the aggregate utility of the community. Furthermore, although ethical governance cannot be informed solely by utilitarian concerns, it should not be unconscious of them. Constitutional governance must, for instance, be effective and based on the will of the people.[66] Without paying consideration to the general level of contentment in the community, it is unlikely that it can meet either requirement.

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[65] It is difficult to conceive a modern economy in which government does not intervene massively. It is an unpersuasive argument that government should not intervene in economic outcomes on the grounds of impartiality when it has pervasively interfered in many of the factors that have led to wealth being produced.

[66] Preamble and section 41(1)(c) of the Constitution

However, I prefaced this discussion with the proviso that unequal economic outcomes are acceptable in a society in which people are free to make their life choices. That may be the type of society assumed to exist in the liberal imagination and toward which the Constitution seeks to progress but does not describe the contemporary constitutional community.[67] Historically, there has been a massive and systematic hobbling of the potential of many different people and it would be implausible to suggest the 'natural' differentiating factors of economic outcomes in a hypothetically free society could fairly apply under those circumstances.[68]

(iv) Difference in the constitutional community

Reconsidering some of the reasons for different economic outcomes sketched above, it becomes clear that, in the South African context (and, no doubt, further afield), any 'natural' differentiating factors have been artificially distorted. For instance, with regard to the differences in effort and experience of two similarly

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[67] A choice may be assumed to be freely exercised when made within the context of a distribution mechanism generally accepted by participants as being just. Naturally, this assumption may be unfounded. Nevertheless, the need for any such consensus can be overstated in relation to the exercise of a choice. If, for instance, of two maths graduates, one chooses to become a teacher and the other an actuary, then, the former is likely to earn less than the latter. It would be unpersuasive for the teacher to claim her lower income is unjust when she was aware of how reward is allocated between teachers and actuaries when she made her choice. The different level of remuneration can be assumed to have been one of the factors that she took into account in making her career decision. The outcomes of the distribution mechanism of monetary reward seem, therefore, to be of secondary importance: provided they are transparent.

[68] Section 9(3) of the Constitution indicates the grounds on which people have been discriminated against (race, gender, sex, pregnancy, marital status, ethnic or social origin, colour, sexual orientation, age, disability, religion, conscience, belief, culture, language or birth). The principal aim of apartheid was to deny equality of opportunity not entrench 'natural' differences. See note 40 above.

situated workers: if additional income in this situation is to act as a rational incentive, it must be reasonably possible to attain the goal that has been set. If, say, one worker has been denied access to adequate education because of her colour, a real possibility in South Africa, it is not a reasonable incentive to expect her to achieve results which are contingent on the possession of a high level of education until that deficit has been made good.[69]

Exceptional reward for the exercise of unusual skills, such as those of the soccer player, frivolous as they may appear, are an embedded aspect of contemporary society, and concerns are better placed with those whose disabilities might unreasonably prevent them from earning an income. (Yet, even here, government may play an important enabling role: a soccer development programme in a poor community may bring talent to the fore that might otherwise go undiscovered.)

Similarly, with regard to entrepreneurial risk taking, the pertinent policy concerns do not lie with a consideration of whether commercial enterprise is socially valuable and should be encouraged but, on the one hand, in ensuring that all potential entrepreneurs enjoy the opportunity to flourish and, on the other hand, that successful entrepreneurs do not conduct socially damaging practices.

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[69] Every society must consider what are relevant barriers. The anti-discrimination provisions of the Constitution provide guidance to the consensus view in this regard in the constitutional community. Yet reasoning on disadvantage may be muddied by the exceptional achievements of certain people from underprivileged backgrounds. Nevertheless, the achievements of the exceptional few should not distract from the fact that, for the unexceptional multitude, hardship cannot be overcome but is imprisoning and self-perpetuating.

(v) Basis of a rational equality policy

A rational equality strategy must be founded on an understanding of the causes of different economic outcomes and combating those factors that are constitutionally repugnant. Inevitably, current efforts must focus on promoting the opportunities of previously disadvantaged groups. But also, and this applies to all societies, government must understand and neutralise the anti-social potential of inequality of outcomes, particularly narrow concentrations of great wealth.

These measures will automatically lead to a convergence of economic outcomes but not an equalisation of outcomes. However, if a convergence of outcomes is socially desirable, it seems reasonable to assume that equalisation must be most desirable policy of all.

V WEALTH EQUALISATION

(a) Equalised economic outcomes

An ideal of equality must lie with an equalisation of wealth, but, in a free society, such an arrangement would be as impossible to maintain as it would to achieve.[70] In addition to the factors of wealth differentiation discussed in the previous section, people have widely differing attitudes and motivations toward the acquisition of wealth, and, even if their attitudes and motivations were similar, their abilities and circumstances would ensure unequal outcomes in any practicable distribution set up. Equalisation is, then, simply 'not consistent with either human nature or the character and motivation of the modern economic system'.[71] Nevertheless, hypothetical equalisation establishes an absolute

[70] As Hume observed, 'men's different degrees of art, care, and industry will immediately break that equality'. See D Hume *Enquiries Concerning Human Understanding and Concerning the Principles of Morals* 3 ed (1975) 194.

[71] Galbraith (1996) (note 57 above) 59

toward which a programme of equality relating to wealth might tend. This absolute, unachievable as it may be, may, nevertheless, provide an indication of the desirability and effectiveness of a programme of promoting wealth convergence. It may also assist in answering the question whether a convergence of economic outcomes is a valid goal in itself.

In order to equalise wealth, the economic positions of those who are not inclined toward or not successful in accumulating wealth would need to be augmented and the positions of those who have accumulated abnormal wealth would need to be reduced.

(b) Example of equalisation

In a hypothetical society that seeks to equalise wealth among its members, there are four classes of citizens. The members of these classes posses only two relevant qualities, those being, utility derived from wealth and motivation to work in order to acquire wealth. The effects of wealth equalisation on these different classes of people may be assumed to be as follows:

(i) Those whose wealth aspirations were satisfied by a level of wealth lower than the equalised median

Augmenting the level of wealth of those whose wealth aspirations were satisfied by a level of wealth lower than the equalised median, will not increase their utility. Their motivation may be unaffected by the change in their degree of wealth, nevertheless the effort they must expend to acquire their wealth will be less.

(ii) Those whose economic aspirations were not satisfied with their previous level of wealth but are satisfied by the equalised median

The utility of the members of this class will increase. Once more, their motivation may not be affected but the they now no longer need to work as hard to reach the level of wealth they aspired to previously.

(iii) Those whose economic aspirations were neither satisfied by their previous level of wealth but nor are they satisfied by the new level of wealth

For the members of this class, wealth equalisation does not increase utility. Furthermore, it seems that their motivation will be negatively affected. Before equalisation, they were motivated to work in order to increase their wealth. After equalisation, increased work cannot lead to increased wealth.

(iv) Those whose economic aspirations were satisfied by their previous level of wealth that was higher than the equalised median

The utility of the members of this class will presumably decrease as they no longer enjoy the level of wealth they previously enjoyed. Furthermore, their motivation will decrease and they do not need to work as hard as they did previously to maintain the equalised level of wealth.

This example does not represent real world conditions but nevertheless indicates that equalisation of wealth is likely to be economically inefficient, because in all cases it either leaves motivation unaffected or decreases it.

Generally, equalisation would bring considerable dissatisfaction to certain groups in society. Given such dissatisfaction, a remarkable amount of policing would be necessary to maintain equalisation.[72] Additionally, the hobbling of those whose attitudes and abilities are attuned to wealth acquisition is unlikely to help those

[72] Hume (note 70 above) 194

whose motivations or aptitudes lie elsewhere. It seems likely that society would indeed be reduced 'to the most extreme indigence; and instead of preventing want and beggary in a few, [would] render it unavoidable to the whole community.' [73]

At first face, therefore, government would be prudent to permit those of its citizens so motivated to excel unimpeded in the lawful acquisition of wealth. Conversely, helping those who hold ambitions to wealth but are incompetent in its accumulation is economically inefficient. Those who are already satisfied would, as individuals, be unaffected by either *laissez faire* or equalisation. Beyond such simplified projections, an equalisation of economic outcomes, oblivious to desires and effort, is intuitively unjust and offends the tenets of distributive justice.

(c) Convergence of economic outcomes

A convergence of economic outcomes may be assumed to demonstrate similar, if less pronounced, tendencies to equalisation, particularly disutility and reduced motivation to work, amongst those who aspire to wealth. However, in the real world, there are other considerations to be taken into account, which disrupt this assumption. I outline certain of these below:

[73] Ibid

(i) Nexus between wealth and effort

Structural inequalities in society obviate a simple nexus between the acquisition of wealth and effort expended.[74] Convergence of economic outcomes, even if not a valid goal in itself, may have the valuable effect of forging such a connection. For instance, a potential entrepreneur from a disadvantaged background may have no capital and so is simply unable to fulfil her promise. By granting her some funds, government may act as the catalyst for her creation of considerable wealth. The initial intervention by government to bring the disadvantaged entrepreneur's position closer to that of an entrepreneur from a privileged background, leads to a sustainable and 'natural' convergence of economic outcomes. Generally, then, unequal economic outcomes may arise from 'unnatural' disadvantages, so that egalitarian interventions may release 'natural' outcomes.

(ii) Differences are relative

People do not imagine wealth in absolute terms. A person gauges her wealth relative to the position of others in her community. Thus, if the absolute wealth of everyone in the community is reduced, say, by inflation,[75] provided relative positions are retained, people are not unduly dissatisfied. Similarly, if everyone in

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[74] There is an ideological aspect to this statement. In the typical neo liberal view, there is such a simple connection. The wealthy deserve to be wealthy; the poor deserve to be poor. In this regard, JK Galbraith *The Culture of Contentment* (1992) 101 quotes, with disbelief, the following sentiments of George Gilder the influential author of *Poverty and Wealth* (1981): 'Material progress is difficult: it requires from its protagonists long years of diligence and sacrifice, devotion and risk that can be elicited only by high rewards'.

[75] Inflation is considered socially damaging, largely, because its effects are not uniform. Inflation disrupts relative wealth positions causing uncertainty and dissatisfaction amongst those negatively impacted.

the community is heavily taxed, in a way that broadly preserves relative positions,[76] the wealthiest person remains the wealthiest person because she remains wealthier than her fellows. If wealth is equalised, the potential for establishing effective measures of social justice that nevertheless preserve broad relative wealth positions falls away. A considerable convergence of economic outcomes may be effected before the disincentives of equalisation arise.[77]

Generally, convergence of economic outcomes is qualitatively, not simply quantitatively, different from equalisation. Rather than inchoate equalisation, with a corresponding diminution of effects, convergence of economic outcomes is a distinct phenomenon that brings overwhelmingly valuable social and economic results.

I now wish to consider why inequality is socially undesirable and, conversely, how a convergence of outcomes can benefit society.

VI WHY INEQUALITY IS SOCIALLY UNDESIRABLE

The Constitution is opposed to inequality per se and this opposition provides sufficient reason for constitutional government to seek to eradicate inequality. However, the socially deleterious effects of inequality should also lead any government of a society, in which significant inequality prevails, to seek its elimination.

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[76] See BS Frey & A Stutzer 'What Can Economists Learn from Happiness Research?' *J of Economic Literature* Vol XL (2002) 402, 405

[77] Under a scheme of progressive income tax, the differences between income groups are attenuated but not eliminated.

(a) Inequality promotes social instability

The World Bank has observed that 'for countries and local communities, extreme inequalities in assets, power, and voice are corrosive, linked and self-perpetuating'. These effects are not limited to those who suffer poverty and inequality directly; society as a whole is diminished, 'stability is undermined, and the ability to solve economic, social, and environmental problems (that require collective action) dissipates.'[78] Prudent government, one that wishes to preside over a stable and content society, will seek to combat inequality for these reasons.

(b) Inequality obviates the elimination of poverty

It may be assumed that any prudent government will seek to eliminate extreme poverty amongst its citizens.[79] Combating inequality is the most effective way of eradicating extreme poverty.

Experience of supply side or *laissez faire* economic policies has demonstrated that significant 'trickle down' from the unfettered wealthy to the unassisted poor does not happen. Even when there is significant economic growth, 'a rising tide'

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[78] World Bank *World Development Report 2003: Dynamic Development in a Sustainable World* (2002) 184

[79] Signatories of the Millennium Declaration undertook to 'spare no effort to free our fellow men, women and children from the abject and dehumanizing conditions of extreme poverty...to making the right to development a reality for everyone and to freeing the entire human race from want'. See the Eighth Plenary Meeting of the General Assembly of the United Nations (8 September 2000) that passed resolution 55/2, item 11.

does not 'carry all boats'.[80] The Taylor Committee conducted an extensive survey of international literature on the subject and, with specific regard to the circumstances of South Africa, constructed a model to measure the effects of different growth strategies on the income of the poor.[81] From this research, the Committee concluded, firstly, that the trickle down argument was unpersuasive, and, secondly, that modest and sustained redistribution, even under conditions of slow economic growth, constituted the more effective means of combating poverty. Furthermore, the Committee was able to confirm the plausibility of the axiom that the greater the degree of income inequality, the higher the growth rate required to reduce poverty. This leads to the conclusion that a prudent government seeking to reduce poverty, particularly the government of a country that has not recently experienced sustained high levels of economic growth, will ensure that the reduction of inequality will be part of its poverty reduction strategy. This conclusion applies whatever the government's direct concerns for a convergence of economic outcomes.[82]

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[80] M Jordan & K Sullivan 'Trade brings riches, but not to Mexico's poor' *Washington Post* in *Guardian Weekly* 2 April 2003 report that, although Mexico's trade volume has almost tripled since its joining the North American Free Trade Agreement in 1994, since the percentage of Mexican poor has not changed since the early 1980s, some 19 million more Mexicans are living in poverty than 20 years ago. Despite the increase in national wealth, a quarter of the Mexican population is classified as extremely poor and unable to afford adequate food.

[81] Taylor Report (note 62 above) para 2.6.2

[82] R Nozick *Anarchy, State and Utopia* (1974) (1993 reprint) 27 presents the intriguing proposition that: 'the term "redistributive" applies to types of *reasons* for an arrangement, rather than to an arrangement itself. We might elliptically call an arrangement "redistributive" if its major (only possible) supporting reasons are themselves redistributive'. Following this line of reasoning, one may argue that the dominant purpose in pursuing an ostensibly redistributive strategy is the pursuit of economic efficiency. After all, countries that have pursued fair distributions of wealth have proved economically successful and socially stable.

VII ECONOMIC BENEFITS OF A POLICY OF CONVERGING ECONOMIC OUTCOMES

Beyond likely social benefits, further motivation for a policy of converging economic outcomes lies in specific economic benefits such a policy may bring.

(a) Contribution to the generation of wealth

There is no simple equation between wealth and equality, or poverty and inequality. Although inequality is, in practice, likely to be associated with widespread poverty,[83] 'poverty and inequality are not synonymous'.[84] Cuba and China have been cited as examples of poor countries that have significantly eradicated inequality.[85] Conversely, the coexistence of significant wealth inequality and high levels of human development within a country is demonstrated by the United States, which is consistently ranked in the top 10 nations in terms of the United Nations Development Programme's Human Development Index but has an unequal and deteriorating distribution of wealth relative to other economically developed countries.[86] Nevertheless, five of the

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[83] K Dixon *Freedom and Equality: The Moral Basis of Democratic Socialism* (1986) 44

[84] C Bundy 'Development and inequality in historical perspective' in R Schrire (ed) *Wealth or Poverty: Critical Choices for South Africa* (1992) 24, 33

[85] Ibid

[86] United Nations Development Programme *Human Development Report 2001: Making new technologies work for human development* (2001) 182; United Nations Development Programme *Human Development Report 2002: Deepening democracy in a fragmented world* (2002) 149.
Its Gini coefficient (rounded to two significant figures) at 0,41 has deteriorated from the 0,38 reported by A Whiteford, D Posel & T Kelatwang *A Profile of Poverty, Inequality and Human Development in South Africa* (1995) 21 in 1995. Australia, the next most unequal top ten country also has a relatively high Gini coefficient of 0,35, but has significantly improved its degree of wealth distribution, from the 0,40, recorded by Whiteford et al 21.

countries ranked in the top 10 (Norway, Sweden, Belgium, Japan and Finland) have Gini coefficients of approximately of 0,25,[87] demonstrating a reasonably even distribution of wealth.

The exception of the United States noted,[88] it may be concluded that high levels of human development tend, in practice, to coincide with low levels of wealth inequality. Whether it is high levels of human development that give rise to an even distribution of wealth, vice versa or some other less causal connection, it is clear that the telos of the Constitution will not be achieved without high levels of human development and an even distribution of wealth.[89]

(b) Prevention of a sclerotic economy

An even distribution of wealth is economically desirable because 'when income is equitably distributed, there is little question as to its ultimate disposition. It is spent or it is saved, invested and thus spent. There are no large pools of funds

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Whiteford et al 44 define the Gini coefficient as 'a measure of inequality which can vary in value from 0, indicating absolute equality (all households earn equal income), to 1 indicating absolute in equality (one household earns all income).

[87] No Gini coefficient was recorded for the other top ranked country, famously egalitarian Iceland, but it may be expected to have a similar, or lower, value. The Netherlands, which previously had a value of approximately 0,25, slumped remarkably to 0,33 according to Human Development Report (2002) (note 86 above).

[88] It is not simply the hegemonic, individualist tradition which distinguishes the United States, its vast natural resources and large numbers of very wealthy citizens, render meaningful comparison with many other countries, particularly developing ones, problematic. Australia and Canada share certain characteristics with the United States.

[89] South Africa improved from second most unequal to six most unequal between 2001 and 2002 but more importantly had improved its Gini coefficient from 0,61 to 0,59 (note 86 above).

that are held in idleness because no one, or not many, have sufficient income to support such accumulations.'[90] An effective policy of convergence of economic outcomes ensures participation of everyone in the economy: the very poor are not excluded through lack of funds and the very wealthy do not abstain because of surplus.

(c) Interruption of wealth condensation

Vilfredo Pareto proposed a law of income distribution that holds that 'income distribution shows a high degree of constancy for different times and countries'.[91] When plotted on a logarithmic graph, this Pareto distribution is represented by a 'curve' that slopes downwards to the right, demonstrating 'an extremely stable inclination'.[92] Whether or not the Pareto Curve is a verifiable phenomenon is not of current concern.[93] Nevertheless, it is relevant that two physicists, Jean-Philippe Bouchard and Marc Mezard, in 2000, constructed a model that indicated how a wealth distribution consistent with the Pareto Curve could arise in an economy.[94] From the operation of this model, they concluded that, when there are unequal incomes in an economy; trading is restricted; and returns on transactions are highly variable, money tends to become frozen in only a few

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[90] Galbraith (1995) (note 45 above) 252

[91] E Roll *A History of Economic Thought* (1973) (1989 reprint) 410

[92] Ibid

[93] Ibid 411

Roll, for instance, questions the empirical and statistical validity of the 'law', and notes Pareto's eccentric ideas on inequality and his ultra liberal preconceptions on the inefficacy of interventions to promote social justice. Nevertheless, there is broad acceptance that this abnormal, so-called 'fat tailed' distribution is manifest in various social phenomena, including the distribution of wealth.

[94] M Buchanan 'Wealth Happens' *Harvard Business R* April 2002

pockets. While Zdzislaw Burda and others who have conducted similar research, argue that the Bouchard-Mezard model is incomplete,[95] they nevertheless agree that unequal wealth and a sclerotic economy provide opportunities not only for acts of corruption on a grand scale but also a 'condensation' of wealth in a few hands.[96] While Pareto, a supporter of *laissez faire* economic and social policies, argued that gross inequality is natural and can only be mitigated by economic growth, however, income distribution can be managed (particularly the avoidance of repugnant wealth condensation) by stabilising investment returns; ensuring the free flow of money in an economy; and intervening to promote more equal income distributions. How stability of investment returns and the free flow of money may be achieved lies beyond the scope of this study, but it seems likely that financial stability is likely to be promoted by sound 'national integrity systems'.[97] These include the institutions mandated by the Constitution, notably the practice of the rule of law and transparency.

It may be concluded that an ideal of an equalisation of wealth is chimerical but strategies that promote a convergence of economic outcomes, can disrupt the pernicious effects of inequality, and have desirable social and economic effects. Progressive taxation of a broad income tax base has proved to be the most effective strategy in achieving convergence.[98]

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[95] P Ball 'Wealth spawns corruption' *Nature Science Update* 28 January 2002

[96] The 10 per cent of richest Mexicans control half of that country's financial assets and real estate. See note 80 above.

[97] L Cockcroft 'Corruption and Human Rights: A Crucial Link' Transparency International Working Paper (1998)

[98] See Chapter 18, section VII below for a discussion of the efficacy of progressive taxation.

VIII AFFIRMATIVE ACTION

(a) Affirmative action and the Constitution

Given the unequal treatment of certain groups within South African society in the past, it is inevitable that the Constitution should sanction current action to rectify the consequences of this discrimination.[99] The 'Constitution views affirmative action as a means of achieving equality. The right to equality does more than simply prohibit discrimination or unequal treatment by the State or by private individuals. It implies a positive obligation on the part of government to ensure that 'everyone fully and equally enjoys all rights and freedoms.'[100]

However, affirmative action, as sanctioned by the Constitution is problematic. It is not because affirmative action programmes privilege particular groups. Such preference is justifiable within the context of the constitutional community because the Constitution declares it to be so and is incidentally congruent with broadly accepted norms of justice.[101] Rather, the affirmative action provision is problematic because it contemplates the advancement only of members of groups who have suffered from unfair discrimination. Consequently, policies that favour members of a weak group in society over the members of a strong group

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[99] Section 9(2) of the Constitution further provides that 'To promote the achievement of equality, legislative and other measures designed to protect or advance persons, or categories of persons, disadvantaged by unfair discrimination may be taken'.

[100] Satchwell J in *S* v *Bresler* 2002 (4) SA 524 (C) 538J-539A

[101] Affirmative action can be justified in terms of the general principles of Aristotelian justice. (See section IV above.) However, if the normal understanding of equality permits preferential treatment of a group in the pursuit of justice, it may be asked why an explicit affirmative action provision was deemed necessary. Furthermore, given the inclusion of a specific provision relating to unfair discrimination, a programme of preferring a particular group, which has not suffered unfair discrimination, must be open to challenge.

may offend the equality guarantee unless such policies are pursued in order to correct unfair discrimination. If, for instance, in the future, the condition of women (through no discernible cause of unfair discrimination) is generally inferior to that of men, the concern arises that policies aimed at improving their condition through preferential treatment might offend the equality guarantee.

Membership of a particular group, identified by race, colour, gender or any other traditional distinction, will not be relevant for the constitutional scheme of taxation that I have in mind. Consideration for contribution and benefit will be individuated.[102] Consequently, there is no plausible objection on constitutional grounds to policies that prefer the poor to the wealthy, since beneficiaries will not be identifiable primarily by group. This coincides with Sachs J's line of reasoning in *Walker*.[103] However, since the majority of the Court rejected this rationale,[104] it is pertinent to consider whether the principle of affirmative action may have a role to play in a constitutional scheme of taxation.

(a) Taxation and affirmative action

There is some support for a proposition of affirmative action in taxation. In *Walker*, the Constitutional Court approved differential user charges for electricity

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[102] I refer here only to tax contribution, including negative contribution by virtue of a guaranteed minimum income. Government expenditure will necessarily be weighted in favour of those from whom it has been historically denied. As a matter of fact and strategic effectiveness, this expenditure will be focused on previously disadvantaged groups.

[103] *Walker* (note 21 above) [117]

[104] Langa J in *Walker* (note 21 above) [38]
However, in *S* v *Jordan* 2002 (6) SA 642 (CC), the Constitutional Court refrained from considering the demographic profile of sex workers (who are almost certainly over-represented by African females from impoverished backgrounds) indicating, perhaps, a movement away from the more analytical approach adopted in *Walker*.

that, by implication, were racially based.[105] Furthermore, the Truth and Reconciliation Commission recommended investigation into the possible exemption from tax of property transferred to beneficiaries as compensation ordered by the Commission.[106]

The crucial issue here is whether preferential taxation of previously disadvantaged groups would coincide with the equality objectives of affirmative action programmes.

(i) Inter and intra group justice

The purpose of affirmative action is not to reward 'an individual, but to advance the category of persons to which he belongs and to achieve substantive equality... Similarly, the aim is not to punish or otherwise prejudice... an individual, but to diminish the over-representation which his group has been enjoying as a result of previous unfair discrimination.'[107] In this way, preferential taxation of previously disadvantaged groups may promote short-term inter-group justice.

[105] See Chapter 20 below for a discussion of user charges.

[106] See note 107 below.

[107] Van der Westhuizen J in *Stoman* v *Minister of Safety and Security* 2002 (3) SA (T) 484D-E

However, affirmative action is a crude tool of justice, seeking as it does, to confer, without focus, benefits on certain groups. Since Black people, as an identifiable group, suffered most obviously from discriminatory state action in the past, theirs is the most obvious candidate group to benefit. It is conceivable that the broad sweep of a preferential tax policy would to promote justice between the groups of Black and White people. However, because such a policy would obviously benefit some members of the preferred group but not others, its impact on intra-group justice must be considered. In fact, the distribution of wealth amongst Blacks is already exceptionally unequal,[108] so that any affirmative action measures in taxation are likely to privilege wealthy Blacks further. Preferential taxation might improve the aggregate position of Blacks relative to Whites, whose

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The converse of affirmative action would be the differentiated disadvantageous treatment of a certain sector of the community. In this regard, the Truth and Reconciliation Commission recommended 'a surcharge on golden handshakes given to senior public servants since 1990'. (DM Tutu (Chair) *Truth and Reconciliation Commission* Final Report, Volume Six, Chapter Five 'Report of the Reparation and Rehabilitation Committee: Reparations and the Business Sector' 143) The selection of a cut off date for the conferral of a benefit or disadvantage will always give rise to anomalies, nevertheless, it seems that some remarkable anomalies might arise from this proposal. If payments to civil servants were excessive, they should have been investigated timeously and corrected within the structures that permitted them to be paid, not more than a decade later through the tax system. Given the narratives of human abuse and misery the Commission was called upon to investigate, it is understandable that it should have made certain recommendations, such as this one, which may have cogency at an emotional level but which offend the rationality demanded by the constitutional order. There can be no hope of a symmetrical balancing of the historically unfair acquisition of wealth and current deprivation. Furthermore, this particular recommendation seems to lie more with a spirit of revenge than ubuntu.

[108] Whiteford et al (note 86 above) 21 record that the Gini coefficient for Africans, at 0,53, was the most unequal intra-group distribution of wealth based on traditional racial categorisations.

economic predominance is in any event increasingly attenuating, but is unlikely to improve the condition of the poor, who are over represented by Blacks.[109]

(ii) Creation of fiscal privileges

A fundamental consideration for equality in taxation lies with the elimination of fiscal privileges that might be conferred on particular status-holders. The creation of a new class of privileged status-holders, as the Truth and Reconciliation Commission has proposed, albeit on a limited scale, would be diametrically opposed to this aim. From a perspective of horizontal equity, socially destructive resentment is likely to arise since some members of the community would be accorded new privileges, which, presumably, would inure long into the future.

The perceived exclusion from the advantages enjoyed by Anglophones was a driving force in Afrikaner particularism, eventuating in the reserving of certain privileges for that group.[110] These privileges were reflected in the egregious tax benefits extended to state employees, who were the direct beneficiaries of discriminatory employment practices. Contemporary social injustices are, in part, directly traceable to the compensatory 'justice' a minority secured for itself.

Constitutionalism must be alert to the lessons of history and have an eye on the future. Even if the egregious problems South Africa has faced: colonialism, apartheid, and extreme manifestations of patriarchy, were to be surmounted, then the experience of other countries suggests that the problems of unequal

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[109] This concern applies equally to Black Economic Empowerment (BEE) which has been most obviously manifest in a small number of Black entrepreneurs acquiring exceptional wealth. Since trickle down of wealth has been revealed to be a myth (see section VI above), meaningful BEE is likely to be better served though the broadest ownership of capital, effected possibly through professionally managed investment trusts of which the least privileged are beneficiaries.

[110] Gunther (note 40 above) 454

wealth distribution would remain. Generally, wealthy Blacks would enjoy a considerable advantage relative to their fellow community members and, specifically, to the less privileged members of their own group.[111] Therefore, a long-term view will focus on establishing patterns of fair contribution across the entire community. Any extension, rather than elimination, of tax privileges would be detrimental to long-term equality.

However important it may be to consider race in order to counter previous, racially based discrimination, affirmative action has the unavoidable potential for division and may act to reaffirm constructed difference rather than eliminate its consequences. In the area of employment there is no obvious alternative strategy that might deliver the goals of affirmative action. However, in taxation, a preference for one group over another, even in an attempt to right historical wrongs, should be opposed. A constitutional scheme of taxation, starting afresh and with an eye to the future, should be individuated, considering the economic well-being of each taxpayer during the period of assessment, regardless of how she might be categorised in terms of traditional identifiers.

IX CONCLUDING COMMENTS

Constitutional equality, like freedom, must promote human dignity and be relevant to the lives of community members. Faced with a legacy of egregious inequality, government may be tempted by policies of immediate equalisation or imprudent preference. However, programmes that pursue constitutional goals must be rational and practicable, bringing sustainable benefit to the community as a whole. While the Constitution demands that equality must be achieved, there can be no expectation of material levelling.

[111] See my comments on de-grouped identity in Chapter 4, para III (b) above.

PART TWO

CONSTITUTIONAL GOVERNANCE

INTRODUCTION TO PART TWO

In this part, I briefly consider the extent to which the Constitution prescribes particular forms of governance and behaviour on the part of government. The issues selected for discussion highlight the ways in which governance of the fiscus may be efficient but also equitable. My purpose here lies in identifying the ways in which government, as principal agent, may demonstrate loyalty to the Constitution. I do not examine possibilities for challenging government fiscal policy through the judicial system.

In Chapter 7, I look at constitutional governance, indicating the areas where conflict may arise between executive government and the judiciary with regard to taxation. The essential point made is that the Bill of Rights is not a hurdle but a modus operandi for constitutional governance.

In Chapter 8, I examine two aspects of the rule of law. The first of these aspects is internal morality, which relates to the 'infrastructure' of a just law. The second is legal coherence, which moors tax laws in the general body of the community's laws.

In Chapter 9, I consider effective governance and how the ostensibly antagonistic desiderata of efficiency and equity can be reconciled.

In Chapter 10, I complete this review of constitutional governance and taxation by looking at transparent management of the fiscus and how this can ultimately contribute to empowerment of the community through participation in the budgetary process.

CHAPTER 7 CONSTITUTIONAL GOVERNANCE

I INTRODUCTION

In Part One, I outlined constitutional values and the context in which community members experience them. In Part Three, I consider how those values may shape a constitutional scheme of taxation. In this part, I consider the crucial role of government and, specifically, in this chapter, the concept of constitutional governance. Firstly, I propose that the Bill of Rights represents a modus operandi of constitutional government, not a halter to untrammelled majoritarian power. Secondly, I outline the possibilities for conflict between different branches of government.

The principal objective of this study is to arrive at a scheme of taxation that is true to the Constitution.[1] This aim does not imply the drafting of a statute that could withstand minute scrutiny by the Constitutional Court. My perspective is not that of a potential litigant, so that the technical rules that might be the subject of legal action are not my current concern. Rather I seek to sketch a fiscal strategy anchored in the bedrock of constitutional values; congruent with the telos of a just society. I consider the potential conflict between branches of government cursorily and simply because that prospect cannot be ignored.

II A GENERAL CONSTITUTIONAL GOVERNANCE

(a) Division of powers

The Constitution allocates powers, functions and responsibilities to the legislative, executive and judicial branches of government. However, this allocation of powers does not imply reciprocally antagonistic power camps. Each

[1] Constitution of the Republic of South Africa Act 108 of 1996 (Constitution)

branch must defer to the Constitution and promote constitutional objectives. A failure on the part of one branch of government to cooperate with the other branches must be disloyal to the Constitution unless good cause exists.

(b) Cooperative government

As the ultimate interpreter of the Constitution, the Constitutional Court is commonly envisaged (particularly in respect of civil and political rights) as a bulwark against the predations of a majoritarian government. In this way, the Court has been invested with epithets such as 'the guardian of the Constitution', 'the protector of human rights', and 'the upholder of democracy'.[2] Yet, the assumption inherent in such descriptions, that, without the judiciary to act as its guardian, the Constitution (particularly the Bill of Rights) would be meaningless, is misplaced. This view indicates a pessimistic scepticism towards democracy, implying that modern government holds a degree of untrammelled power associated with absolute monarchy. It also implies that the judiciary is the sole branch of government animated by constitutional principles; that there are two conflicting power blocs: one, the judiciary, characterised by a predisposition to constitutionalism; and, the other, the undifferentiated executive and legislature, characterised by a will to oppose constitutional values. Conceiving government in such schismatic and antagonistic terms may have been appropriate for envisaging the historical power struggles between absolute monarchs and their subjects, but is inapt for modern government and certainly the form of government prescribed by the Constitution.[3]

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[2] Madala J in *Soobramoney* v *Minister of Health (KwaZulu-Natal* 1998 (1) SA 765 (CC) [45]

[3] Section 41(1) of the Constitution provides that 'all spheres of government and all organs of state within each sphere must -

...(h) co-operate with one another in mutual trust and good faith...'

(i) Areas of no conflict

First, there are many areas of practical governance where conflict does not arise. Most of the laws, which have been enacted after the Constitution in South Africa – and, indeed, most of those antecedent to the constitutional dispensation - are constitutionally compatible. Only exceptionally will acts of the executive or legislature come under judicial scrutiny. Constitutional governance is generally conducted without the necessity of judicial intervention.

(ii) Executive and private power

Second, the government of the day holds the power to disrupt the strategies and behaviour of private interests. Prudent use of this power may practically guarantee civil rights.[4] For instance, policies may be formulated and laws introduced in order to prevent the monopolisation of the media. In this way, variety and opportunity of expression and, ultimately, freedom of speech become more likely.

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[4] Z Eisenstein 'Stop Stomping on the Rest of Us: Retrieving Publicness from the Privatization of the Globe' *Indiana J of Global Legal Studies* (1996) Vol 4:1 (no constant pagination), asserting the need for government to counter powerful private interests, observes that 'Full publicization of life leads to fascism or statist communism. But what does full privatisation lead to? It leads to the depiction of the "the" public as the enemy – as the arena of special/divisive interest that balkanise the country. The anti-tax, antigovernment stance has displaced publicness and made the poor the enemy'.

(iii) Executive practically guarantees socio-economic rights

Third, only the favourable will of the executive can ultimately guarantee socio-economic provision,[5] and, for most South Africans, the realisation of bio-liberty through such provision will be the surest sign of constitutional delivery.

For many members of the constitutional community, executive government will represent the agency of constitutional delivery. Naturally, in the exceptional, if 'catastrophic',[6] civil and political cases, the judiciary will be required to protect groups or individuals against the misguided predations of government, acting as a majoritarian agency or for its own expediency. Nevertheless, in an optative view the Bill of Rights is not a halter on the instincts of majoritarian government, rather a template for constitutional governance.

(b) Common law analogies

Under the common law, an agent acts on behalf of her principal in good faith, whereas a trustee, in addition to the expectation of her demonstrating prudence and honesty, is normally endowed with a broad discretion to give effect to the terms of the relevant trust deed. These differentiated roles may be referred to analogously, so that constitutional government may be portrayed as the agent of the Constitution but also the trustee of the constitutional community.

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[5] The current government has acknowledged it potential and it burden. The Presidency *Toward a Ten Year Review: Complete Report* (2003) 2 states: 'In line with the prescripts of the new Constitution, new policies and programmes have been put in place to dramatically improve the quality of life of all the people.'

[6] I use the term 'catastrophic' because, although the occurrence of such breaches is likely to be rare, relative to the satisfaction or denial of quotidian socio-economic rights, they may be deeply traumatic for civil society.

Undifferentiated constitutional government, not one particular branch, will achieve the constitutional scheme of taxation I envisage. Therefore, it is not a fundamental concern whether such a scheme of taxation is brought about by the government of the day from its own instance or is the result of judicial intervention. Nevertheless, it is useful to consider briefly the different roles of trifurcated government, particularly as they may give rise to disputes between the executive and the judiciary with regard to taxation.

III ALLOCATION OF FUNCTIONS

The Constitution charges the state with respecting, protecting, promoting, and fulfilling the provisions of the Bill of Rights.[7] The state must further respect the jural supremacy of the Constitution,[8] defer to the rule of law, and, in its conduct, demonstrate accountability, responsiveness and openness.[9] These obligations fall equally on each branch of government but each has different functions to perform in achieving constitutional goals.

Executive government is required to take reasonable, progressive measures to eliminate or reduce social deprivation,[10] whereas the judiciary is expected to guarantee that democratic processes are protected. In this way, the courts may ensure accountability, responsiveness, and openness on the part of the executive. However, courts are functionally ill-suited to decide polycentric

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[7] Section 7(2) and (3) of the Constitution

[8] Section 2 of the Constitution

[9] Section 1(d) of the Constitution

[10] Sections 26 and 27 of the Constitution. The text of the Constitution refers to 'the State', which includes all three branches of government. Nevertheless, from a non-technical perspective, 'the State' connotes the government of the day and not the judiciary.

disputes of interest, and the Constitutional Court has recognised that the judiciary is not 'institutionally equipped to decide how public revenues should most effectively be spent'.[11] Consequently, the Constitution casts the judicial branch of government in the role of ensuring that the state takes measures to meet its constitutional obligations and evaluating the reasonableness of these measures.[12] Should the court find that the state has failed in its obligations, it may make any order that is just and equitable.[13]

There may be no 'bright lines' delineating the different roles of the legislature, the executive and the courts, but certain matters fall within the unique domain of one or other of the arms of government. Broadly speaking, the formulation of policy falls beyond the ambit of the judicial prerogative.[14] However, this principle does not imply that courts may not or should not make orders that have an impact on

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[11] *Minister of Health* v *Treatment Action Campaign* (2) 2002 (5) SA 721 (CC) [37]

[12] *Treatment Action Campaign* (note 11 above) [38]
The Court's is limited to auditing the rationality of general measures not their reasonableness: although reasonableness is relevant to judicial review if it is established that a scheme, though rational, affects citizens' rights. See *New National Party* v *Government of the Republic of South Africa* 1999 (3) SA 191 (CC) [24].

[13] *Treatment Action Campaign* (note 11 above) [102]

[14] There is an urgent expectation of good faith on the part of government, and, revisiting the analogy of trusteeship, utmost good faith. Government, which is ideologically opposed to the provision of comprehensive socio-economic benefits, could choose to raise so little revenue that its obligations toward the relevant rights would be rendered nugatory. This raises the query whether such a policy would constitute an actionable breach of government's duty of loyalty to the Constitution, as contemplated in section 41(1)(d). The Constitutional Court, faced by the policies of a democratically-elected government inspired by, say, Nozickian ultraminimalism, would effectively be called upon to order it to change its political stripe, a deeply problematic consideration for a democracy.

policy.[15] The nature of the order is not relevant, and even a simple declaratory order against the state or an organ of state can affect policy and, is, therefore, likely to give rise to budgetary and, so tax, implications. It is inevitable that certain types of judicial orders may have significant budgetary impact. Others, supervisory orders, in particular, are likely to prove a considerable source of friction between the executive and judiciary. Nevertheless, the executive is constitutionally bound to give effect to valid judicial orders, whether or not they affect its policies, and must find the resources to do so. Consequently, judicial determinations of reasonableness may have practical budgetary implications, even if they are not in themselves directed at reallocating budgets.[16] The constitutional community is, however, a democracy, whose government is 'based on the will of the people'[17]. If lawmaking under the constitutional dispensation is to remain democratic, and therefore necessarily politicised, the content of tax laws must principally be the concern of democratically elected representatives and not the judiciary.[18]

III POTENTIAL JUDICIAL CHALLENGES TO TAX POLICY

A conclusion of this study is that the current scheme of taxation does not comply with the fundamental aims of the Constitution,[19] particularly the foundational

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[15] *Treatment Action Campaign* (note 11 above) [98]

[16] *Treatment Action Campaign* (note 11 above) [38]

[17] Preamble to the Constitution

[18] Without the primacy of Parliament (as opposed to an unfettered *supremacy*) in determining the content of laws, we must approach the Platonic ideal of governance by wise elders. That is not compatible with paradigmatic conceptions of democracy. See Plato *The Republic* (trans HDP Lee, 1955) (1973 reprint) 156.

[19] See Chapter 21 below.

principles of human dignity and equality.[20] I do not suggest, however, that such broad grounds for constitutional complaint lend themselves to judicial action. Tax laws or their may give rise to various grounds for specific complaint, and the judicial process may offer recourse in these regards. The concern of this study lies, however, with broad policy and substantive justice. Under a constitutional scheme of taxation, it is expected that each arm of government – principally, the executive, from its own instance - would seek to anticipate and so avoid any such conflict. Nevertheless, it is pertinent to outline the areas where conflict over fiscal matters, between the government of the day and the courts, is possible.

In addition to disputes relating to the allocation of taxes collected, there are two main areas of potential conflict between executive government and the judiciary with regard to taxation.

(a) Rationality of tax measures

The first potential area for conflict lies with the Court's power to audit the rationality of government measures, including its tax laws. I do not suggest, in this regard, that the Court would entertain, say, a challenge to government's

[20] See Chapter 12 below for a discussion of the ways in which dignity may inform a scheme of taxation, and Chapters 14 to 18 below for a discussion of the role of equality.

economic assumptions that underpin its tax policies.[21] However, certain taxes, particularly those intended to modify behaviour, may be challenged, if it can be shown that there is no rational connection between their stated purpose and likely consequences.[22]

(b) Sufficiency of revenue raised

A second possible area for conflict, however unlikely it may be in practice, is that the Constitutional Court could order the state to raise more revenue.

It may seem an improbable suggestion, particularly to those accustomed to the doctrine of parliamentary sovereignty, that a court might instruct an elected government to raise more revenue. Yet, it would be wrong to think that any government in practice has a free hand to set the amount of revenue it raises. International financial agencies, particularly the International Monetary Fund (IMF), may impose conditions relating to taxation before granting loans.

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[21] There is an expectation of reasonableness in government policies but rationality is the justiciable requirement. (See Chapter 2, para II (e) above for an outline of constitutional rationalism.) A goal of, say, economic growth is reasonable even if strong counter arguments can be raised. See, for instance, EF Schumacher *Small is Beautiful: A Study of Economics as if People Mattered* (1973) (1978 reprint). In theory, the means by which government seeks to attain economic growth are open to rationality review. However, although rationality has pretences to objectivity, there is considerable ideological content. Some economists argue that long-term growth can be obtained by cutting taxes. Other economists find that there is no connection between low taxes and growth. (See PR Orszag 'Testimony on the Administration's Tax Proposals' Testimony before the Committee on Financial Services Subcommitee on Oversight and Investigations, United States House of Representatives, 18 March 2003.) To the opposing argument, the other's proposition must be 'irrational', as it will not lead to the stated goal. Given that arguments for rationality in fiscal matters will include a high ideological content, the courts will be wary of finding jurisdiction.

[22] I consider the constitutionality of behaviour modifying taxes in Chapter 20 below.

Furthermore, actions of an independent central bank may also significantly influence tax yields.[23]

Government must 'be loyal to the Constitution, the Republic and its people'.[24] A deliberate policy of raising insufficient revenues to fulfil relevant constitutional duties, would not demonstrate the requisite loyalty. Furthermore, if this obligation is to have meaning, it must be actionable. Therefore, it must be possible for the Court to instruct executive government to raise sufficient revenue to manifest loyalty to the Constitution, its injunctions and objectives.

(c) Allocation between government departments

Beyond the privileging of human dignity, no hierarchy of constitutional rights has been enunciated in South Africa, and rights must be balanced in accordance with particular situations.[25] Should the Constitutional Court be called upon to balance competing socio-economic rights, it seems unlikely that it would presume to direct government to commit expenditure for the benefit of a particular right at the

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[23] Section 224(1) of the Constitution establishes the primary object of the central bank of the Republic, the South African Reserve Bank (SARB), as protecting 'the value of the currency in the interest of balanced and sustainable economic growth in the Republic'. Section 224(2) provides that the SARB must, in the pursuit of its primary object, consult with the relevant Minister but otherwise 'perform its functions independently and without fear, favour or prejudice'. It is conceivable that pursuit of this primary object and exercise of independence may affect tax yield.

[24] Section 41(1)(d) of the Constitution

[25] L Blauuw-Wolf & J Wolf 'A Comparison Between German and South African Limitation Provisions' (1996) 113 *SALJ* 267, 282 describe the operation of the theory of balancing of rights (*Güterabwägung*) under German constitutional law. S Woolman 'Limitation' in M Chaskalson et al (eds) *Constitutional Law of South Africa* (1996, 5 rev 1999) 12-i, 12-54 describes the metaphor of balancing as being 'deeply embedded in our constitutional discourse' but notes how problematic the balancing of rights is likely to be in practice.

expense of another. Provided executive government has rationally allocated the scarce resources at its disposal amongst government the departments that actuate socio-economic rights, no judicial challenge seems feasible.

However, not all government functions have obvious constitutional correspondence and government expenditure on matters, which are not required by the Bill of Rights, must be subordinate to those that are. Even so, it seems most unlikely that the Constitutional Court would intervene to, say, prevent government allocating disproportionate amounts of revenue to defence spending, to the detriment of housing provision. Yet, it seems a point must be reached beyond which the imprudent allocation of revenues becomes a matter for judicial review.[26] Nevertheless, in the normal course of events, the discretion to allocate revenue lies solely with the executive. Expectations on the part of the community of effective delivery accompany this power.

IV CONCLUDING COMMENTS

The Constitutional Court is unlikely to entertain challenges to general tax laws. Specific provisions, which are manifestly unjust, will be vulnerable to judicial action,[27] but assaults on broad government policy cannot be countenanced. In practice, the government of the day has a free hand in setting policy and therefore attracts a considerable expectation that it will adhere to constitutional values and objectives in good faith. In Part III, I outline how this expectation may be met in a constitutional scheme of taxation. In the following chapters of this

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[26] For example, if government resolves to commit the bulk of its budget to a space programme, this might constitute grounds for a judicial challenge to its budget.

[27] *First National Bank of SA Ltd t/a Wesbank* v *Commissioner, South African Revenue Service* 2002 (4) SA 768 (CC) concerned a minor aspect of enforcing tax debts. The Court made it clear that it was not reviewing the equity of the tax. Ackermann J observed at [38] that: 'The question here is not about equity in tax, but whether it is constitutionally permissible to seize a third party's property for another person's custom debt.'

part, I consider certain other expectations, specifically, those relating to the behaviour of government in managing the fiscus.

CHAPTER 8 THE CONSTITUTIONAL STATE AND THE RULE OF LAW

I INTRODUCTION

Following the constitutional state's foundation on the rule of law,[1] in this chapter, I consider two aspects of the rule of law (internal morality and legal coherence) that are crucial for a constitutional scheme of taxation. After defining 'the rule of law' in the context of the constitutional community, I look at certain of the requirements of internal morality in framing tax laws. Then, to highlight the principles of legal coherence, I consider certain arrangements under the current tax structure that demonstrate a marked incoherence in relation to the general law.

II RULE OF LAW IN THE CONSTITUTIONAL COMMUNITY

It is likely that every modern state would lay claim to being governed by the rule of law, and may be justified in doing so, however eccentric its conceptions of justice may appear to an outsider. This paradox is possible because no particular conception of the rule of law can have universal validity.[2] Therefore, when it is said that constitutional governance complies with the rule of law, nothing more is

[1] Section 1(c) of the Constitution of the Republic of South Africa Act 108 of 1996

[2] W Friedman *Law in a Changing Society* 2 ed (1972) 500

implied than compliance with its own constitutional rules.[3] The rules established by the Constitution do not claim a universally valid ideological content, but their common recognition within the constitutional community imbues them with predictability and thereby permits them to 'strike at arbitrariness'.[4] If constitutional government is conducted in accordance with the rule of law, the exercise of all public power will comply with the Constitution.[5]

I now discuss two principles of the rule of law that should inform the policies of constitutional government, particularly its scheme of taxation: internal morality and legal coherence.

III INTERNAL MORALITY

In addition to being constitutionally compliant, legislation should comply with generally accepted procedural principles. Lon Fuller's 'distinct rules of legal excellence' or principles defining 'the internal morality of law' are probably the best known and a sufficient account for current purposes. Fuller proposed that any legislative enactment should demonstrate the following characteristics:

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[3] Chaskalson P, Goldstone J and O'Regan J in *Fedsure Life Assurance Ltd* v *Greater Johannesburg Transitional Metropolitan Council* 1999 (1) SA 374 (CC) [56] cite with approval the following statement by the Supreme Court of Canada in *The Matter of a Reference by the Government in Council Concerning Certain Questions Relating to the Secession of Quebec from Canada:* 'Simply put, the constitutionalism principle requires that all government action comply with the Constitution. The rule of law principle requires that all government action must comply with the law, including the Constitution'.

[4] Ngcobo J in *Van der Walt* v *Metcash Trading Ltd* 2002 (4) SA 317 (CC) [36]

[5] Chaskalson P in *Pharmaceutical Manufacturers Association of South Africa: In re ex parte President of the Republic of South Africa* 2000 (2) SA 674 (CC) [20]

generality; prospective operation; intelligibility and clarity; avoidance of contradictions; avoidance of impossible demands; constancy through time; congruence between official action and publication.[6] His alternative characterisation of these rules as the 'procedural version of natural law' might alert one to the prospect of an ideological content to his prescriptions but they are not controversial, and were well characterised by HLA Hart as being 'essentially principles of good craftsmanship'.[7] (Beyond the operation of the rule of law,[8] these prescriptions may be couched in constitutionally appropriate terminology, such as reasonableness,[9] and transparency or clarity of legislative message.[10]) The desirability of Fuller's prescriptions is generally self-evident. However, I wish to consider certain of the desiderata that require further elucidation.

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[6] LL Fuller *The Morality of Law* Revised ed (1969) 42

[7] Cited by Friedman (note 2 above) 502 note 5.

[8] Fuller (note 6 above) requires congruence between rules and official action, and the prospective operation of rules whereas the Constitution requires the rule of law and just administrative action.

[9] Fuller (note 6 above) requires the avoidance of impossibility. If the Constitution does not directly demand reasonableness, it does require rationality, proportionality and effective governance. These do not allow room for impossibility in laws.

[10] Fuller (note 6 above) requires clear and intelligible rules, whereas the Constitution requires transparency. While this injunction applies to governance in general, it may also apply to the legal dialogue between government and citizens.

(a) Certainty

Of Fuller's prescriptions, certainty in law is the quality traditionally considered the most important for taxation.[11] Indeed, there is a tendency to portray a special claim to certainty for tax laws: Adam Smith, for instance, proposed that tax certainty is 'a matter of so great importance that a very considerable degree inequality...is not so near so great an evil as a very small degree of uncertainty'.[12]

Tax laws do not have any special claim to certainty, and certainty of tax liability, in principle and practice, must be subordinate to broader social justice. Retrospectivity, for instance, is generally repugnant in tax laws, as in any other area of the law. There is no constitutional principle which requires that tax laws should be constant so as not to disrupt settled arrangements. The need for lawfulness should not provide a mask for conservatism, and, as Fuller observes, 'If every time a man relied on existing law in arranging his affairs, he were made

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[11] Fuller's requirement of constancy through time corresponds with a constitutional conception of equality that may include equal treatment across time. CS Shoup *Public Finance* (1969) 23 includes certainty as an element of equal tax treatment because it assures the individual that she will be treated equally in successive periods should the same bundle of relevant circumstances recur.

[12] A Smith *An Inquiry Into the Nature and Causes of the Wealth of Nations* (1776) (1952 reprint) 362
It would be unreasonable to judge this proposal out of its historical context. Writing at the end of the eighteenth century, Smith was anxious to counter the practice of corrupt tax collectors, who, taking advantage of ambiguous laws, demanded arbitrary and excessive payments; an urgent issue at that time. Contemporary concerns regarding the taxpayer-collection agency dialogue in South Africa are more likely to relate to the degree of discretion conferred on the collection agency, rather than its probity.

secure against change in legal rules, the whole body of our law would be ossified forever'. [13]

The extant tax system retains remarkable inequalities by any standards, and, to that extent, the current scheme of obligations must not be secure against change, even at the expense of an element of uncertainty being introduced: as Lord Maitland proposed in regard to the doctrine of precedent 'Certainty in law must not become certainty in injustice'.[14]

(b) Clarity of legislative message

(i) Comprehension and prediction

Oliver Wendell Holmes's characterisation of 'the law' as 'The prophecies of what the courts will do in fact, and nothing more pretentious' identifies the essential quality of predictability that lies at the root of the rule of law.[15] For legislation, the possibility of prediction starts with the ability to understand the text. Yet, the prolixity and legalistic style of taxing statutes tends to exclude non-specialists. For instance, the text of the Income Tax Act,[16] South Africa's most important

[13] Fuller (note 6 above) 60

[14] Cited by RWM Dias *Jurisprudence* 4 ed (1976) 279.

[15] OW Holmes 'The Path of the Law' *Harvard LR* 10 (1897) 457, 461

[16] Income Tax Act 58 of 1962

taxing statute, has evolved, mostly in a piecemeal fashion, over some 90 years.[17] Furthermore, the power to interpret and make decisions regarding statutes vests in a relatively small number of people, notably specialists in accounting and legal practice, or employees of financial institutions and the South African Revenue Service (SARS).

(ii) Interpretative power

It seems inconceivable, therefore, that those members of the constitutional community, not possessed of tax vocation might, without professional assistance, engage with the provisions of the Income Tax Act, either to formulate 'predictions' regarding their affairs or to critique, when the text is forbidding and exclusionary. Roger Cotterrell has observed in this regard that:

> Although the law is reason, reason alone will not give mastery of it...Thus, obviously, actual knowledge of law is denied to the community. This knowledge is necessarily – by its nature – the monopoly of lawyers, who appear as the absolutely indispensable representatives of the community in stating, interpreting and applying the law.[18]

Internal morality does not uniquely demand clarity. Transparent governance implies the drafting of legislative texts in such a way that they are readily

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[17] The first Income Tax Act 28 of 1914 has been followed by consolidation acts in 1925 (Act 40 of 1925), 1941 (Act 31 of 1941) and 1962 (Act 58 of 1962). For a history of income tax in South Africa, see I Isaacs, WD Fielding & L Lazar *Law and Practice of South African Income Tax* (1963) 3; Murray *Income Tax Act* (1926) and Ingram *The Law of Income Tax in South Africa* (1933) cited by AP De Koker & G Urquhart *Income Tax in South Africa* (1992) para 1-4; and generally C Divaris & ML Stein *Silke on South African Income Tax* 9 ed (1978).

[18] R Cotterrell *The Politics of Jurisprudence* (1989) 34

comprehensible to ordinary taxpayers and not merely a relatively small coterie of specialists.[19] This is an unequal power distribution which government can play some role in equalising.[20] While I am sceptical of claims that, in a complex modern economy, the mechanics of taxation can be simple, a clear text promotes general understanding and a dissipation of interpretative power.

(iii) From prolixity to principle

The legislative message of South African taxation is generally conveyed in complex, legalistic texts. It has long been recognised that auxiliary explanatory documents are necessary to supplement the relevant statutes,[21] and SARS has made commendable efforts to summarise important provisions in plain language.[22] Nevertheless, explanatory brochures do not substitute the legislative

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[19] P Nonet 'Legal Competence' in CM Campbell & P Wiles (eds) *Law and Society* (1979) 268 observes that although the aim of the legal order is that everyone should be equal before the law, notwithstanding their power, social standing or political leverage, the administration of law does not work in a vacuum. Cost and ignorance are considerable barriers. Nonet 270 concludes that 'The perfection and growth of the law will therefore depend upon *how effectively legal authorities are sensitised and made responsive* to the problems and demands of their constituency'. (Emphasis in original.)
Equality can be promoted in taxation by clear communication of relevant rights and duties.

[20] TJ Johnson 'Professional Control' in Campbell & Wiles (note 19 above) 219 observes that 'Dependence on the skills of others has the effect of reducing the common areas of shared experience and knowledge and increases social distance'.

[21] B Sabine 'The New Taxpayer's Charter or Taxation without Tears' *British Tax R* (1991) 411 describes a document produced by the United Kingdom's Board of Stamps and Taxes in 1799 with the self-explanatory title of *A Plain, Short and Easy Description of the Different Clauses in the Income Tax so as to Render It Familiar to the Meanest Capacity.*

[22] See, for instance *Income Tax and the Individual* Law Administration Department, SARS (2002).

text, as SARS is at pains to caution. Therefore, while the *Capital Gains Tax FAQ* brochure may be a model of clarity, the Eighth Schedule to the Income Tax Act, which it succinctly summarises, is quite the contrary. The legislative text itself must be rendered more easily comprehensible to ordinary taxpayers and not merely supplemented by auxiliary explanatory aids.

Provided the purpose and principles of a statute are adequately and concisely formulated, exclusionary texts may be redrafted in a more accessible style. John Avery Jones, for instance, argues that traditionally prolix and complex, United Kingdom tax statutes can be recast in a way that follows the simpler European Union practice of formulating principles.[23] Brevity, is not, however, the principal concern. New Zealand has successfully completed the first part of its programme to rewrite its income tax legislation in plain English. However, the redrafted text is lengthy since it incorporates diagrams, flowcharts, readers' notes and list of definitions following provisions as interpretative aids.[24]

Simplifying the text does not merely result in improved communication. Plain language texts require considerable discipline in the formulation and communication of policy and core principles. When these are unambiguously enunciated, there is less opportunity to hide preferences and special cases in legislative prolixity. In this way, 'short-term sectional interest must give way to the wider considerations of national interest'.[25] Conversely, opacity and ambiguity in

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[23] J Avery Jones 'Tax Law: Rules or Principles?' *Fiscal Studies* (1996) Vol 17 No 3, 63

[24] Income Tax Bill 2002

The Lesotho Income Tax Act, 1993 is also a model of clarity. The Labour Relations Act 66 of 1995 is a notable South African example of a user-friendly legislative text.

[25] E Wajsbrem 'Taxation Reform: A New Agenda for the Nineties' 21 *Australian Tax R* (1992) 140

legislative texts may provide both the collection agency and taxpayers with an excuse to interpret the law in their own favour.[26]

(iv) Separation of legal texts

It is incongruous that a single statute, the Income Tax Act, which incorporates four distinct taxes,[27] should be used to communicate rights and obligations to both multinational enterprises and individuals. (Of course, the text merely reflects the fundamental discourse.) The economic activities and circumstances of the vast majority of individuals bear no resemblance to those of complex modern business organisations, particularly those engaged in cross-border activities. If corporate taxation and the taxation of individuals were to be separated, government could, on the one hand, institute initiatives to attract direct foreign investment without affecting equity amongst resident individuals, and, on the other hand, establish equitable taxation of resident individuals, without obviating enterprise.

IV A PRINCIPLE OF LEGAL COHERENCE

In addition to complying with the rule of law, constitutional governance must be coherent.[28] Considering these two requirements together, laws should be consistent with discernible principles that apply throughout the legal system. This phenomenon may be described as 'legal coherence'. Legal coherence would

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[26] Ibid 144

[27] Income tax (both individual and corporate), donations tax, secondary tax on companies and capital gains tax. The same text previously incorporated non-resident shareholders' tax, undistributed profits tax and the levy on financial services.

[28] Section 41(1)(c) of the Constitution

anchor the tax system in the broad, constitutionally animated legal system. In practice, legal coherence would make taxpaying more certain for the taxpayer and remove economic distortions. At a basic level, it would eliminate egregious privileges, and, thus, promoting equality.

Two arrangements under the current income tax system illustrate the principle of legal coherence: these are the ways in which dividends and long-term insurance policies are taxed.[29] In neither case is the assessment for income tax derived from the legal substance of the arrangements. This is deplorable in a constitutional state, which is bound by the rule of law.

V LEGAL COHERENCE AND THE TAXATION OF DIVIDENDS

(a) Dividend taxation and egregious privilege

No current tax arrangement is more at odds with constitutional principles than the way in which dividends are taxed, both in terms of an inequitable contribution burden, and divergence from legal coherence.

Example

A inherits a large portfolio of South African shares that generates sufficient dividends to support her in comfort without working. Provided she does not trade in the shares, she will not pay any income tax in her lifetime. Furthermore, if she does not dispose of any shares at a profit, she will not be subject to capital gains tax.

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[29] Retirement funds are taxed similarly to long-term insurers and will be included in the discussion.

This bizarre possibility is a consequence of an ostensible dilemma governments face when taxing company profits, that is, whether such profits, and the consequent distribution of dividends, should be treated as discrete transactions or as part of the same flow of money.

(b) Equal treatment of sources of company finance

The real problem arising from the taxation of corporations lies in the convention of permitting companies to deduct interest payments to debt-holders from their taxable incomes but not dividends paid to equity-holders.[30] Since both dividends and interest represent the consideration paid to a person who extends capital to a corporation (from financial and legal perspectives) they should be treated equally for tax purposes, both in the hands of the beneficial recipient and the company. (Curiously, South Africa taxes income from interest-bearing or dividend-bearing investments in foreign corporations equally, yet exempts dividends, but not interest, paid by domestic corporations.[31]) If no distinction were made between the tax treatment of interest and dividends, income tax on corporations would, in effect, be eliminated.[32]

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[30] J Friedman & R Greenstein 'Exempting corporate dividends from individual income taxes' Centre on Budget and Policy Priorities (2003) 2 note 2 observe that 'In a comprehensive package of corporate tax reforms, tax-free treatment of dividends would more likely take the form of making these payments deductible at the corporate level, rather than exempting them from taxation at the individual level'.)

[31] The taxing of foreign dividends is not derived from principle but rather arises from the difficulties faced in categorising distributions made by different offshore investment vehicles.

[32] Under such an arrangement, an undistributed profits tax (UPT) would inevitably become necessary. UPT operated in South Africa before the full exemption of dividends became effective in 1990.

(c) Problems faced in taxing companies

Taxation of dividends is always likely to be problematic. It is believed that the classical system,[33] by encouraging companies to retain profits rather than distribute them to shareholders (who would pay tax at a higher rate) has caused management to be less accountable and investors to be more cavalierly speculative.[34] Yet, the supplementing of corporate income tax by the secondary tax on companies (STC) is specifically aimed at encouraging companies to refrain from distributing profits and to reinvest them productively.

(d) Double taxation

(i) Economic double taxation

There is a commonly encountered view that company profits and dividends paid to shareholders are economically the same and should not be taxed twice.[35] Sijbren Cnossen, for instance, argues that in an ideally equitable system 'corporate profits, whether distributed or retained, should be subject to personal income tax only' with corporation tax acting 'as a prepayment of income tax

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[33] Discussed below in para (d) below.

[34] C Leaf 'Love that tax cut!' *Fortune* 3 February 2003

[35] The charge of double taxation with regard to corporate profits and dividends is conceptually wrong (see Chapter 15 section V), if a potent rhetorical canard. RS McIntyre 'The Taxonomist: New Gang, Old Myths' *The American Prospect* Vol 13 No 24, 13 January 2003 argues that, furthermore, it is often factually wrong. He cites research by Citizens for Tax Justice that found that in 2002, principally due to tax avoidance and shelter schemes, less than half of the profits of American corporations were subject to income tax.

creditable against the final liability'.[36] However, from a legal perspective, when corporate profits are distributed via dividends there are two discrete events. The company, a legal person separate from its members, earns profits and, being in a position to compensate its members for the capital they have extended to it, resolves to distribute its profits by way of dividends. Both events may legitimately give rise to a tax liability.

(ii) Ways of taxing dividends

(aa) Income tax plus STC

South Africa taxes corporate profits and charges STC on profits available and actually distributed via dividends. Dividends paid by domestic companies are not subject to income tax in the hands of shareholders but, generally, dividends paid by foreign companies are taxable in the hands of resident shareholders.

Members of the Organization of Economic Cooperation and Development (OECD) tax company profits and shareholder dividends in various ways: none, incidentally, have arrived at South Africa's solution.[37]

(bb) Classical system

The classical system recognises the separate legal personae of a corporation and its shareholders, and taxes both company and shareholders fully on amounts that they severally receive. Austria, Belgium, Hungary, Japan, Luxembourg,

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[36] S Cnossen 'Equity and double taxation of dividends' in S Cnossen (ed) *Comparative Tax Studies: Essays in Honor of Richard Goode* (1983) 87

[37] Policy Advice Division, New Zealand Inland Revenue Department *Tax Matters* 8 March 2002

Netherlands, Poland, Sweden, and Switzerland use the classical system. The United States has recently introduced a variation on the classical system so that qualifying dividends are taxed at a preferential 15 per cent rate in the hands of shareholders.

(cc) Imputation

Imputation is the major alternative to the classical system. Under this arrangement, profits are taxed in the hands of a company but dividends paid to a shareholder carry a tax credit to be set off against the shareholder's general tax liability. Australia, Finland, France, Mexico, New Zealand and Norway practise full imputation. A variation of the imputation method is partial imputation. Under that system, a dividend carries only some tax credit for company tax. Canada, Denmark, Germany, Iceland, Ireland, Italy, Korea, Portugal, Spain, Turkey and the United Kingdom practise partial imputation.

There is no international consensus on the issue of taxing corporate profits and dividends. As the United States moves away from the classical system, Germany, Ireland and the United Kingdom move toward the classical system to promote harmonisation of corporate taxation within the European Union.[38]

(iii) Prescription of legal coherence

Legal coherence prescribes that tax liability be derived from the legal nature of the taxable item or transaction. It is counterintuitive for the community to grant corporations the privilege of legal personality, and certain constitutional protections separate from their members, but to ignore these privileges for tax

[38] Speech by Michael Cullen, New Zealand Minister of Revenue to the International Fiscal Association, Wellington, 2002

purposes. The separate juristic personality of a corporation is a legal fiction that may test a suspension of disbelief, on occasions. Nevertheless, all relevant law is predicated on this pretence, with the 'corporate veil' normally pierced only in the event of extraordinary misbehaviour by those who manage or control the corporation.[39] Indeed, excepting the taxation of dividends, the Income Tax Act respects the fiction of corporate personality. Conversely, the Act treats partnerships as fiscally transparent arrangements,[40] even though partnerships are economically similar to corporations.[41]

(iv) Advantages of imputation

Although the classical system of taxing dividends is the more legally coherent, it seems likely that South Africa will adopt some form of imputation. Whether a classical or imputation system is adopted, two inequitable anomalies under the current system would be neutralised.

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[39] Ottolenghi 'From peeping behind the corporate veil, to ignoring completely' 1990 *Modern LR* 338, 349 (extract in R Grantham & C Rickett *Company and Securities Law: Commentaries and Materials* (2002) 237) identifies four categories of disregarding the corporate veil.

[40] Section 1 of the Value-Added Tax Act 89 of 1991 includes unincorporate bodies of persons, such as partnerships, within the definition of 'person'. In terms of section 50 of that Act, branches and divisions of companies may register as vendors, implying a subservience of legal coherence to commercial reality.

[41] Section 1 of the Income Tax Act also includes trusts and deceased estates within the ambit of the definition of 'taxpayer' although such arrangements are generally not persons under modern South African law.

(aa) Combating arbitrage

First, at 2003-04 rates,[42] a company which fully distributes its profits by way of dividends pays an effective rate of 38,75 per cent (comprising 30 per cent income tax and 12,5 per cent secondary tax on companies paid on the value of the dividend after income tax has been deducted). This compares with a highest marginal rate for individuals of 40 per cent (42 per cent before 1 March 2002) and presents a real opportunity for arbitrage. Indeed, if the shareholding is held in a qualifying small or medium sized enterprise, the first R150 000 of taxable income is subject to a rate of 15 per cent, representing a remarkable arbitrage opportunity. Understandably, there is broad consensus amongst fiscalists that the tax rate for companies and the highest marginal rate for individuals should be the same.

(bb) Aggregation of all income

The second anomaly arises when any type of income is exempted from income tax, since it may indirectly affect the marginal rate at which other types of income are taxed.

Example

Ms B receives income of R60 000 by way of domestic dividends and further earned income of R60 000. Since the domestic dividend element of her income is excluded from the calculation of her income tax liability, she will pay income tax of R5 400, that is, at an average rate of four and a half per cent.

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[42] See section 5 of the Income Tax Act, read with Schedule 1 to the Exchange Control Amnesty and Amendment of Taxation Laws Act 12 of 2003.

Ms C has the same amount of total income but it is all earned. She will pay income tax of R10 200, that is, at an average rate of eight and a half per cent and almost double that of Ms B, notwithstanding their identical amounts of income.

If dividends (or any other form of currently exempt income) were taken into account in calculating taxable income, even if a credit were granted for tax 'prepaid' by the relevant dividend paying corporation, other income would be taxed at a higher marginal rate. In other words, there would be a proper reflection of the change in the taxpayer's wealth or economic well-being during the period of assessment.

(cc) Removal of privilege

As a final but important point, it is self-evident that, given the unequal distribution of capital, the wealthy are most likely to benefit from an exemption of dividends. Following the Bush government proposals for scrapping income tax on dividends, research was conducted to predict who would benefit from such an exemption in the United States. In this regard, the Urban Institute - Brookings Institution Tax Policy Center found that:

- 70 per cent of benefits would accrue to the wealthiest five per cent of tax filers;
- 46 per cent of benefits would accrue to the top one per cent of tax filers; and
- 29 per cent of benefits would accrue to the top one fifth of one per cent of tax filers.

In broad terms, the quarter of a million top earning tax filers would receive a similar amount of benefit in aggregate to the bottom 125 million tax filers,

expressed differently, the top one fifth of one per cent of tax filers would receive as much benefit as the bottom 95 per cent of tax filers.[43]

While American experience cannot be directly implied to South African circumstances, these remarkable figures nevertheless indicate that the wealthy are likely to enjoy a disproportionate benefit from the exemption of dividends. Employing the analytical approach to equality employed in *Walker*, such a benefit indubitably accrues primary to members of traditionally advantaged groups. There is not obvious justification for such a privilege, which is, therefore, unconstitutional.

VI LEGAL COHERENCE AND LONG-TERM INSURANCE POLICIES

(a) Taxation of long-term insurers

A second significant area, where, for the purposes of convenience or to confer favour, lawmakers have overlooked the legal substance of an arrangement, lies in the way in which long-term insurance policies are taxed. An individual's investment with a long-term insurer is taxed in accordance with the so-called trustee principle, although no trust is formed when an insurance policy is concluded.[44] The taxable income and capital gains attributable to the investment, aggregated with similar investments in a notional individual policyholder fund, are taxed at a flat rate of 30 per cent, which represents a presumed 'average' rate of

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[43] Friedman & Greenstein (note 30 above) 3

The authors refer to 'tax filers', not the general population.

[44] While, in terms of the Financial Institutions (Protection of Funds) Act 28 of 2001, a financial institution, its officers, and employees owe a similar duty of care with regard to invested moneys as common law trustees, a long-term insurance contract is not a trust.

policyholders' tax. Policy proceeds are then normally free from income tax, including capital gains tax.

(i) Potential for arbitrage

From a practical perspective, this immediately presents a significant arbitrage opportunity, as an investor who holds a similar investment directly could be taxed at income tax rates of up to 40 per cent on the income that arises from that investment. By 'wrapping' the investment in an insurance policy, she will reduce the rate of tax on the investment income by up to 10 per cent.[45]

(ii) Cross-subsidisation of wealthy

Unlike a high-income policyholder, a low-income policyholder may effectively pay at a rate far higher than if the investment were held directly. This is a remarkable manifestation of cross-subsidisation. Tax, which might otherwise been paid by policyholders from higher income groups, is made good by an overpayment by policyholders from lower income groups. Cross-subsidisation may not be objectionable in principle but the less wealthy are not expected to subsidise the more wealthy so blatantly in a just polity.[46]

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[45] In practice, insurers rarely pay tax at the nominal rate and so the effective tax saving is likely to greater.

[46] See Langa J 's comments on cross-subsidisation in *City Council of Pretoria* v *Walker* 1998 (2) SA 363 (CC) [62].

(b) Taxation of retirement funds

Retirement funds are taxed in a similar way to long-term insurers.[47] However, the potential injustice has been still more pronounced, given that an investment in a long-term insurance policy arises from a discretionary investment decision, whereas membership of an employer-sponsored retirement fund is compulsory for all eligible employees.

Example

(i) Ms A is the sole director and shareholder of a private company, which sponsors her membership of an approved pension fund. The company is permitted to pay and deduct 20 per cent of her approved remuneration into a pension fund,[48] and she will be able to contribute an additional, deductible 7,5 per cent.[49]

If she has annual remuneration from the company of R300 000:

(aa) The company, which she owns and controls, will obtain a tax deduction of R60 000);
(bb) Ms A will personally obtain a tax deduction of R22 500; and
(cc) The investment income held in the fund will be taxed at a rate of 18 per cent,[50] in comparison to her marginal rate of 40 per cent.[51]

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[47] See section 4 of the Tax on Retirement Funds Act 38 of 1996

[48] Section 11(l) of the Income Tax Act

[49] Section 11(k) of the Income Tax Act

[50] Section 2 of the Tax on Retirement Funds Act

(ii) Ms B earns less than R30 000 a year and is a member of a provident fund to which her employer does not contribute.

(aa) No tax concessions are granted to her in respect of her contributions, as member contributions to a provident fund are not tax deductible.[52] (Even if a tax deduction were to apply to contributions made by provident fund members, she would benefit from such a tax concession, since her income falls below the income tax threshold.)

(bb) The investment income held in the fund will be taxed at a rate of 18 per cent (in an approximation of her normal tax liability), yet she has no liability for income tax.

These anomalies arise because the method of taxing such investments does not correspond with the legal substance of the agreement between investor and investment intermediary. The investment made with a long-term insurer or retirement fund is legally similar, in essence, to a deposit made with a bank.

(c) Similarity of investments

The ordinary relationship between a bank and a depositor is one of debtor and creditor.[53] Thus a bank does not hold a depositor's money on trust but, by borrowing it, takes ownership of it. The similarity between the bank-depositor and insurer-policyholder relationships is indicated by the statutory definition of

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[51] Section 5 of the Income Tax Act 58 of 1962, read with Schedule 1 to the Exchange Control Amnesty and Amendment of Taxation Laws Act 12 of 2003.

[52] Section 11 Income Tax Act

[53] Under the *Foley* v *Hill* principle established by English law, and followed in South Africa. See *Estate Ismail* v *Barclays Bank (DC & O)* 1957 (4) SA 17 (T).

'deposit',[54] which specifically excludes premiums paid to an insurer. Without this exclusion, premiums would be deposits, and an insurer would qualify as a bank.

In terms of both the bank deposit and the investment via an insurance policy, the investor transfers ownership of the sum invested to the financial intermediary in exchange for the promise of a return of an amount in the future. Like the deposit holder in relation to a bank, the policyholder has no claim to the assets once invested, only a right to enforce the terms of the policy contract. The assets invested, and any income which accrues to them, are the sole property of the insurer or fund, as are the assets and the return they generate, invested with a bank. The tax consequences of the transaction with the bank, however, are derived from the legal substance of the agreement.

(d) Prescription of legal coherence

Legal coherence requires income to be taxed in the hands of the insurer or fund, with net proceeds or benefits being taxable in the hands of the policyholder, member or beneficiary when she becomes entitled to them.[55]

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[54] Section 1 of the Banks Act 94 of 1990

[55] Discussions on taxing retirement funds tend to employ a combination of taxability of contributions, investment build up and benefits. In this way, under the New Zealand system of 'T - T-E', contributions are made from post-tax moneys; investment build-up is taxed; and income taken in the form of an annuity is tax-free. It is commonly argued that private retirement funding cannot thrive without upfront tax concessions and it seems likely that South Africa will retain a tax incentive to contribute. Nevertheless, it is interesting to note that provident funds, which do not enjoy contribution tax concessions for members, have grown remarkably in popularity within the past 15 years in South Africa.

Other desirable consequences would arise if a legally coherent method of taxing investments were adopted:

(i) Reflection of change in wealth

First, the change in economic well-being of the policyholder or beneficiary would be properly reflected in her tax liability,[56] as would that of the insurer, which would be taxed in accordance with its legal status as a profit-making corporation.

(ii) Neutrality between investments

Second, as an issue of technical equality, the tax privileges conferred on one particular type of financial intermediary and its counter-parties would be removed, allowing investors to make investment decisions, which are not skewed by tax considerations.[57]

(iii) Increased tax yield

Third, appreciably more money would enter the tax net. In the calendar year ending 31 December 2000,[58] long-term insurers paid benefits of R105,3 billion, which is approximately equal to the yield from personal income tax.[59] Inclusion of these accruals in the tax base does not imply that net tax revenues would

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[56] In Chapters 15 and 16 below I discuss why tax liability should be derived from a consideration of the change in a taxpayer's wealth or economic well-being during the year of assessment.

[57] See Chapter 11, section III for a discussion of the principle of neutrality in taxation.

[58] Financial Services Board *Annual Report of the Financial Services Board* (2001) 14

[59] The estimate of revenue before tax proposals for 2002-03 was, in fact, R105 billion in respect of personal income tax.

increase by a similar amount. There is an expectation that tax should only be payable on investments profits. Thus, only policy proceeds net of premiums would be taxable. Furthermore, certain types of policy proceeds are currently taxable. For instance, the proceeds of company-owned policies are taxable, and estate duty may apply to lump sum retirement benefits and certain insurance policy proceeds.

(e) Taylor Committee's recommendations

Rather than seeking to curb the privileges accorded to long-term insurance investments, the Taylor Committee proposed a further concession.[60] Since the proceeds of maturing long-term policies, if taken in instalments, run the risk of being construed as an annuity and, hence, becoming taxable, the Committee recommended that all proceeds from the taxed policyholder fund should be free of income tax, to encourage policyholders to take a flow of income rather than a lump sum. The Committee's concern in this regard, rather than engendering sympathy for further concessions, draws attention to another significant privilege accorded to long-term insurance investments, specifically that of the exemption from income tax of the capital portion of an annuity voluntarily purchased from a long-term insurer.[61] (This concession does not apply to an annuity arising from any other source.)

The Committee's recommendations regarding retirement funds and long-term insurance investments may be viewed as a pragmatic refrainment from disrupting

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[60] V Taylor (Chair) *Report of the Committee of Inquiry into a Comprehensive System of Social Security for South Africa: Transforming the Present – Protecting the Future* RP 53/2002 (2001) para 9.2.4.4

[61] Section 10A of the Income Tax Act

the success the financial services industry has enjoyed in delivering privately-funded social security. However, the Committee offered no ethical motivation for recommending the further privileging of long-term insurance policyholders. There is no obvious justification for privileging long-term insurance investments over similar investments with other profit-making intermediaries. Retirement funds, however, unlike long-term insurers, are non profit-making organisations. Recognition of the legal substance of the arrangement would still permit retirement funds to be a tax-attractive means of long-term saving. Contributions would be made from post-tax moneys, as is the case currently for provident fund contributions. Therefore, the build-up in the fund would accrue to a non-profit making organisation and would be free of tax. All benefits would then be fully taxable (under a T-E-T system).

V CONCLUDING COMMENTS

The provisions of a constitutional scheme of taxation will demonstrate an internal morality. From a practical perspective, certainty - to the extent that it is compatible with social justice - and a clear legal message indicate good faith in the discourse between government and taxpayers.

Strict adherence to a principle of legal coherence in all areas of tax law may be practically or politically impossible. Nevertheless, the proposition that tax laws should cohere with the general body of a community's laws, may still provide a benchmark for assessing how tax measures are skewed in relation to general laws. Investigation into why an aberrant tax measure does not conform to the mainstream legal principle may then be conducted. In the constitutional context, such an investigation may reveal deeper flaws, such as a preference for a class of taxpayers which would not stand up to constitutional scrutiny. The application of this method to the taxation of dividends and long-term insurance policies demonstrates remarkable privileges that cannot be justified.

CHAPTER 9 EFFECTIVE GOVERNANCE

I INTRODUCTION

The focus of this study is substantive justice, specifically, the content of just tax laws in a particular community. However, there are other important elements of a just legal system. In the previous chapter, I considered one of these elements, what may be described as the infrastructure of just laws. Nevertheless, laws that are just in their content and structure, remain abstractions if they are not administered in a way that is just. There are various elements of just administration.[1] In this chapter, I consider one of these elements, perhaps one that is not immediately obvious, which is effective governance.[2] An imperative of effective governance gives rise to the expectation that the laws of the constitutional state will manifest cost, administrative, economic and legal efficiency. I now consider this expectation in respect of a constitutional scheme of taxation.

II COST EFFICIENCY

It is axiomatic that government programmes should be constructed and operated in a cost-efficient way. And so, if two tax measures or administrative arrangements are likely to have similar desired effects, all things being equal, the more cost effective option should be preferred.[3] Clearly, such cost sensitivity is not peculiar to taxation. What is specific, but not unique, to taxation, is that cost

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[1] Section 33 of the Constitution of the Republic of South Africa Act 108 of 1996 (the Constitution) guarantees 'administrative action that is lawful, reasonable and procedurally fair'.

[2] Section 41(1)(c) of the Constitution

[3] Cost efficiency is also identified as a manifestation of simplicity: see for instance, P Kenny 'Capital Gains Taxation for New Zealand: Fairer and More Efficient' (2001) Vol 7: 4 *New Zealand J of Taxation Law and Policy* 265, 286. In practice, it seems that a simple tax is more likely to be cost efficient, although simplicity is not be definitive of cost efficient.

effectiveness is a subordinate concern. With regard to an assessment, for instance, of whether tax administration should be centralised or localised, a comprehensive analysis of estimated costs and benefits should be decisive. However, the principal criterion in the consideration of a substantive tax measure under the constitutional dispensation must be its correspondence with fundamental constitutional values. This principle was demonstrated in relation to capital gains tax (CGT), when objections were raised on the grounds that such a tax might raise less revenue than it would cost to administer. However, the principle of taxing capital gains was possessed of such equitable urgency that these (unfounded) predictions of Pyrrhic administrative costs could not impede its actuation.[4] Certainly, ways of promoting cost efficiency within the structure of a just tax should be rigorously sought but it must be the tax's substantive qualities that are decisive and not its administration costs.

III ADMINISTRATIVE EFFICIENCY

(a) Efficiency and just administrative action

Administrative efficiency is a correlative of the constitutional principle of just administrative action. Both imbue just laws with quotidian meaning. Without efficient administration, just laws, justly administered may simply not deliver justice. Thus, while a state guaranteed minimum income is an inevitable part of a constitutional scheme of taxation, if the administration is unable to make payments efficiently, the social justice of such a measure would be greatly thwarted. Administrative efficiency also has important practical equality implications. If the collection agency does not have the skills and resources to

[4] DH Houghton & J Dagut (eds) *Source Material on the South African Economy: 1860-1970, Volume 2 1899-1919* (1972) 3 observe that: 'It was not until the fiscal year ended March 1913 that the total revenue of the Union government exceeded its expenditure on revenue services.' It may be assumed that contemporaries of the novel income tax objected to the tax on the grounds of administrative cost in the way that opposition is currently raised to CGT.

investigate the wealthy (who have the means to throw a cloak of obfuscation over their financial arrangements) then, not only may they be permitted to pay an unfair share of tax but also a disproportionate investigation of the less wealthy may occur.[5]

(b) Subordinate nature of administrative efficiency

The requirement of administrative efficiency in a tax system is self-evident, but may be overstated. The Katz Commission,[6] for instance, having identified significant anomalies in the equity of the extant tax system, recommended that no corrective action be taken until the collection agency could handle the necessarily complex corrections. And so, when considering whether to propose taxation of post mortem capital transfers in the hands of beneficiaries (an inheritance tax) or in the hands of the transferor (an estate tax), the Commission recommended maintenance of the existing estate duty, based on assumptions of the tax administration's capacity to collect each of these different types of tax.[7] Remarkably, the existence of a corpus of judicial and administrative precedent relating to estate duty was a particularly persuasive factor in the Commission's recommendation against change. As will be explained later,[8] the failure to tax capital transfers in the hands of beneficiaries is not a trivial matter but is one that

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[5] DC Johnston 'Affluent Avoid Scrutiny on Taxes Even as I.R.S. Warns on Cheating' *New York Times* 7 April 2002 reported the scrupulous attention given to the low income claimants of the Earned Income Tax Credit in comparison to the lax auditing of partnerships, which permits an estimated loss to the United States fiscus of as much as $64 billion a year.

[6] MM Katz (Chairperson) *Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa* (1994), references to interim reports.

[7] Third Katz Report (note 6 above) para 7.3.3

[8] See Chapter 15, section III below for a discussion of the merits of taxing inheritances in the hands of beneficiaries.

significantly affects fairness. A tax, which has been approached by taxpayers with cynicism, was retained at the expense of justice, despite the fact that estate duty 'has never been taken seriously by Inland Revenue in South Africa'.[9] The Commission's ratiocination, in short, appears to have been that, for the sake of immediate, administrative convenience, the legacy of past practices should be allowed to dictate current and future arrangements, whatever the equity costs might be. Since the Constitution 'retains from the past only what is defensible and represents a radical and decisive break from that part of the past which is unacceptable',[10] this rationale would surely have been found wanting in any other area of the law or public life, on first official analysis after the institution of constitutional democracy.

Such criticism of the Commission's conservatism is not an ex post facto assessment. In response to the publication of the Commission's recommendations, the Parliamentary Joint Standing Committee on Finance contemporaneously observed that 'the present weakness of Inland Revenue to administer this or any other tax should not form the basis of an in-principle decision whether or not to impose such a tax, but rather act as a spur to address the problems of administration' and concluded that 'the substantive arguments for or against imposing such a tax should be the determining factors'.[11] In the event, in the years since the Commission published its recommendations on capital taxes, in which a conservative approach was most pronounced, the South African Revenue Service (SARS) has accommodated, amongst other measures, new

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[9] D Davis 'Taxation in a post-apartheid South Africa' in R Schrire (ed) *Wealth or Poverty: Critical Choices for South Africa* (1992) 105, 118

[10] Mohamed DP in *Shabalalah* v *Attorney-General (Transvaal)* 1996 (1) SA 725 (CC) [26]

[11] Parliamentary Joint Standing Committee on Finance *Final Draft Report of the Joint Standing Committee on Finance on the Third Interim Report of the Katz Commission of Inquiry into Taxation* (1996) ('PJSCF') 15

legislation governing transfer pricing;[12] controlled foreign enterprises;[13] and capital gains;[14] all notoriously complex provisions to administer.[15] Additionally, revenue collected has consistently exceeded budget estimates, and SARS's efficiency has allowed it to assume the administration of the skills development levy[16] and the unemployment insurance fund[17] that might otherwise be managed by other government agencies. The conclusion to be drawn is that concerns for administrative capacity should not be put before justice but nor should government underestimate the capacity of a professional and properly funded administration to collect the revenue necessary for social transformation.

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[12] Transfer pricing measures determine the taxable income of taxpayers engaged in international trade with connected persons. Complexities arise as transfer pricing legislation requires the setting of a notional, arm's length price for transactions between related parties. See section 31 of the Income Tax Act 58 of 1962.

[13] Measures relating to Controlled foreign entities (normally referred to as 'controlled foreign corporations' or 'CFCs') deem the passive income of an offshore entity, controlled by a taxpayer, to have accrued to the taxpayer. Complexities arise from, inter alia, the involvement of foreign legal systems and timing. See section 9D of the Income Tax Act.

[14] Capital gains tax measures bring gains from the disposal of certain types of investments into the income tax net. Valuation is particularly problematic for the administration of capital gains tax. See the Eighth Schedule to the Income Tax Act.

[15] At the time of the Commission, the collection agency was the office of the Commissioner for Inland Revenue, a government department. Under section 2 of the South African Revenue Service Act 34 of 1997, SARS was established 'as an organ of state within the public administration, but as an institution outside the public service'.

[16] The Skills Development Levies Act 9 of 1999 provides for the funding of workers' vocational training. Such a levy might be expected to be collected by the Department of Labour.

[17] The Unemployment Insurance Fund Contributions Act 4 of 2002 provides for unemployment insurance. Similar legislation was previously administered by a separate government agency.

IV ECONOMIC EFFICIENCY

Government programmes must be efficient in terms of cost and administration, provided there is no conflict with fundamental principles. However, the commonly encountered claim that these programmes, particularly tax measures, should be economically efficient is less sustainable.

(a) Detachment of economic theory from reality

First, orthodox economic theory, based on the implausible premise of the rational economic actor seeking to maximise her utility, does not reflect reality, notably failing to take account of the influence of others on the economic actor's decision-making. Consequences of this dislocation from lived experience include the traditional inability of economists to predict accurately the economic results of fiscal actions in the short term, and for governments to surrender to an 'illusion of control' over economic phenomena, particularly the business cycle.[18] There has been a general failure amongst economists to predict accurately. 'The problems of forecasting are not confined to official bodies, nor to any particular theory of how the economy operates. All approaches, whether government or private, Keynesian or monetarist, have done equally badly'.[19]

(b) Ideological content of economic prescriptions

Second, certain economists' methods of prediction may be so ideologically animated to defy rationality. Joseph Stiglitz, commenting on the dislocation from reality of certain International Monetary Fund (IMF) economists, who frequently possess the power to prescribe the fiscal policies of developing countries,

[18] P Ormerod *Butterfly Economics: A New and General Theory of Social and Economic Behaviour* (1998) 80

[19] Ibid

observes that 'In some of the universities from which the IMF hires regularly, the core curricula involve models in which there is never unemployment. After all, in the standard competitive model – the model that underlies the IMF's market fundamentalism – demand always equals supply. If the demand for labour equals supply, there is never any *involuntary* unemployment'.[20]

In the light of such failure and detachment from lived experience, many economic predictions and their consequent policy prescriptions are better viewed as expressions of ideological or methodological faith.[21] The predictions for economic efficiency of proposed tax measures issued by an economist who believes in the hypothesis underlying the Laffer curve,[22] for instance, will be irreconcilable with those of an economist who dismisses it as groundless. I do not refer here to econometric analyses provable by scientific measurement and reasonable inferences drawn from past experience. These are essential if the effectiveness of fiscal measures is to be understood. My objection lies with certain economists' predictions that are methodologically flawed and ideologically biased.[23]

Predictions of economic efficiency, which invariably belie a free market ideological stance, should not be relied upon to provide primary guidance in government policy, particularly the construction of a constitutional scheme of

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[20] JE Stiglitz *Globalization and Its Discontents* (2002) 35

[21] JK Galbraith *The Culture of Contentment* (1992) 78 cites Conrad P Waligorski's observation that: 'Economists regularly engage in political theory, masking normative judgments with seemingly objective analysis.'

[22] See Chapter 18 para VI (a) for an outline of the hypothesis underlying the Laffer curve.

[23] See note 21 above

taxation.[24] Largely they may be treated as any other ideologically inspired opinion, rather than scientific facts.

(c) Importance of institutions

Rejecting modish free market prescriptions may appear reckless, however, specific economic policy has been shown to be a negligible contributory factor in the success of prosperous countries. William Easterly and Ross Levine recently examined the economic experiences of 72 countries that had once been colonies.[25] The purpose of their research was to test the three main hypotheses for economic success, specifically: endowments (such as temperate location, ecological conditions unfavourable to disease or suitability for cultivating grains), institutions, and economic policies. They concluded that, although endowments may influence institutions, economic success predominantly springs from sound institutions.[26] Although economic policies may indicate institutional failure, they are not relevant to economic success. Countries that have experienced political stability and are possessed of sound institutions (notably property rights, unimpaired legal systems, and inclusive social mechanisms)[27] tend to prosper whatever their economic policies. Conversely, countries without those institutions perform badly whatever the economic policies they adopt.

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[24] The principal objective of many economists is the promotion of the unimpeded operation of the market. While this may be a rational aim, it does not necessarily coincide with the goals of government, which often lie in correcting the socially undesirable consequences of market distributions.

[25] W Easterly & R Levine 'Tropics, Germs and Crops: How Endowments Influence Economic Development' NBER Working Paper 7946 (2002)

[26] Ibid 32

[27] Ibid 11

(d) Constitution establishes requisite institutions

By establishing a system of fundamental values and rights, the Constitution promotes certainty and, additionally, requires extensive 'integrity structures'.[28]

European settlement has endowed the constitutional community with excellent institutions.[29] The principal issue lies in developing these institutions for the benefit of all community members.

It may be concluded from the above that:

(i) Government is free to determine policy

First, economic policy is a prerogative of the government of the day. No specific policy choices, other than those that develop and support institutions, hold a claim to supra-ideological validity.

(ii) Equity cannot be subordinated to efficiency

Second, predictions of economic inefficiency cannot trump demands for social justice.

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[28] L Cockcroft 'Corruption and Human Rights: A Crucial Link' Transparency International Working Paper (1998) argues that a robust 'national integrity system' is crucial for combating corruption and upholding human rights.

[29] South Africa has been a 'settler' society, one in which European colonists put down roots and established institutions (albeit primarily for their benefit not the indigenes') that mirrored those of their economically successful countries of origin. Because of these institutions, settler societies have proved more successful than 'extractive' colonies whose primary purpose was to provide raw materials to the motherland and not a home for settlers. (See D Acemoglu, S Johnson & JA Robinson 'The colonial origins of comparative development: an empirical investigation' *American Economic R* 91, 1369, cited by Easterly & Levine (note 25 above) 10.)

In this latter regard, arguments are frequently encountered that a particular tax measure, invariably one which promotes social justice, is likely to be economically inefficient, when the underlying message is that the measure would offend the tenets of free market ideology. Advocacy of low rates or regressive forms of individual taxation on economic grounds tend to be deeply conservative and often belie a broadly repressive strategy. In this regard, Roberto Unger has observed that one of the general failings of modern democracies is found in the way in which economic and political organisations enable relatively small numbers of people to control the basic terms of collective prosperity by making the crucial investment decisions.[30] He concludes that radical proposals for promoting social justice can always be opposed by the threat, real or perceived, of disinvestment and the flight of capital. Yet, there is ample evidence to suggest that the equitable treatment of citizens may act as a dynamo of economic growth.

V ECONOMIC EFFICIENCY AND EQUITY

(a) Tax as an economic friction

From an economist's perspective, all taxes are supposed to be frictions and hence immanently inefficient.[31] In this view, a tax that holds a pretence to efficiency introduces the least economic inefficiency.[32] At first face, then, equity and efficiency in taxation are idioms of reciprocally unintelligible languages, and,

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[30] RM Unger *The Critical Legal Studies Movement* (1986) 28

[31] WJ Baumol & AS Blinder *Economics: Principles and Policy* 5 ed (1991) 705

[32] W Hettich & SJ Winer 'Rules, Politics and the Normative Analysis of Taxation' in R Wagner & J Backhouse (eds) *Handbook of Public Finance* (2002) 1, 25 note the existence of a body of literature which proposes that a government's power to introduce economic efficiencies should be curtailed by constitutionally limiting the scope of taxation. There is no such restriction on constitutional government in South Africa.

indeed, they are frequently presented as mutually exclusive choices, so that a workable scheme of taxation necessarily requires a trade-off of one against the other. Stiglitz, for instance, has argued that 'The optimal tax structure is one that maximises social welfare, in which the choice between equity and efficiency best reflects society's attitude to these competing goals'.[33]

However, the proposition that an equitable scheme of taxation must sacrifice economic efficiency and vice versa is too simple, and, perhaps, plain wrong.

(b) Compatibility of equity and efficiency

(i) Areas of no conflict

Even if it is accepted that equity and efficiency are fundamentally opposed, there are, nevertheless, significant areas of no conflict.

(aa) Desirability of neutrality

The phenomenon of tax shifting, which occurs when economic reactions to a tax cause prices and outputs in the economy to change, thereby shifting part of the tax burden onto others,[34] is economically undesirable but also offends principles of justice. In this way, the economist's aversion to tax shifting corresponds with the constitutional principle of rational purpose, inasmuch as both seek to ensure

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[33] JE Stiglitz *Economics of the Public Sector* 2 ed (1988), cited with approval by National Treasury Tax Policy Chief Directorate 'Capital Gains Tax Briefing to the Portfolio and Select Committees on Finance 24 January 2001'.
More recently, Stiglitz (note 20 above) 79 has expressed the view that a trade-off between social justice and growth is not always necessary.

[34] Baumol & Blinder (note 31 above) 707

a rational means of actuating an intended legitimate purpose.[35] Conversely, an unintended consequence may amount to a disproportionate means of achieving a legitimate purpose.

(bb) Excess burden and proportionality

Similarly, it is an imperative of economic efficiency that there should be no excess burden within a tax or benefit system. (If a tax or benefit system can be altered so that a similar amount of revenue can be received, or dispensed, while making some persons better off, without making anyone worse off, an excess burden exists, which can be removed or reduced by effecting such an alteration.[36]) By failing to confer what is due to different citizens, excess burden in a fiscal system clearly offends the principles of distributive justice.

(ii) No trade-off

One may go further than identifying points of no conflict to illuminate the compatibility of equity and efficiency. Thus, the World Bank has concluded that 'the notion of a trade-off between growth and equity' which has 'helped to entrench antigrowth policies in socialist economies and antiequity policies in conservative ones' has been disproved particularly 'by the many economies that consistently outperform the rest on both counts'.[37]

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[35] This is not to suggest that the economist who promotes neutrality has the same motivations as the constitutionalist: in the first case, the goal is the unimpeded operation of the market; and, in the second, justice.

[36] CS Shoup *Public Finance* (1969) 28

[37] World Bank *World Development Report* (1991) cited by Lieb Loots 'The post-apartheid challenge to fiscal policy' in Schrire (note 9 above) 90, 95

(iii) Interdependence of equity and efficiency

Equity and efficiency are fundamentally interdependent, integral elements of a successful economic system rather than as conflicting forces within it. For instance, an equitable distribution of income promotes the free flow of money and counters harmful wealth condensation.[38]

(aa) Equity promotes efficiency

In its least compassionate expression, classical economic theory recognised that social justice and efficiency were correlative not antagonistic. Therefore, while others might be reliant on appeals to justice, Adam Smith could oppose slavery purely on the grounds of economic efficiency.[39] Considering less extreme circumstances, Smith recognised that a successful economic system manifests equity, arguing that 'they who feed, clothe, and lodge the whole body of the people, should have such a share of the produce of their own labour as to be themselves tolerably well fed, clothed and lodged'.[40] From a contemporary perspective, 'Productivity depends on having workers who are educated, safe, healthy, decently housed, and motivated by a sense of opportunity'.[41] Amplifying this idea, the creation of the comprehensive welfare state in industrialised and urbanised countries may be justified on the grounds of economic efficiency, not

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[38] See Chapter 6, section VIII for an outline of these phenomena.

[39] A Smith *An Inquiry Into the Nature and Causes of the Wealth of Nations* (1776) (1952 reprint) 168

[40] Smith (note 39 above) 33

[41] ME Porter & ME Kramer 'The Competitive Advantage of Corporate Philanthropy' *Harvard Business R* December 2002

only social justice.[42] In other words, social justice may act as the engine of economic growth not a barrier to it. The current government's own *Human Resources Development Strategy* indicates how social justice may be championed as a potential accelerator of growth rather than portrayed as a brake to development.

(bb) Efficiency permits equity

If the goals of social justice do not obviate economic efficiency, then, conversely, 'if a fair redistribution system is to be sustainable it must be efficient'.[43] Consequently, if the telos of a just society is to be realised, then, fiscal policy must strive toward efficiency.

In short, far from being mutually exclusive choices, equity and efficiency are interdependent requirements of effective governance.

VI LEGAL EFFICIENCY

(a) A principle of legal efficiency

Government is effective, in a further sense, if its laws are efficient. Laws may be said to be efficient when citizens generally comply with their provisions at minimal cost (in terms of government expenditure on enforcement and citizens' freedoms forgone). It is trite that members of a community owe a duty to comply with the

[42] A Lindbeck 'Changing Tides for the Welfare State' (2002) Center for Economic Studies & Institute for Economic Research Working Paper No. 645 (3) 2

[43] Loots (note 37 above) 95

community's valid laws.[44] This duty is realised, extraneous enforcement excepted, when community members generally hold a conviction that the community's laws ought to be obeyed.[45] Furthermore, they must recognise specific laws and regulate their conduct according to the requirements of those laws.[46] Governance is facilitated when the personal values of most citizens are supportive of the government mission. The prosecution of war, for instance, is most easily pursued in a country where the passions of patriotism or affront run high.[47] Similarly, legislation is likely to be effective when it activates prevailing norms but ineffective when it seeks to create new norms which are not rooted in the community.[48]

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[44] With regard to the constitutional community, Langa DP in *City Council of Pretoria* v *Walker* 1998 (2) SA 363 (CC) [93] observed, 'The kind of society envisaged in the Constitution implies also the exercise of responsibility towards the systems and structures of society'.

[45] E Ehrlich *Fundamental Principles of the Sociology of Law* (trans 1936) 467 identifies this phenomenon as opinio necessitas.

[46] Ibid 167
Ehrlich identifies this phenomenon as the doctrine of recognition (*Anerkennungslehre*).

[47] RA Posner *The Economics of Justice* (1981) 122

[48] J-R Tyran & LP Feld 'Why People Obey the Law: Experimental Evidence from the Provision of Public Goods' (2002) Center for Economic Studies & Institute for Economic Research Working Paper No. 651 (2) 21
The locus of their research being Switzerland, they were able to compare the willingness to comply with legislation introduced in consequence of a specific referendum, and the willingness to comply with laws that had not followed the referendum process. This may indicate the democratic effectiveness of the peculiarly Swiss employment of referenda. Nevertheless, for most political communities for which referenda are exceptional occurrences, compliance is likely to be similarly forthcoming if governance is demonstrably transparent, responsive, and accountable.

(b) Interaction of state law and other norms

The interaction between legal and other norms is not always straightforward, as may be illustrated by the following example: since a fundamental prescription of Islamic doctrine requires an adherent to give alms to the poor, it would be reasonable to assume that a state, whose taxpayers are overwhelming Muslim, could found its tax-welfare programmes on that religious duty of alms-giving. Yet, by way of a practical refutation, *Sharia* courts in Saudi Arabia have denounced progressive taxation because Islam requires a proportionate payment of one-fortieth of personal income to charity, with all other taxes being illegal.[49]

(c) The rational state

A community's laws should represent 'the value consensus' of that community.[50] The validity of such laws will not be derived from sanctions and power,[51] but from this convergence of the community's morality with its laws. In the Hegelian view, 'the state which is fully rational will be one which expresses in its institutions and practices the most important ideas and norms which its citizens recognise, and by which they define their identity'.[52] Conversely, a state whose laws are incompatible with the morality of the people it governs, runs the risk of

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[49] Anon. 'Cruel, or just unusual' *The Economist* ' 16 June 2001

[50] A Hunt 'Marxism and the Analysis of Law' in A Podgorecki & C J Whelan (eds) *Sociological Approaches to Law* (1981) 94

[51] R Dahrendorf *Law and Order* (1985) 52
Although, as HR Hahlo & E Kahn *The South African Legal System and Its Background* (1968) 4 observe, 'A rule of law without force behind it, says Jhering, is a contradiction in terms – "a light that lights not, a fire that burns not."'

[52] C Taylor 'Hegel: History and Politics' in MJ Sandel (ed) *Liberalism and Its Critics* (1984) 177, 190

incomprehension, disbelief or general non-compliance. For instance, although the Indian Constitution has outlawed discrimination against 'untouchables' or Dalits for more than 50 years, members of this Hindu caste continue to suffer remarkable oppression and indignity at the hands of certain of their fellow members of society.[53] A bare legal efficiency might suggest that Indian laws should not oppose this well entrenched prejudice but, in the constitutional state, legal efficiency unmoored from the ethical anchor cannot be sufficient.

(d) Bridging an ethical gap

I have described the Constitution as the record of the ethical imagination of the constitutional community, rather than a codification of morality. If there were a precise coincidence between community morality and the provisions of the Constitution, then, legal efficiency in the constitutional community would be manifest in laws that are precisely congruent with the provisions of the Constitution. However, as the example of constitutionally protected, yet socially outcast, Dalits indicates, there may be an ethical gap to be bridged. The state may seek to close the gap between the desired ethical conception and that actually held, through appeals to reason or sentiment,[54] but may ultimately be compelled to resort to force to install justice.

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[53] See, for instance, the reporting of Human Rights Watch on the continuing plight of Dalits.

[54] The incumbent Commissioner for SARS has sought to appeal to a sentiment of patriotism to promote tax morality: see P Gordhan 'Tax falling on the just and unjust alike' *Financial Mail* April 30, 1999. Trevor Manuel, the Minister of Finance, has appealed to a sentiment of solidarity in the language of universal liberation, seeking to link 'struggle' values to fiscal policy. See, for instance, Minister of Finance, TA Manuel 'Budget Speech' 20 February 2002.

(e) Behavioural norms and laws

Behavioural norms and formal laws do not operate independently. Behavioural norms may animate formal laws, but laws can influence behaviour beyond simple compliance. Considering, for instance, the position of women in society, it can be seen that improvements in their general condition in many parts of the world are not attributable solely to an improvement in their economic position or, conversely, to statutory prohibitions on sexual discrimination. Rather, various factors have influenced and catalysed each other. This interaction also explains why a proclamation of equality before the law will ring hollow when economic circumstances and cultural attitudes do not change.[55] Effective government must influence citizens' behaviour as and where it can to promote a convergence between morality, law and the ethical imagination. One prerequisite for reasoned consensus lies with community members' being able to understand the laws that affect them. Consequently, policies and legislation should be clearly communicated and readily comprehensible.[56] If people are unaware of the substance, strategies, and likely consequences of laws, their assessment of these laws against their own values simply cannot be informed.[57]

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[55] See F Engels 'Origin of Family, Private Property and State' in K Marx & F Engels *Selected Works* (1968) (1977 reprint) 461, 500 in relation to the position of women in marriage.

[56] J Plender 'Revolutionary Forces Which Will Destroy Income Tax' *Financial Times* 27 November 1993 has cautioned that 'the stability of the nation may depend on having a tax system which citizens think is reasonable, however much they dislike paying'.

[57] The Parliamentary Joint Standing Committee on Finance, in response to the perceived opacity of the Katz Commission, called for 'a considered, far-reaching communications campaign that will help build tax morality and an understanding of rights, obligations and of how revenue raised is used'. See PJSCF (note 11 above) 4.

VII LEGAL EFFICIENCY AND THE VOLUNTARY PAYMENT OF TAXES

If legal efficiency in taxation is realised when there is a coincidence of taxpayers' ethical imaginations and community's tax laws, then, it might be considered that the ideal tax would be one that is paid voluntarily. Rousseau presented a subtle argument along these lines when proposing the use of sumptuary taxes.[58] Considering taxes on 'articles the use of which we can deny ourselves', he reasoned that as 'the individual is under no absolute necessity to pay, his contribution may count as voluntary' and questioned 'for why should a people oppose the imposition of a tax which falls only on those who desire to pay it?'

However, taxes are not paid voluntarily and there should be no pretence that they might be.[59] Ideally, a taxpayer should pay *willingly* as there should be consonance between her ethical convictions and the relevant law. Nevertheless, taxpaying is compulsory, even if triggered by activities or transactions, such as selling shares or buying goods, which are voluntarily entered into or concluded. Furthermore, sumptuary taxes of the type Rousseau had in mind are often levied on goods such as tobacco, which in economic terms, may be demand inelastic, and, from a psychological perspective, they may manifest an element of addiction. This suggests that their consumption is not wholly voluntary. Generally, consumption taxes include necessities within their ambit and so any claims for voluntariness in that regard are suspect.[60]

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[58] J-J Rousseau 'A Discourse on Political Economy' in *The Social Contract and Discourses* (trans GDH Cole, revised JH Brumfitt & JC Hall, 1973) (1992 reprint) 128, 167

[59] Both the judicial and ordinary understandings of a 'tax' are that it should be compulsory. See, for instance, the examination of the requirement of compulsion in *Commissioner of Customs and Excise* v *Tayob* 2002 (6) SA 86, 93.

[60] See Chapter 19 below for a discussion of the incompatibility of value-added tax with constitutional values.

Voluntary contribution to government is conceivable but, normally, ostensible donations to the state entail the contribution of things, for instance, a work of art attached to a quid pro quo - invariably the reduction of estate taxes. So-called 'conscience money' may be paid voluntarily but normally represents unilateral compensation for default. There is no way of knowing the degree to which the conscience money reflects the tax due, which, of course, remains due if, as is most likely, evasion has occurred.

VIII EFFECTIVE GOVERNANCE AND COERCION

When discussing freedom, I argued that an unjustified breach of bio-liberty, in a negative sense, would be constitutionally offensive.[61] From the perspective of effective governance also, there are practical reasons for avoiding coercive policies.

(a) Coercion and resistance

First, coercion invites resistance. Foucault proposed that there can be no power relation without the possibility of recalcitrance, and, significantly, given the ubiquity of power, there is a corresponding potential for a ubiquity of forms and types of resistance; 'a plurality of resistances with no single locus of great Refusal'.[62] Illuminating this idea, Colin Gordon has observed that 'the existence of those who seem not to rebel is a warren of minute, individual, autonomous tactics, and strategies which counter and inflect the visible facts of overall

[61] See Chapter 4, section III above for an outline of the concept of bio-liberty.

[62] A Hunt & G Wickham *Foucault and Law: Towards a Sociology of Law as Governance* (1994) 17

domination, and whole purposes and calculations, desires and choices resist any simple division into the political and apolitical'.[63]

It may be politically attractive to typify African opposition to colonial taxation in terms of 'heroic', armed insurrection, such as the so-called Bambatta Rebellion of 1906.[64] However, case law arising from the operation of the natives tax indicates that resistance to colonial taxation was generally prosaic, quotidian and fluid. Notwithstanding harsh penalties, there was widespread evasion of the tax and other manifestations of recalcitrance were evident. In *Shillen Nkosi*, for instance, a case which concerned, in part, the duty on every landowner to render to Revenue details regarding resident natives, the affected taxpayers, for undisclosed reasons, and despite the repeated request of the European farmer on whose land they resided, simply refused to cooperate.[65]

(b) The state is not omnipotent

Second, although the state is commonly presumed to be omnipotent and ubiquitous, state policies are frequently 'incoherent and chaotic',[66] with strategies of coercion and control, in particular, demonstrating a 'curious anti-functionality of the norm'.[67]

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[63] C Gordon 'Afterword' in M Foucault *Power/ Knowledge: Selected Interviews and Other Writings 1972-1977* (trans and ed C Gordon) (1980) 229, 257

[64] See Jay Naidoo *Tracking Down Historical Myths* (1989) 144 for a portrayal of the rebellion in 'non heroic' terms.

[65] *Shillen Nkosi* v *R* 6 SATC 279 (1933)

[66] Nico Poulantzas, cited by Hunt & Wickham (note 54 above) 31

[67] Gordon (note 63 above) 250

(c) Delusions of effectiveness

Third, government may be seduced into delusions of disciplinary potential whereby a direct chain of causation is believed to connect statutory or other action, on the one hand, and compliant behaviour of subjects, on the other. Yet, the effectiveness of modern governance to discipline society frequently amounts to no more than a 'fantasy of a disciplined society peopled by docile, obedient, normalised subjects'.[68] Such a delusion may again be detected in relation to the natives tax, specifically the commonly encountered proposition of a simple chain of causation that flatters the coercive ambitions of the colonial government.[69] In this view, the colonists required labour; government, therefore, introduced a tax on natives that required cash settlement; as planned, natives abandoned their traditional homes and lifestyles to work in the cash economy. Yet, observers at the time were not so accepting of the plausibility of such cause and effect. The 1903 Report of the Transvaal Labour Commission, for instance, rejected as a canard the common view, what a modern observer might describe as a 'myth', that taxes could constitute an effective way of drawing Africans into the cash economy.[70]

There are cogent reasons, other than taxpaying, to explain Africans' moving outside the traditional milieu in order to earn cash.[71] In short, they had become

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[68] Ibid 255

[69] See, for instance, TW Bennett *A Sourcebook of African Customary Law for Southern Africa* (1991) 152 and L Callinicos *Working Life 1886 - 1940 Factories, Townships and Popular Culture on the Rand* (1987) 27.

[70] Cited in Houghton & Dagut (note 4 above) 89.

[71] See W Beinert 'Women in Rural Politics: Herschel District in the 1920s and 1930s' in B Bozzoli (ed) *Class, Community and Conflict: South African Perspectives* (1987) 326.

consumers: not docile victims of colonial machinations but active pursuers of their own desires. If this is the case, the natives tax took advantage of a pre-existing phenomenon but did not create it; the tax was parasitic on a social trend not generative of it. (This does not, of course, excuse the manifold injustices of the natives tax.) It is not a matter of current concern to decide which is the more plausible explanation. Nevertheless, there is enough doubt to be sceptical of the capacity of government to engineer society and direct peoples' behaviour, particularly through tax policy.

IX CONCLUDING COMMENTS

It is axiomatic that constitutional government should demonstrate efficiency. Constitutional objectives cannot be achieved without an efficient administration or an economy that effectively produces new wealth. However, social justice must not be sacrificed in the name of an unproven economic efficiency. The sound integrity institutions required by the Constitution, if sustained in the long-term for the benefit of all community members, will be the surest guarantees of both wealth and justice.

CHAPTER 10 PRUDENT AND HONEST FISCAL MANAGEMENT

I INTRODUCTION

Rousseau proposed that if the people of a community were to govern themselves without the mediation of the state, 'as they would all keep in sight the recovery and employment of such [tax] assessments, no fraud or abuse could slip into the management of them; the State would never be involved in debt, or the people overburdened with taxes; or at least the knowledge of how the money would be used would be a consolation for the severity of the tax'.[1] While self-governance of this nature is impossible in a modern political community, certain techniques of governance can replicate Rousseau's ideal. In this chapter, therefore, I consider transparency, the accountability it facilitates, and the possibility of popular participation in the budgetary process. (Empowering community members to participate in the budgetary process, effectively permits them to participating in setting taxes.)

II BENEFITS OF TRANSPARENCY

Transparency on the part of government can promote the advantages of Rousseau's imaginary self-governing community. Citizens 'can keep in sight' the sources of revenue; the costs of administration; and the beneficiaries of expenditure. Transparency is crucial to constitutional governance and to a constitutional scheme of taxation. Therefore, in this chapter I outline certain of the benefits, requirements and possibilities for transparency that may enhance a constitutional scheme of taxation.

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[1] J-J Rousseau 'A Discourse on Political Economy' in *The Social Contract and Discourses* (trans GDH Cole, revised JH Brumfitt & JC Hall, 1973) (1992 reprint) 128, 152

(a) Assessment and accountability

Transparent governance, the thwarting of corruption and the protection of human rights are inextricably linked and interdependent, with each requiring a strong 'national integrity system'.[2] By virtue of its Constitution,[3] South Africa has established the foundation for such a strong national integrity system. In addition to the general requirements of effective, transparent, accountable and coherent governance,[4] the Constitution sets various imperatives for fiscal management, notably requiring that budgets and budgetary processes 'must promote transparency, accountability and the effective financial management of the economy, debt and the public sector'.[5] However, if these promises are to have practical meaning, community members must be able to gauge the actions and performance of the different branches of government.

The principal benefit of transparency lies in enabling an assessment of general government behaviour and achievement. By analogy, if the texts of legislation were not made public, we would have no way of assessing whether government has complied with the rule of law. Without transparency, an assessment of

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[2] L Cockcroft 'Corruption and Human Rights: A Crucial Link' Transparency International Working Paper (1998) (no constant pagination)

[3] Constitution of the Republic of South Africa Act 108 of 1996

[4] Section 41(1)(c) of the Constitution

[5] Section 215(1) of the Constitution
New Zealand's Fiscal Responsibility Act 1994 is probably the most demanding legislation relating to fiscal transparency, requiring the Minister of Revenue to publish an annual budget policy statement and periodic, fiscal and economic updates. Before a national election, the Minister is required to disclose policy decisions and other matters that might influence the state of the fiscus in the future. Resembling fair financial reporting for public companies, this appears to be an instance of a particularly useful migration of private sector principles to the public sector.

government's performance and a measure of its effectiveness are equally impossible. In turn, accountability, which crucially 'connects knowledge and interest' and 'binds the communitarian notion of popular sovereignty with ideas of individual responsibility',[6] would be a mere abstraction without the insightful information transparency may provide.

Nevertheless, accountability, particularly in relation to taxation, is not open-ended; rather it is restricted to answerability within the structures and processes of constitutional democracy. A citizen or a group of citizens cannot invoke an expectation of government accountability with an eye to controlling or containing constitutionally compliant government policy.[7] Interest groups should expect sufficient usable information to be available in the public domain to permit understanding and assessment of governance. If dissatisfactions arise from the knowledge gained in this way, then, there are democratic and, potentially, juridical processes in place for pursuing change.

(b) Facilitation of coherent governance

The exercises required for transparency benefit government as well as citizens. As enterprises benefit from the financial analyses required for reporting purposes, since they facilitate a measuring of results against objectives, so

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[6] SE Bronner *Of Critical Theory and Its Theorists* (1994) 335

[7] Moore, in his proposal for a 'real time' national sales tax to replace income tax in the United States, calls for accountability but reveals a motivation which is more fundamental than the ostensible goals of a cost efficient, non-invasive and visible tax, when he argues that, in terms of such a tax, 'Americans would be begin to demand less government, because taxpayers could receive an immediate dividend in reductions in spending - via a reduction in sales tax'.
See S Moore 'The Economic and Civil Liberties Case for a National Sales Tax' paper delivered to the Hoover Institution conference 'Frontiers of Tax Reform' National Press Club Washington, DC, 11 May 1995.

government itself can enjoy the benefits of comprehensive analysis, such as the possibility of aligning tax measures with guiding principles. In effect, government can itself test the coherence of its policies, including inter-departmentally.[8] Generally, the basic tests under the Constitution for the legitimacy of government action lie in determining rational connection and proportionality. Full and relevant information is crucial if these assessments are to be made with regard to fiscal matters.

(c) Recognition of patterns of distribution

Transparency is self-evidently crucial for a coherent process of distributing revenues raised through taxation. Analysis of useful fiscal information permits a consideration of with whom, in practice, the monetary burdens and benefits of just laws lie, in other words. Such financial analysis permits an audit of distributive justice.[9] From a practical perspective, 'the distribution of benefits should usually be in an easily recognisable pattern in order to enlist support', not

[8] State involvement in gambling is an apparent instantiation of incoherent policy, where, on the one hand, government benefits considerably from tax revenues levied on gambling and yet, on the other hand, bemoans the social effects of a permissive gambling policy. The incumbent Minister of Social Development, Zola Skweyiya, amongst others, has expressed concerns regarding the destructive impact of permissive gambling legislation on family and broader social life. Yet, government is a direct beneficiary of gambling operations, collecting more than R350 million in VAT and more than R230 million in provincial taxes from casinos between April 1999 and March 2000. (C Keeton 'Gambling gnaws at SA's social fabric' *Mail & Guardian* 14 April 2001) Furthermore, government permits and benefits from the National Lottery, whose regressive effects counter strategies of social justice. Given the considerable ethical concerns a National Lottery raises, a monetary calculus would not be a sufficient measure of its social acceptability. Nevertheless, government should at least weigh the liquidated social costs against the financial benefits of a permissive gambling policy.

[9] G Mulgan *Connexity: How to Live in a Connected World* (1997) 214 argues that taxation 'should be transformed into a more visibly effective tool for achieving commonly agreed goals'. He has referred to this proposal as 'reconnecting taxation'.

only for the allocative decision but also for the taxes which make distribution possible. Likewise, revenues should 'not be distributed so that no one is aware of them, or in a manner generally unascertainable'.[10] But, even without comprehensive analyses, comparisons of, say, the proportion of revenue allocated to defence compared with that spent on education, simplistic as they may appear, may still promote public debate and, ultimately, influence government policy and responsiveness. Government's reasons for particular allocations may be unimpeachable, but it must be able and prepared to articulate them.[11] Issues of this nature should be brought into the public forum for debate. Accurate and readily comprehensible information released into the public domain can have a considerable impact on public finance debate and, thus, practical democracy.[12]

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[10] CS Shoup *Public Finance* (1969) 37

[11] This should not be a matter of defensive justification. In certain regards, government has good cause to publicize its spending patterns. According to the United Nations Development Programme *Human Development Report 2001: Making new technologies work for human development* (2001) 195, South Africa, at 7,6 per cent of gross national product, dedicated a higher proportion of its means to education than all but three of the 48 states which were classified as high human development countries. Conversely, the 3,3 per cent of gross domestic product spent on health is likely to appear too low to many, and the 1,3 per cent of gross domestic product expended on military expenditure, although a third of the 1990 proportion, too high for a country with no obvious military threats. Naturally, deeper analysis is needed to establish whether these significant proportions of national income are spent wisely and efficiently.

[12] The website of the Environmental Working Group, a non governmental organization which records in detail to whom United States federal farm subsidies are awarded, for instance, is credited with transforming the debate on the equity of farm subsidies.
See E Becker 'Web Site Helped Change Farm Policy' *New York Times* 24 February 2002.

(d) Promotion of rationality

Naturally, taxpayers hold perceptions about sources of government revenue and its distribution. It is the interests of government, through processes of active communication, to ensure that taxpayers have sufficient information to confirm or refute their perceptions. Perceptions of government activity, particularly expenditure, impact both on public opinion and the direction of political debate, so that ill-informed views may have a deleterious impact on government programmes. In this regard, Noam Chomsky has observed that opposition to foreign aid in the United States was particularly strong amongst the quarter of the population that believed the largest item of the federal budget to be foreign aid. Yet, given the absolute magnitude of the federal budget, foreign aid was a negligible item of United States government expenditure. Conversely, almost half of discretionary federal spending 'goes to the Pentagon', a fact that was known by less than one-third of the population.[13] Seemingly irrational support for the creeping suspension of estate tax in the United States provides another graphic example of ill-founded perceptions apparently clouding judgment.[14] Paradoxically opposition to estate tax is strongest in rural states,[15] where its impact is felt least. Naturally such opposition could be based on principle but appears to be

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[13] N Chomsky *Power and Prospects: Reflections on Human Nature and the Social Order* (1996) 107

[14] In terms of the United States Economic Growth and Tax Relief Reconciliation Act of 2001, the value of assets excluded from estate tax would increase until 2010, when all assets would be excluded. However, without further legislation, the estate tax will revert to 2001 levels in 2011. While this may appear paradoxical, Stiglitz explains that this must be so, since even the legislators who voted for the suspension of estate tax realized that America could not in the long-term afford the multi-trillion dollar deficits that would ensue.
See JE Stiglitz 'Bush's Tax Plan – The Dangers' *New York Review of Books* 13 March 2003.

[15] C Hulse 'Ads Push Estate Tax as Issue in Campaign' *New York Times* 14 July 2002

influenced by the empirically unsupportable perception that many small, family-operated farms are lost to meet estate tax liabilities.[16]

In South Africa, during the period 1969-84, when White economic predominance had started to wane[17] but racially separate income taxes were in place, it was a commonly held misconception among certain ill-informed Whites that Blacks did not pay taxes.[18] Similarly, today, without a full understanding of the disproportionate burden borne by the poor in terms of indirect taxes and user charges for public goods, the perception might be formed that only those within the income tax net contribute to the fiscus.

Transparency can be an important tool for promoting the rationality the Constitution expects. It holds the potential for contributing to a defusing of socially destructive myths, and may facilitate informed debate. Nevertheless, the potential for rationality is, of course, no guarantee that reasoned opinions will be formed. In this way misconceptions relating to the impact of estate taxes on capital formation remain important opposition arguments,[19] although John

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[16] DC Johnston 'Focus on Farms Masks Estate Tax Confusion' *New York Times* April 8, 2001 reported that Neil Harl, an Iowa State University economist and farm tax specialist, after thorough investigation had concluded that no farms had been lost to pay estate tax. He dismissed the proposal as 'a myth'. Indeed, because of estate planning techniques, farmers rarely pay estate tax.

[17] See C Bundy 'Development and inequality in historical perspective' in R Schrire (ed) *Wealth or Poverty: Critical Choices for South Africa* (1992) 24, 34.

[18] See Chapter 2, section II above regarding separate taxation in South Africa.

[19] T Blumkin & E Sadka 'Estate Taxation' Center for Economic Studies & Institute for Economic Research Working Paper No 558 (2001) 1

Maynard Keynes revealed them as unsupportable canards as long ago as 1936.[20]

III TRANSPARENCY IN TAXATION: VISIBILITY AND CONSCIOUSNESS

(a) Tax visibility

A tax is visible to the extent that informing principles, legislative requirements, and the burdens and benefits it confers are communicated to taxpayers. Correspondingly, tax consciousness is the extent to which this information is received and held by taxpayers. These are not straightforward matters. Certain taxes, such as customs duties, unseen by the consumer-taxpayer, are prima facie invisible. Yet, consumers travel and have access to information sources that allow them to compare prices of goods in different countries. Consequently, a person intending to purchase an expensive item may be acutely aware of the impact of customs and ad valorem excises on that good. Income tax, about which there is a high level consciousness, reiterated monthly for those subject to Employees' Tax,[21] is considered opaque by certain commentators next to value-added tax (VAT).[22] Conversely, VAT, despite its theoretical visibility has low taxpayer consciousness. Although not in terms of the law,[23] VAT is perceptually bundled into the price of a good or service, and it is most improbable that a consumer should contemplate her monthly aggregate VAT burden, less her

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[20] JM Keynes *The General Theory of Employment, Interest and Money* (1936) 372

[21] See Fourth Schedule to the Income Tax Act 58 of 1962. Employees' Tax is commonly referred to as pay-as-you-earn (PAYE).

[22] See, for instance, Moore (note 7 above). However, directly withheld income tax is relatively more significant in South Africa than the United States.

[23] See sections 64 and 65 of the Value-Added Tax Act 89 of 1991

annual burden, in the way that she is presented with her monthly PAYE contribution and annual income tax assessment.[24]

The tax visibility-consciousness dualism is, as Richard Bird observes, 'central to an understanding of the political and social factors which appear to shape tax structures as much as, or more than, economic realities'.[25] He argues, for instance, that the so-called taxpayer revolt of the 1970s, particularly in California, was attributable to the increased visibility of certain taxes rather than an increase in overall burden. Recognition of tax consciousness may guide government action in undesirable ways. For instance, a government that considers voters mistakenly opt for too few public goods may be tempted to 'extol tax anesthesia'.[26]

The Margo Commission, which conducted its investigation at a time of widespread civil disobedience and unrest, when a non-democratic government may have anticipated politically motivated tax default, alluded to the effectiveness of *l'impôt invisible* in raising taxes surreptitiously.[27] Nevertheless, even in a democracy, government may consider surreptitious taxes to be effective. Thus, if it is assumed that significant numbers of economically active people earn income outside the formal economy, and hence the income tax net, the operation of VAT may be assumed to ensure that their consumption is taxed and, to that extent,

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[24] Modern payroll systems invariably record year-to-date, cumulative deductions of PAYE and, although till slips show a separate amount for VAT, it is implausible to think that a consumer might keep a tally of her cumulative VAT liability.

[25] RM Bird *Financing Canadian Government: A Quantitative Overview* (1979) 41

[26] Shoup (note 10 above) 37

[27] C Margo (Chair) *Report of the Commission of Inquiry into the Tax Structure of the Republic of South Africa* (1987) para 4.46

their ability to contribute to the fiscus is actuated.[28] But since VAT is unable to distinguish between consumers who have paid their income tax due and those who have not, the equity gap between those two groups is maintained.[29] Constitutional government must found its tax strategies on an assumption that just laws will be enforced and complied with, and not rely on de facto compliance with unfair laws.[30]

(b) Tax visibility and ethical governance

Ensuring the visibility of taxes is an imperative of ethical governance, and an important element of an open and transparent discourse between government and its citizens. As a basic principle, constitutional government should not actively or passively conceal its sources of revenue and beneficiaries of

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[28] There an assumption that VAT brings into the tax net the economic actors of the grey economy, those being people who have the economic means but do not pay income tax. Free riding of that nature is without doubt socially repugnant and it is incumbent on SARS to ensure that all those who ought to pay income tax do. A less obvious category of taxpayers, whose members do not contribute adequately to the fiscus, includes those whose economic circumstances are not properly considered by the Income Tax Act. Traditionally, for instance, high earning individuals have been able to set off exceptional loss provisions against other income (plantation schemes, aeroplane syndicates being historical examples). While many of these loopholes have been closed, the tax privileges accorded to farming income probably permit certain wealthy individuals to pay lower amount of income tax than they would if their income arose purely from other sources. It seems that VAT would bring their income into the tax net to the extent that it is consumed. However, because investment spending falls outside of the VAT net (and the wealthy consume a smaller proportion of their income than the less wealthy) this will be an inadequate response.

[29] If it assumed that A and B have similar incomes but A pays no taxes, a horizontal equity gap lies between the two. If government seeks to bring A into the tax net by charging VAT on all expenditure, the equity gap is maintained – in fact, it increases - because B also pays VAT.

[30] I consider the issues of VAT and fairness in Chapter 19 below.

expenditure from its citizens but should rather highlight them in order to encourage democratic debate, understanding and acceptance of its policies.[31] Crucially, if a government programme is to meet the constitutional expectation of reasonableness, 'its contents must be made known appropriately'.[32]

(c) Vertical and horizontal aspects of tax visibility

There is a discernible tendency for taxpayers to portray taxes as beneficial payments to the collection agency, to government, or even, a metonymic 'Trevor', the forename of the incumbent Minister of Finance, although it seems implausible that they should really conceive of them as such. Nevertheless, this common caricaturising of taxes in this way indicates that tax consciousness has a strong

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[31] Parliamentary Joint Standing Committee on Finance *Final Draft Report of the Joint Standing Committee on Finance on the Third Interim Report of the Katz Commission of Inquiry into Taxation* (1996) 4 urged that tax collection should not be perceived of as 'damaging' to the economy, but rather the means by which economic growth and development are assisted, and socio-economic programmes carried out as part of the redistributive function of government are funded. It, therefore, recommended 'a considered, far-reaching communications campaign that will help build tax morality and an understanding of rights, obligations and of how revenue raised is used'. It envisaged that such a campaign should also raise the awareness of the full range of taxes. It further recommended that reports, such as the Katz Report (MM Katz (Chair) *Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa* (1994)), should be made widely available in popular form simultaneously with their official publication in order to ensure greater availability and accessibility. The Committee further proposed that two important principles be adopted in this regard, specifically: 'a clear statement be issued on our policy and principles with regard to how taxation is weighted in South Africa and why; and the principle be accepted that the source of taxation should not determine who benefits from public spending or *vice versa*'.

[32] *Minister of Health* v *Treatment Action Campaign (2)* 2002 (5) SA 721 (CC) [123]
Although the issue to be decided in that case related to the provisions of section 27 of the Constitution, which require reasonable government action to meet basic socio-economic needs, citizens may expect broad publication and explanation of all government programmes.

vertical aspect. Logically, one may only arrive at a perception of fairness of contribution by assessing one's current contributions with one's own previous contributions (vertically across time) or with others' contributions (horizontally). Tax consciousness has, therefore, a crucial but less obvious horizontal aspect, one that was indicated in *Walker*, when the complainant sought to compare the circumstances of a group to which he considered he belonged, with that of another discernible group whose members were differently situated. As Langa J summed up the applicant's contention, 'He does not contend that he is paying more than he should be paying, rather that *others* are paying less than they should'.[33]

Arguing in this way, the applicant drew a perceptual connection between contributory obligation and horizontal equity, an area ripe for socially destructive myths to flourish and wreak havoc with just policies. Mr Walker lost his case but highlighted the importance for government of ensuring that citizens understand and accept the rationale of its policies.[34]

IV BARRIERS TO TAX VISIBILITY

The desirability of tax visibility for constitutional governance and specifically a constitutional scheme of taxation having been established, it is pertinent to consider the factors that might stand in its way.

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[33] *City Council of Pretoria* v *Walker* 1998 (2) SA 363 (CC) [94] (emphasis in original)

[34] Lin M T 'Taxpayers' Perceptions of Fairness of the Tax System – A Preliminary Study' (1998) Vol 4:2 *New Zealand J of Taxation Law and Policy* 59, 62 argues that in addition to the perception of burden in relation to others, taxpayers hold a perception of 'equity of the trade', that is, a comparison of benefits received for taxes paid.

(a) Multiplicity of taxes

One of the principal obstructions which lies in the path of understanding holistic tax burden is a multiplicity of taxes, and the current scheme of taxation in South African, like that of most countries, is a salmagundi of taxes and levies, representing well-established principles, but also ad hoc responses to socio-economic developments and specific opportunities.[35] Whatever the historical explanation for this multiplicity of revenue sources, a wide variety of taxes necessarily tends to obscure public realisation of the total tax burden, and, intended or not, acts to reduce public resistance to taxes.[36]

(b) Ways in which fiscal information is sorted

Traditionally, when reporting fiscal information, a distinction is drawn between direct and indirect taxes.[37] Direct taxes are supposed to have a subjective element which requires a 'personal' relationship between the taxpayer and the collection agency, whereas indirect taxes are paid by a third party on behalf of the taxpayer. Since the SITE/PAYE final income tax system obviates many taxpayers entering into dialogue with the South African Revenue Service (SARS), this distinction is arguably outmoded in South Africa, and the National Treasury, following the Organization of Economic Cooperation and Development (OECD) practice of classifying taxes in terms of incidence on particular items, tends to

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[35] See, for instance the demutualisation levy instituted by the Demutualisation Levy Act 50 of 1998.

[36] CN Mitchell 'Taxation, redistribution and justice' *University of Toronto LJ* 88 (1988) 151, 170

[37] UA Hicks *Public Finance* 3 ed (1968) 133 attributes this distinction to particular British legal and administrative requirements.

distinguish between taxes on income or property.[38] However, the direct/indirect distinction has continued relevance inasmuch as direct taxes tend to incorporate progressive rates, whereas indirect taxes normally employ proportional rates.[39] A system of classification premised on ethical considerations would distinguish between taxes that are progressive (rates of tax increase as ability to pay increases) or regressive (the effective rate of tax decreases as ability to pay increases)[40]. VAT, for instance, when levied at a standard rate, is regressive in relation to the lower income earner when two consumers with different levels of income purchase similar goods or services. Employing this distinction and considering South African taxes: income tax on individuals and its annexe, capital gains tax, are progressive, and hence striving for equity (ethical validity)[41], whereas other major taxes are regressive, and so operate counter to constitutional principles.[42]

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[38] In accordance with section 216 of the Constitution, the National Treasury is required to adhere to: generally recognised accounting practice; uniform expenditure classifications; and uniform treasury norms and standards. Following OECD reporting norms in this regard seems, therefore, eminently prudent.

[39] See Chapter 18 below for a discussion of equitable tax rates.

[40] BP Herber *Modern Public Finance* (1983) 123

[41] In Chapter 1 above, I equated 'ethical', in the specific constitutional context, with 'constitutional', that is, consistent with constitutional values. In Part III below, I explain why progressive taxation is eminently compatible with constitutional values and objectives.

[42] According to National Treasury 'A People's Guide...Budget 2003', personal income tax contributes 32 per cent of revenue; VAT 26 per cent and customs, excise and fuel levy 13 per cent in aggregate. Certain efforts have been made to imbue other taxes with equity, so that certain items, which are deemed to be of specific benefit of the poor, are zero rated for the purposes of VAT. Significant exemptions apply to estate duty and donations tax but rates are regressive. Furthermore, transfer duty employs two rates, combined with a significant exemption.

Government is not expected to sort fiscal information in a way that distinguishes progressive from regressive taxes, but is expected to ensure that sufficient fiscal information is readily available in the public domain to permit users or 'constituencies for information' to conduct their own analyses.[43] Once government has published such useful information, and interest groups have conducted their analyses, demands on government to explain and justify its preference for regressive taxes may be expected.

(c) Difficulties in comparing sources of revenue

It would be specious to draw concrete conclusions from the amounts or proportions of revenue yield derived from different sources alone. For instance, comment is frequently made on the decline in contribution to tax revenues made by the gold mining industry, which contributed almost nine per cent of national tax yield in 1984 but only one tenth of one per cent in 2001.[44] While this a remarkable decline in proportionate contribution, there may be sound explanations, such as the increasing costs of extracting ore from aging mines, and a persistently low gold price. Lower taxable profits may even be attributable to higher costs of employment, representing improvements in wages and working conditions for miners, and benefits for their dependants. However, this is no more than conjecture. If a traditionally important industry such as gold mining is

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[43] World Bank *World Development Report 2003* (2002) 186 concluded that:
'Although information provision can sometimes be a catalyst for change, the most effective systems are those that create constituencies for information. The constituencies may be public agencies that use the information to plan and assess strategies for pollution control, crime prevention, or public health delivery. Or they may be civil society organizations that use information to mobilize dispersed interests. It is demand by users that stimulates and maintains the production of relevant, reliable information.'

[44] National Treasury Tax Policy Chief Directorate 'Capital Gains Tax Briefing to the Portfolio and Select Committees on Finance 24 January 2001' (2001) (no constant pagination)

suspected of shirking in its fiscal duties, then this matter should be investigated and rational, informed debate commenced.[45]

A comparison of revenue sources can be illuminating (although caution must be exercised in doing so). For instance: in the fiscal year 2000-01, excise duty on mineral water (R120 million) raised ten times the revenue yield from donations tax (R12 million);[46] in the first two years of its existence,[47] the National Lottery (Lotto) transferred R987 million to the National Lottery Distribution Trust Fund;[48] approximately R100 million more than the amount raised by estate duty in the same period.[49] (Needless to say, the amount actually spent on lottery tickets by

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[45] The Minister of Finance, TA Manuel, 'Budget Speech' 26 February 2003 announced that special tax privileges for goldmines were considered unjustified and would be removed. This may indicate that gold mines have enjoyed irrational privileges and have not, therefore, contributed fairly to the fiscus.

[46] National Revenue Account Schedule 1 Revenue Revised Estimate for 2000-01
Excise duty on mineral water was removed in 2002.

[47] The state-sanctioned national lottery is an egregious manifestation of regression in public finance. Although these revenues are not collected by SARS and are not reflected in the National Revenue Accounts, they are of public benefit in the way of a tax. However, they do not constitute a compulsory contribution for the benefit of the fiscus. This disqualifies the purchase of lottery tickets from being classified as a tax. Nevertheless, as a significant source of public revenue, which would otherwise be raised by taxes, it is pertinent to consider lottery ticket purchases and receipts with taxes. In short, there can be no justification for raising public finance in this way under the constitutional dispensation.

[48] H Khoza (CEO of Uthingo) 'Lotto is turning two' 25 February 2002 (press release)
Between 1 April 1999 and 28 February 2003, the lottery earned R2,5 billion, including interest accrued. (Alec Erwin, Minister of Trade and Industry in an answer to a parliamentary question, reported by Donwald Pressly 'Only 16% of the lottery funds distributed' *Mail & Guardian Online* 8 April 2003.)

[49] National Revenue account: Revised estimate 2001-02 (R440 million) and 2000-01 preliminary outcome (R443 million).

gamblers is considerably more than the net amount transferred for distribution, perhaps as much as R5 billion a year.[50]) VAT, which, in principle, is only paid by consumers, generally raises in the region of ten times the revenue of the secondary tax on companies, which is payable by companies on their profits actually distributed by way of dividends to shareholders.[51]

Notwithstanding plausible economic explanations for low yields from certain sources, these figures suggest gross unfairness, and should be brought into the light for analysis and public debate.

(d) Incomplete accumulation of relevant information

Taking the example of capital transfers: it is self-evident that informed debate on a revitalised estate duty or an inheritance tax cannot take place without some knowledge of the quantum of aggregate deceased estates. Yet, according to the Department of Justice, there is no mechanism for calculating the aggregate value of deceased estates in South Africa.[52] Such figures are simply not calculated and the systems for calculating the amounts administered by the different Masters'

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[50] According to the estimates of prominent economist, Azar Jammine of Econometrix, reported by Keeton (note 8 above). Together with the distribution rate of only 16 per cent (note 47 above), this indicates that the lottery is not only regressive but a remarkably inefficient means of raising and disbursing revenue. Its only 'virtue' is that people do not generally conceive of it as a tax.

[51] For instance, according to the Budget Review 2001, the preliminary outcome for 2000-01 was a VAT yield of R54,4 billion and an STC yield of R4 billion. STC yield varies considerably with the business cycle.

[52] I requested the Department of Justice to provide an approximation of the aggregate value of deceased estates in South Africa in any year. The department's representative, despite considerable efforts, for which I wish to record my gratitude, was unable to provide even an estimate.

offices, and those estates still administered under Black Administration, do not exist. Yet, without this information, it is inconceivable that proper consideration of the potential contribution of a restructured estate tax has been made.

V TRANSPARENCY OF NEXUS BETWEEN REVENUE AND EXPENDITURE

South Africa has inherited the bifurcated expression of the collection–redistribution continuum established by the United Kingdom so that, despite the crucial importance of the aggregate amount of revenue to be raised in a particular fiscal year, tax legislation is silent on the issue. Rather 'it concerns itself entirely with the rules as to the incidence and amount of tax to be paid by individual persons and on individual transactions'.[53]

Yet, an unambiguous nexus should be drawn between the paying of taxes and the expenditure of government. In this regard, at least, libertarianism of an 'around the braai' nature is relevant. Government does not 'own' the money it collects from taxpayers: it collects and allocates moneys in a quasi-fiduciary capacity in order to reflect its political commitments, tempered by the general will of the national community. Community members, like the beneficiaries of a common law trust, expect demonstrable transparency and accountability in the management of 'trust' moneys, particularly in connecting moneys accrued with those expended.

There may be a traditional hesitancy on the part of government to link revenues with expenditures, and it is axiomatic that budgetary decisions are primarily government's preserve. Nevertheless, participatory democracy must have a practical oversight role to play with regard to fiscal matters, and not simply through the quadrennial opportunity to elect parliamentarians. If citizens understand the sources of revenue and how it is spent, value choices come to

[53] TC Daintith 'Legal Analysis of Economic Policy' 9 *J of Law and Society* (1982) 191, 215

the fore. Greater democratic participation is likely, and, public discussion, which has an invaluable role in defining what economic goals are socially feasible,[54] will take place. Finally, the prospect of informed citizens becoming actively involved in the budgeting process becomes possible. I consider this prospect below.

VI EMPOWERMENT AND PARTICIPATIVE BUDGETING

(a) Citizen's participation in the fiscal process

Participation rights are crucial to a healthy democracy. Even if individual citizens do not actually participate in democratic processes, they still value the right to be able to participate, and the consequent feelings of control, self-determination and influence on the political sphere.[55]

In a modern economy, appropriate specialists necessarily make important financial decisions but this does not infer the inevitability of an opaque technocracy. To employ a common analogy,[56] in a democratic community, it is axiomatic that an engineer should ensure the structural integrity of a bridge, but members of the community should not be excluded from the debate whether scarce resources should be allocated to building a bridge, as opposed to, say, a hospital. Ultimately, transparency and, particularly, accountability can contribute to genuine democratic participation and empowerment. (The World Bank identifies 'empowerment' as 'the expansion of assets and capabilities of poor people to participate in, negotiate with, influence, control, and hold accountable

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[54] A Sen 'Democracy as a Universal Value' *J of Democracy* 10.3 (1999) 3, 11

[55] BS Frey & A Stutzer 'Beyond Bentham – Measuring Procedural Utility' Center for Economic Studies & Institute for Economic Research Working Paper No 492 (2001)

[56] See, for instance, E Bodenheimer *Power, Law and Society* (1972) 54.

institutions that affect their lives'.[57]) While recognising cultural differences that may impact on arrangements in different countries, the World Bank proposes four key elements of empowerment that must underpin accountable budgetary institutions. These requirements are:[58]

(b) Access to information

Informed citizens are better equipped to take advantage of opportunities, access services, exercise their rights, and hold state and non-governmental actors accountable. The World Bank has found that information and communication technologies often play a pivotal role in broadening access to information. Naturally, government transparency is crucial in this regard.

(c) Inclusion/participation

Opportunities for poor people and other excluded groups to participate in decision making are critical to ensure that the use of limited public resources incorporates local knowledge and takes cognisance of local priorities. Sustaining inclusion and informed participation usually requires a change in the budgetary process in order to create space for people to debate issues and participate in local and national priority setting, budget formation, and delivery of basic services.

(d) Accountability

Government must be answerable for its policies, actions, and use of scarce funds. Government agencies, both administrative and political, must have internal

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[57] World Bank (PREM) *Empowerment and Poverty Reduction: A Sourcebook* (2002) vi

[58] The following section summarizes the text of the World Bank *Empowerment Handbook* (note 57 above).

accountability mechanisms, and must also be accountable to their citizens for their performance.

(e) Local organisational capacity

The World Bank identifies 'participatory budgeting' as 'a process in which a wide range of stakeholders debate, analyse, prioritise, and monitor decisions about public expenditures and investments'.[59] The ambit of stakeholders may include the general public; poor and vulnerable groups, particularly women; organised civil society; the private sector; representative assemblies or parliaments; and donors.

The World Bank provides various examples of participatory budgeting arrangements from both economically advanced and developing countries. Ireland's corporativist process involves consultation with 19 'social partners' which are taken to represent 'the four pillars of society', these being trade unions; business and employer organisations; farmers' organisations; and community and voluntary organisations.[60] Perhaps the best known participative budgeting arrangement is that of the Brazilian city of Porto Allegre which is estimated to have increased participation from 1 000 submissions in 1990 to 14 000 in 1996, and, including informal consultations, it is thought that as much as eight per cent of the city's population takes part in the budgetary process.[61]

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[59] Ibid 123 (One of twenty 'tools and practices')

[60] Ibid 126

New Zealand's Local Government Act 2002 requires consultative budgeting on the part of municipal councils.

[61] Ibid 127

In South Africa, IDASA's Women's Budget Initiative is credited with a significant influence on the budgetary process as far as the interests of women are concerned.[62] Generally, the Minister of Finance invites citizens to submit their views through the 'Tips for Trevor' initiative, but there is no indication that this process is a meaningful contribution to the formulation of fiscal policy. A general contribution to fiscal debate is needed in South Africa, but this is militated against by many factors that bolster the status quo, none more than the dearth of useful fiscal information made available to constituencies for information.

VII CONCLUDING COMMENTS

Transparency is an integral element of an open and honest discourse between government and taxpayers, and completes the expectations held by community members for constitutional government. With these expectations outlined, I turn in the next part to the construction of a constitutional scheme of taxation.

[62] Ibid 129

PART THREE

CONSTRUCTING A CONSTITUTIONAL SCHEME OF TAXATION

INTRODUCTION TO PART THREE

Having established relevant constitutional imperatives and the expectations of community members with regard to fiscal management, I now turn to a consideration of the specific requirements of a constitutional scheme of taxation.

I consider how the foundational values of the Constitution (human dignity, freedom and equality) may be actualised under a constitutional scheme of taxation.

CHAPTER 11 CONSTITUTIONAL VALUES AND TRADITIONAL TAX CRITERIA

I INTRODUCTION: GENERAL ACCEPTANCE OF EQUITY AND EFFICIENCY

A consideration of a scheme of taxation under the constitutional dispensation must spring primarily from an inquiry into its compatibility with constitutional values and injunctions.[1] Established tax principles may be pertinent but will be subordinate.[2] While this proposition may imply a radical departure from traditional guidelines for tax policy, in practice, constitutional tax requirements have broad correspondence with certain established tax criteria, and distinctions tend to lie in emphasis or nuance.[3] There is broad consensus that a scheme of taxation

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[1] Ackermann J in *First National Bank of SA Ltd t/a Wesbank* v *Commissioner, South African Revenue Service* 2002 (4) SA 768 (CC) [31] observed that 'even fiscal statutory provisions, no matter how indispensable they may be for the economic well-being of the country – a legitimate government objective of undisputed high priority – are not immune to the discipline of the Constitution and must conform to its normative standards'.

[2] J Rawls 'Distributive justice' in A Ryan (ed) *Justice* (1993) 73, 87 dismissed 'the traditional criteria of taxation' as being 'subordinate' to his two principles of justice, arguing that 'once the problem is seen as that of designing a whole social system, they assume the status of secondary precepts'. This suspicion of traditional values applies equally to fundamental constitutional justice. Nevertheless, traditional tax criteria remain relevant, particularly if recognition and acceptance of new proposals are sought. Tax policy planners have not adopted Rawlsian principles of justice. I am, therefore, slower to dismiss traditional criteria than he. Rather, I seek to illuminate the commonalities shared by established tax principles and constitutional principles as they may apply to taxation.

[3] By analogy, the Constitutional Court has not engaged with section 36 of the Constitution of the Republic of South Africa Act 108 of 1996 (Constitution) (which requires an assessment of restrictions to rights in the light of what is reasonable and justifiable in an open and democratic society based on freedom, dignity and equality) in an idealised, theoretical way but has interpreted it as requiring comparison with actual restrictions imposed by countries such as Australia, Canada and the United States. See, for instance, *Metcash Trading Ltd* v *Commissioner, South African Revenue Service* 2001 (1) SA 1109 (CC) [61].

should principally be fair and effective;[4] these are also fundamental constitutional concerns. (Naturally, conceptions of fairness vary,[5] and the greatest part of my analysis will involve the identification of a specific form of equity suitable for a constitutional scheme of taxation.) Other commonly expressed desiderata, which would enhance a constitutional scheme of taxation, unless they conflict with fundamental principles, include simplicity (including convenience)[6] and neutrality. Before turning to constitutional principles, I briefly consider these two criteria, along with the qualities of competitiveness and appropriateness.

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[4] For instance, Adam Smith's four maxims of taxation included equity and administrative efficiency (A Smith *An Inquiry Into the Nature and Causes of the Wealth of Nations* (1776) (1952 reprint) 361). The influential Meade Committee Report included incentives and economic efficiency; distributional effects; simplicity and costs of administration and compliance, as desirable characteristics. (See Institute for Fiscal Studies *Structure and Reform of Direct Taxation: Report of a Committee chaired by Professor J. E. Meade* [from a non-paginated extract in TS Emslie, DM Davis and SJ Hutton *Income Tax Cases and Materials* 2 ed (1995)].) Chapter 4 of the Margo Report identified equity and costs, inter alia, as canonical characteristics of a good tax system. (See C Margo (Chair) *Report of the Commission of Inquiry into the Tax Structure of the Republic of South Africa* (1987).)

[5] A Ryan 'Utility and Ownership' in RG Frey (ed) *Utility and Rights* (1984) 175, 190, considering a utilitarian perspective, suggests two concrete considerations for a scheme of taxation, specifically, that incentives should be maintained in order to avoid depressing initiative, and the system should do justice to different classes of persons. In other words, he proposes fairness and efficiency. His third criterion relates to the distribution of power. However, this does not fall within the scope of realisable tax goals (see Introduction).

[6] Smith (note 4 above) 362 included convenience as one of his canonical maxims of taxation.

II SIMPLICITY

(a) Identifying simplicity

After equity and efficiency, the most commonly proposed quality for a tax systems simplicity.[7] However, definitions of simplicity vary considerably amongst proponents. For instance, Australia's Ralph Report identified 'facilitating simplification' in the broadest of terms, specifically, as 'Optimum design of the business tax system – from policy legislation to administration – to ensure maximum simplicity, certainty, stability and voluntary compliance as well as lowest system operating costs'.[8] Alternatively, simplicity is taken to refer to the

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[7] The Margo Commission (note 4 above), Katz Commission (MM Katz (Chair) *Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa* (1994)), and National Treasury (National Treasury Tax Policy Chief Directorate 'Capital Gains Tax Briefing to the Portfolio and Select Committees on Finance 24 January 2001' (2001)) have all expressed a preference for simplicity. Australia's *Reform of the Australian Tax System, Draft White Paper* (1985) included simplicity along with equity and efficiency as the essential criteria for assessing a tax system. A later report – *A Strong Foundation: Establishing Objectives, Principles and Processes* (1999) ('Ralph Report') – included 'facilitating simplification', with 'optimising economic growth' and 'ensuring equity', as 'national objectives'. (Extracts provided in G Cooper, R Krever & R Vann *Income Tax: Commentary and Materials* 4 ed (2002).)

The Margo Commission also included criteria of neutrality, flexibility, stability, distributional effectiveness, and a fair balance from the point of view of taxpayers between the respective burdens of direct and indirect tax.

[8] Ralph Report Box 6.1 National Objectives (note 7 above)

drafting of legislation, the conduct of administration and substance of tax laws.[9] Other reviews limit simplicity to administrative efficiency.[10]

(b) Basis for simplicity in taxation

Whatever the scope of the conception of simplicity adopted, it is reasonable to expect that text of tax legislation will readily comprehensible,[11] and tax administration will be structured to make compliance as simple and cost-efficient a matter as is practicable. However, substantive simplicity is more problematic,[12] and, although it appears to have taken on the mantle of a fiscal Holy Grail, does not seem to be a goal in itself. Robert J Shapiro for the Progressive Policy Institute, for instance, argues for tax simplification on the grounds that it would not only make it easier for taxpayers to comply but would have economic

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[9] J Prebble 'Can Income Tax be Simplified?' (1996) Vol 2:4 *New Zealand J of Taxation Law and Policy* 187

[10] P Kenny 'Capital Gains Taxation for New Zealand: Fairer and More Efficient' (2001) Vol 7: 4 *New Zealand J of Taxation Law and Policy* 265, 286 argues that simplicity is generally considered by comparing the administration costs incurred by government in collecting a tax with the compliance costs incurred by taxpayers in paying the tax. The ratio of these two costs provides a measure of tax rand per compliance rand. While such measurements are important for gauging administrative efficiency, they cannot constitute guiding principle. Kenny presents an unduly limited conception of tax simplicity.

[11] Ralph Report (note 7 above) para 6.39 called for tax policy intentions to be 'converted into legislation in as a simple, transparent and user friendly manner as possible'.

[12] W Anderson & A Sawyer 'Legislative Complexity – the Need for Appropriate Variables and Some Likely Candidates' (1997) Vol 3:1 *New Zealand J of Taxation Law and Policy* 3, 31 conclude that, although the nexus between complexity and perceptions of fairness (which promotes compliance) is established, there is no certainty as to which variables capture the essence of legislative complexity.

advantages, notably those which are assumed to arise from neutrality.[13] It seems that he envisages simplicity as a means of delivering convenience and neutrality, rather than considering it to be a worthwhile goal in itself.

(c) Simplicity and flat taxes

Simplicity in taxation is a purported aim of flat tax proponents.[14] Their argument is persuasive in this regard to the extent it implies that, without simple and consistent guiding principles set for the long-term, tax laws are likely to be complex.[15] However, a flat rate of tax does not deliver simplicity except in a most superficial way. Once the amount to be taxed has been determined, differentiated rates of tax cannot present genuine complexity problems. Tax due is invariably

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[13] RJ Shapiro 'The Case for Tax Fairness' (1996) Progressive Policy Institute *Talking Points*

[14] According to JM Bickley 'Flat Tax Proposals and Fundamental Tax Reform: an Overview' (2003) Issue Brief for Congress, there are 11 tax reform proposals currently under consideration by the United States legislature that promote some form of 'flat tax'. The Dorgan, Gephardt, and Snowbarger proposals seek ways of simplifying administration of the tax, whilst retaining, if modifying, the current tax base. However, the Armey, Crane, English, Linder, Shelby, Souder, Specter, and Tauzin proposals seek to change, implicitly or explicitly, the tax base from income to consumption. It is this latter group of proposals that I contemplate when using the term 'flat tax'. These proposals may be subdivided into two broad types, namely the Hall-Rabushka model (after the Hoover Institution researchers, who first formulated the plan) and the Nunn-Dominici model (after two former legislators who championed that proposition). Under the Hall-Rabushka model (broadly followed by Armey, Linder, Shelby, Specter and Tauzin) the tax base would be derived from consumption only. Under the Nunn-Dominici model (broadly followed by Crane, English and Souder) only active income would be subject to income tax.

[15] S James, A Sawyer & I Wallschutsky 'The Complexities of Tax Simplification: Progress in Australia, New Zealand and the United Kingdom' (1998) *Australian Tax Forum* Vol 14 No 1 29, 62 conclude that 'rewriting tax law alone is insufficient to achieve significant simplification of the tax system. Complicated, inconsistent and frequently changing tax policy will be reflected in complex legislation however it is written or however frequently it is rewritten'.

tabulated, if not computerised. Simplicity is primarily determined by the tax base, and that, in turn, by informing principles. Indeed, the generic flat tax proposal can only claim simplicity 'in large part because it eliminates, on paper, deductions and exclusions that no Congress has dared touch',[16] or is likely to.

There can be no objection to substantive simplicity in taxation but it is an idea that is difficult to identify and one that fits uneasily with complex modern organisations and arrangements.[17] Taxing salaries at source is, for instance, simple but taxing complex investment arrangements cannot be. Unless government gives up taxing certain types of income, calculation of the taxable value of certain types of income will remain complex.[18]

III NEUTRALITY

The principle of neutrality in taxation requires taxes to be structured so that taxpayers' economic decisions are not influenced by tax concerns. Although neutrality is traditionally cited as a criterion by which a tax system should be assessed, it appears to be a principle that is generally observed in the breach. Indeed, Shoup indicates that policymakers jettisoned neutrality as tax policy long

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[16] WG Gale 'The Flat Tax: Simple, Efficient, Fair: Or Is It?' *Brookings R* Summer 1998 45

[17] RM Bird *Financing Canadian Government: A Quantitative Overview* (1979) 92 argues that simplification of the tax structure would curtail government growth. Presumably, a simplified tax structure, one that has a narrow tax base, will permit government to raise less revenue than under a broad based tax system and so limit its functions. Effective government is a constitutional imperative but limiting tax revenues is not the way to achieve this.

[18] M Gammie *Tax Simplification: Is it Possible?* (1995) 47th Conference of the Canadian Tax Foundation, cited by Prebble (note 9 above) 189.
The types of income that are difficult to quantify (typically complex investments) tend to accrue to the wealthy. It is self-evident that exemption of such types of income in the name of simplicity would constitute an unjustified preference under the constitutional dispensation.

ago.[19] His contention is plausible: governments tend to use taxes to lead taxpayers in a particular direction, or to confer favours and privileges, but often with unpredicted economic consequences. The principal objection to such partiality, from an economist's perspective, is that the market mechanism is rendered inefficient so that scarce resources are not allocated, as they would be without extraneous influence.[20] Such an objection assumes that the way in which the market would have effected the allocation is desirable. However, the very purpose of government in conferring a privilege may be to promote an outcome different from the one that the market would have provided. Nevertheless, the capacity for tax policy to manipulate economic outcomes is limited and often it is the conferring of the privilege that is the prime motivation for government.

A more pressing concern relating to partiality and a constitutional scheme of taxation, is that the conferral of advantages or disadvantages on particular groups or individuals may be unjustified and in breach of the equality guarantee. Furthermore, a tax privilege may correspond with an irrational or arbitrary preference: for instance, in the way that certain items may be zero-rated or disadvantageously taxed under a value-added tax (VAT) system.[21] Generally, then, the principle of neutrality is relevant to a constitutional scheme of taxation, not because interference in the market mechanism is inherently objectionable but

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[19] CS Shoup *Public Finance* (1969) 21 note 2

[20] WJ Baumol & AS Blinder *Economics: Principles and Policy* 5 ed (1991) 705

[21] See Chapter 19, section V below for a discussion of arbitrary distinctions between goods under consumption taxes.

because partiality may give rise to unjustifiable inequalities or other irrationalities.[22]

IV COMPETITIVENESS

(a) Competitiveness and multinational enterprises (MNEs)

Voicing a commonly encountered argument, Michael Katz proposed that the South African tax system should be 'internationally competitive',[23] implying that there should be a low tax burden. Competitiveness is certainly a valid concern with regard to the taxation of public corporations, particularly branches and subsidiaries of MNEs.[24] However, the proposition that a scheme of taxation should be internationally competitive is unsustainable in relation to individuals. Such a strategy would be fundamentally incompatible with constitutional values and objectives. Tax competition is, in effect, a race to the bottom, as jurisdictions seek, on the one hand, to outdo each other in privileging capital, and thus the wealthy, and, on the other hand, to minimise public expenditure, to the primary detriment of the non-wealthy.[25]

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[22] RA Epstein 'Taxation in a Lockean World' in J Coleman & E Frankel Paul (eds) *Philosophy and Law* (1987) 49, 55 argues that neutrality would be a founding principle of a Lockean scheme of taxation. However, the concerns of a Lockean scheme of taxation for neutrality are different from those that lead a constitutional scheme of taxation toward neutrality. In the former case, neutrality is important because it tends to preserve selections made by individuals before taxation. In the latter case, neutral treatment tends to eliminate unjustified inequalities. There is no bar to a constitutional scheme of taxation including preferences provided they are justifiable.

[23] *ITPA news* International Tax Planning Association (1998)

[24] Since my current concern lies with the individuals who make up the constitutional community, I do not consider the position of MNEs.

[25] See E Janeba & G Schjeldrup 'The Future of Globalization: Tax Competition and Trade Liberalization' Background paper to the World Bank's *World Development Report 2003* (2002) 11.

(b) Tax competition and constitutional goals

A 'competitive' scheme of taxation (one that would privilege capital and raise insufficient revenues to fund social programmes) would be contrary to the needs of the constitutional community for reasons including the following:

(i) Entrenchment of preference for capital

The principal failing of the current tax system lies in its timidity in taxing capital rationally and fully. A constitutional scheme of taxation must rectify this deficit.

(ii) Tax competition based on dubious grounds

Justification for tax competition in relation to individuals springs from the unproven Tiebout hypothesis,[26] which is detached from lived experience.
The South African fiscal community is inclusive and exclusive. How other communities arrange their schemes of taxation is relevant but cannot dictate arrangements within the constitutional community.

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[26] C Tiebout 'A Pure Theory of Local Expenditures' *J of Political Economy* (1956) 64: 416
PW Rhode & KS Strumpf 'A Historical Test of the Tiebout Hypothesis: Local Heterogeneity From 1850 – 1990' (2000) NBER Working Paper 7946 7 outline the hypothesis as follows: 'if mobility costs are zero and the number of communities C is at least as large as the number of types T, the individuals of each type will sort themselves into homogeneous community providing their ideal public goods bundle...[t]he important point is that in the Tiebout model *population heterogeneity is inversely related to social welfare*'. [Emphasis in original]
I discuss the Tiebout hypothesis further in Chapter 18, para VI (e) below.

V APPROPRIATENESS

(a) Appropriateness is crucial

Although commentators may normally imply that a scheme of taxation should be appropriate for the circumstances of the country in which it operates, this is a requirement that warrants explicit enunciation. It is not feasible that effective and coherent governance can be manifest in policies that are not tailored to the circumstances of the particular society in which they operate. Appropriateness has particular urgency under the constitutional dispensation, since a policy or law, which is arbitrary or capricious because of the context in which it operates, is irrational and, therefore, unconstitutional.[27]

(b) Limited need for appropriateness recognised

Lieb Loots provides an indication of appropriateness, in a limited sense, when he argues that the overall level of tax should be commensurate with the level of development in an economy.[28] However, his proposition has a subordinate relevance to a constitutional scheme of taxation. The size of the economy presents undeniable, practical constraints on the amount of potential revenue, and hence its proportionate relationship to national income. However, prudent and honest budgeting for government expenditure, in realising the expectations of the constitutional community must set the level of tax in the country.[29] Besides,

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[27] See the second leg of the rationality test outlined by Yacoob J in *New National Party* v *Government of the Republic of South Africa* 1999 (3) SA 191 (CC) [25].

[28] L Loots 'The post-apartheid challenge to fiscal policy' in R Schrire (ed) *Wealth or Poverty: Critical Choices for South Africa* (1992) 90, 96

[29] There is an expectation, not simply of current, prudent budgeting but also of intergenerational equity. Intergenerational equity is instantiated when sufficient revenues are raised now so as not to shift unreasonable burdens onto future generations.

the distribution of tax burden amongst taxpayers is a more important concern than the aggregate ratio of tax yield to national income. An imperative of appropriateness is more fundamental and general than an identification of certain economic characteristics: it implies a comprehensive consideration of South Africa's specific set of experiences and circumstances.[30]

(c) Appropriateness and the Constitution

Analogous to the pitfalls of adopting inappropriate judicial practices and ideas, a constitutional scheme of taxation should be alert to the 'blithe adoption of alien concepts or inapposite precedents'.[31] Most pertinently, there must be a proper consideration of how the circumstances of economically advanced countries, which are most likely to provide tax models, differ from those of South Africa.

(d) Organization of Economic Cooperation and Development (OECD) models

Every society faces its own particular socio-economic challenges. Naturally, certain problems faced by other countries are similar to those faced by South Africa but others are significantly different. It would be astonishing, therefore, if each society's responses, including taxes, were identical. Yet, it seems, South Africa, like, no doubt, other similarly situated countries, has sought to homogenise its tax system with a notional OECD model, even though the socio-economic circumstances of OECD members are quite different from its own. (If I have portrayed this tendency on the part of developing countries as voluntarily mimetic, Joseph Stiglitz indicates that pressures exerted by the IMF may be the

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[30] See Chapter 2 above for an outline of the defining characteristics of the constitutional community and its particular historical experiences.

[31] Kriegler J in *Bernstein* v *Bester NO* 1996 (2) SA 751 (CC) [133], referring to the adoption of foreign legal principles.

real cause of the uniformity of fiscal strategies in those countries.[32]) Furthermore, although surveys, such as that of the Katz Commission, tend to review the tax provisions of other developing countries, these considerations are not conclusive.

(i) Reporting suspect

First, the fiscal reporting from certain of the countries surveyed may be suspect.[33]

(ii) Experience of peer countries

Second, it is also highly likely that developing countries surveyed have themselves followed trends established by developed countries (or prescribed by their agencies) rather than developing organic solutions to the challenges they have faced that are similar to those faced by South Africa.[34]

(e) Differences from OECD countries

There may be sound reasons for harmonising corporate tax laws with those of major trading partners,[35] but my concern lies with the just treatment of the individual members of the constitutional community.

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[32] See, generally, JE Stiglitz *Globalization and Its Discontents* (2002).

[33] My own working experience suggests that frequently the provisions recorded in collections of fiscal documentation for African countries vary considerably from practice.

[34] Columbia University's Initiative for Policy Dialogue, headed by Stiglitz, seeks to break the mould of the 'one model fits all' advice to developing countries, allegedly prescribed by the IMF.

[35] J Owens 'Taxation in a global environment' *OECD Observer* 1 March 2002 argues that intensified co-operation between countries on tax policy 'is the only appropriate response to the pressures of globalisation. National governments maintain their power to design their tax systems, but accept that these decisions will be influenced by international considerations'.

There are numerous structural differences between countries, particularly between postcolonial countries and their erstwhile colonists. I do not presume to offer an exhaustive list but suggest the following distinctions indicate that a constitutional scheme of taxation is likely to differ, particularly in emphasis, from schemes typical in the OECD.[36]

(i) Comprehensive welfare measures

Economically developed countries, from whose experience tax criteria are invariably derived, tend to operate well-established and comprehensive welfare systems. This is indisputably not the case in South Africa. The tax policy consequences of failing to recognise this crucial difference between developed and undeveloped welfare systems were starkly illuminated by the Katz Commission's consideration of VAT. The Commission concurred with an argument, which might have cogency for an OECD member, but certainly not for South Africa, that the most severe of the regressive effects of VAT could be rectified by targeted social assistance.[37] Yet, no such social assistance was available and none was expected in the immediate future.

(ii) Even wealth distributions

There are considerable differences in the patterns of wealth distribution between of South Africa and OECD members, particularly the countries of Western Europe. In approximate terms, South Africa has a Gini coefficient of 0,6,

[36] It would be idle to suggest that there is a common social philosophy informing the tax systems of all OECD members. The neo liberal ascendancy is clearly more evident in United States tax policies than those of other major economies. Nevertheless, there are many similarities in the tax measures of Western countries, particularly those attributable to homogenisation efforts made by members of the OECD and the European Union.

[37] Third Katz Report (note 7 above) para 2.4.4

indicating egregious inequality, compared to the norm of 0,25 for Western European countries, which indicates a realistically even distribution of wealth. The achievement of such a degree of wealth equalisation and a broadly held sentiment that the poor have been adequately protected appears to have led Western policymakers to lose enthusiasm for further radical egalitarian measures, such as, revitalised wealth transfer taxes.[38] There is no consensus in those countries that further egalitarian measures would produce significant socio-economic benefits. However, it would be idle to propose that such attitudes have relevance to contemporary South Africa, and, given the constitutional demand for progressively realised equality, a constitutional scheme of taxation must include meaningful egalitarian measures.

(iii) Experience of low inflation

Although South Africa has been fortunate in avoiding the rampant hyperinflation suffered by many developing countries, nevertheless, it has experienced persistent levels of inflation, which are alien to the political memory of developed countries, where employment has been ruthlessly sacrificed as a bulwark against price increases.[39] Certain members of the Taylor Committee observed in this regard that the current government has taken inappropriate tax advice from countries, which, unlike South Africa, have experienced low rates of inflation.[40] An instantiation of this practice appears to be the controversial policy choice to

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[38] AA Tait 'Net wealth, gift and transfer taxes' in S Cnossen (ed) *Comparative Tax Studies: Essays in Honor of Richard Goode* (1983) 139

[39] JK Galbraith *The World Economy Since The Wars* (1994) (1995 reprint) 256

[40] V Taylor (Chairperson) *Report of the Committee of Inquiry into a Comprehensive System of Social Security for South Africa: Transforming the Present – Protecting the Future* RP 53/2002 (2001) para 9.2.4.2

refrain from index-linking capital gains.[41] It appears that the United Kingdom's experience was influential here,[42] notwithstanding the fact that the United Kingdom has experienced low rates of inflation for some two decades. Zimbabwe, which has experienced long-term, high rates of inflation and index-links capital gains, may have provided better guidance in this regard.

(iv) Comfortable majorities

In the advanced economies, it is 'the large, economically and socially comfortable community' which has the democratic power to rule in its own interest, unconscious of the claims and aspirations of those who live on the margins or outside the modern economy.[43] Conversely, in South Africa, the historically excluded potentially hold the preponderance of democratic power and it is their experience of exclusion that the Constitution seeks to redress. There is, then, both a practical and fundamental constitutional urgency to a consideration of the expectations of the dispossessed. Unlike the situation in the West, elected government cannot ignore their claims.

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[41] Since a capital gain may arise over several years, the nominal value of the gain may exceed the real value of the gain. Therefore, capital gains tax (CGT) systems tend to adjust the nominal value of a capital gain to take into account the effects of inflation. Such so-called index linking can be administratively burdensome. To simplify its CGT system, South Africa chose take account of inflation by including only 25 per cent of a capital gain rather than index linking. (See Eighth Schedule to the Income Tax Act 58 of 1962.) This has the effect of disconnecting nominal and real gains. Thus, a gain obtained in the short-term may have suffered negligible loss in real value, whereas the real value of a long-term gain may be considerably less than 25 per cent of the nominal value.

[42] Treasury (note 7 above)

[43] Galbraith (1995) (note 39 above) 263

VI CONCLUDING COMMENTS

Many of the expectations of the constitutional community relate to prudent and honest governance. Such expectations are common to people everywhere, if, perhaps, so well met in developed countries so as to be taken for granted. People around the world commonly expect effectiveness, transparency, accountability and coherence on the part of those who govern them. However, it is the pervasive injustice of the vastly differing conditions of the privileged and the dispossessed - not uniquely but spectacularly met in one country - which distinguishes South Africa. More than any other quality, it is a restitutive, substantive form of justice that must distinguish a constitutional scheme of taxation. A dogged following of the strategies of the OECD countries that have been constructed in the context of their very different circumstances cannot be a sufficient response to the needs and expectations of the constitutional community. Fundamentally, immanent human dignity, marrying the enabled freedom of bio-liberty with equality, must inform a constitutional scheme of taxation.

CHAPTER 12 DIGNITY AND A CONSTITUTIONAL SCHEME OF TAXATION

I INTRODUCTION

In Chapter 4, I identified human dignity as the core value of the Constitution,[1] which informs other values and establishes the fundamental constitutional expectation. Members of the constitutional community must experience the state's cherishing of human dignity in practical ways. The first objective of a constitutional scheme of taxation is to ensure that human dignity is a lived experience for taxpayers

II DIGNITY AND INCLUSION

(a) Inclusion and equality

Dignity may be actualised through policies of inclusion. While such inclusion is crucial in itself, it also establishes a platform upon which constitutional policies, particularly those aimed at achieving equality, may be built. Arriving at equality via inclusion prevents an assessment of equality in taxation from being introspective, and merely taking account of the circumstances of those whom the current law charges with a tax. Inclusion brings into consideration both those who have been excluded and the circumstances contributing to their exclusion. Following such a fuller consideration, the needs and abilities of those previously excluded may be incorporated into programmes to promote equality.[2]

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[1] Constitution of the Republic of South Africa Act 108 of 1996

[2] Canadian courts have adopted a purposive interpretative strategy in engaging with the idea of equality by concentrating on a law's content, purpose, and impact on those to whom it applies, and, significantly, by considering the circumstances of those whom it excludes from its application. See J Kentridge 'Equality' in M Chaskalson et al (eds) *Constitutional Law of South Africa* (1996, 5 rev 1999) 14-i, 14-4

(b) Exemption and exclusion

Historically, the exclusion of Blacks and women from full participation in the economy and thus the hegemonic tax structure in South Africa has entrenched their alterity.[3] The present consequences of this historical exclusion are demonstrated by poverty data, which show the poor to be predominantly Black and female.[4] Similarly, many community members, disproportionately represented by Blacks and women, continue to be excluded from the income tax net and hence the equitable considerations of the tax system.[5] Exemption of those whose income is below a certain level is, of course, an equitable measure but one that fails to consider the vastly differing circumstances of those who are excluded. Furthermore, such exclusion obviates an holistic and integrated consideration of equality across the entire community.[6] Consequently, inclusion must precede an application of traditional conceptions of equality in taxation.

A constitutional scheme of taxation will not simply look to a concept of immanent human dignity as an ethical benchmark, rather it will seek to promote that ideal, by ensuring that opportunities to participate in the activities of the community are

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[3] See Chapter 2, section II above for comments on the historical exclusionary effects of colonialism, apartheid and patriarchy on taxation in South Africa.

[4] A Whiteford, D Posel & T Kelatwang *A Profile of Poverty, Inequality and Human Development in South Africa* (1995) 5

[5] Adam Smith memorably described taxation as 'a badge of liberty'. (See A Smith *An Inquiry Into the Nature and Causes of the Wealth of Nations* (1776) (1952 reprint) 377.) Exclusion from a consideration for taxation represents exclusion from the full experience of democratic freedom.

[6] Currently, South African income tax policy concerns itself only with issues of equality (vertical equity) between those whose taxable incomes fall between R30 000 and R255 000 per annum. (See Schedule 1 to the Exchange Control Amnesty and Amendment of Taxation Laws Act 12 of 2003.)

enjoyed by all. An integrated benefit/contribution structure, which incorporates a state guaranteed minimum income, will best promote this goal.

III STATE GUARANTEED MINIMUM INCOME

(a) Background

A state-guaranteed minimum income for all citizens, also known as a 'social grant', 'demogrant', 'negative income tax', or, with an eye to acronymic reception, 'basic income grant (BIG)', was first proposed in 1942 by Juliet Rhys-Williams. Her proposal was followed by Milton Friedman in 1962, James Tobin and others in 1967, and was remarkably espoused in 1972 both by George McGovern, the progressive Democrat candidate for the United States presidency, and Edward Heath's United Kingdom Conservative Party.[7]

There is catholic support for a guaranteed minimum income for everyone in the community at a philosophical level. Naturally, there is communitarian motivation for the proposition that everyone should enjoy a minimum share in the social product.[8] However, Hayek, the doyen of individualism, who was of the opinion that assuring 'a certain income to particular groups' should be 'outlawed as

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[7] AB Atkinson *The Economics of Inequality* (1975) 227

The supra-ideological appeal of a guaranteed minimum income is further indicated by the fact that Rhys-Williams was a Conservative Party Member of Parliament whose proposals were submitted to the 1952 Royal Commission of Taxation by the Liberal Party.

See C Balfour 'Selling Basic Income to U.K. Conservatives' BIEN International Congress, Amsterdam, 10-12 September 1998 for a discussion of the compatibility of a guaranteed minimum income with compassionate conservatism.

[8] See M Waltzer 'Welfare, Membership and Need' MJ Sandel *Liberalism and Its Critics* (1984) 200

immoral and strictly anti-social', also supported 'a flat minimum for all who cannot earn more in the market'.[9]

Currently in South Africa, the BIG enjoys the support of the grassroots African National Congress,[10] the liberal Democratic Alliance, and a broad coalition of church and union groups.

If a guaranteed minimum income has such broad support why, it may be asked, does it not feature as a normal part of fiscal structures.

(b) Objections to state guaranteed minimum income

As a preliminary point, several countries, including New Zealand, the United Kingdom and the United States, have incorporated discernible elements of a negative income tax into their earned income tax credit schemes. However, these arrangements tend to aid low and middle-income earners, normally those with families to support, while separate schemes provide benefits for the unwaged outside of the tax system.[11]

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[9] F A Hayek *Law, Legislation and Liberty* Volume 2 *The Mirage of Social Justice* (1976) 150
As noted, the pre-eminent free market economist, Milton Friedman, has also promoted a guaranteed minimum income.

[10] F Haffajee 'Ideals of an African Utopia hamper the BIG, big time' *Mail & Guardian Online* Tuesday, 3 June 2003 reported that, although the BIG enjoys broad support amongst the ranks of African National Congress members, President Mbeki is not a supporter.

[11] The Alaska Permanent Fund is a public trust fund that pays all Alaskan residents an annual dividend from oil revenues. However, as this fund makes a flat payment without consideration of the recipients' circumstances, it is of minimal relevance to the current discussion. See J Kasson 'The Creation of the Alaska Permanent Fund: A Short History' (1985) Alaska Permanent Fund Corporation Trust Paper V.

(i) Existing welfare benefits

One of the most significant problems faced by advanced welfare states in introducing a guaranteed minimum income lies in synthesising existing welfare benefits with an integrated income tax-benefit structure. Frequently there is an objectionable discontinuity, whereby a small change in the circumstances of a beneficiary/taxpayer, such as moving from social security benefits to low paid employment, quantitatively leads to a large change in tax due or welfare payment lost.[12] In its latest income tax-benefit scheme, the United Kingdom uses 'taper rates' to ensure that no one should face the situation whereby she is no better off if she works or has saved for her retirement. Nevertheless, because of the 'clash of benefits', even these carefully constructed taper rates cannot prevent marginal loss at crossover from occasionally exceeding the highest marginal income tax rate of 40 per cent.[13]

South Africa posses a dubious advantage in introducing a guaranteed minimum income, namely its lack of existing welfare benefits.[14]

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[12] WJ Baumol & AS Blinder *Economics: Principles and Policy* 5 ed (1991) 809 Discontinuity of this nature can be viewed as a breach of the principle of equal treatment across time. (See CS Shoup *Public Finance* (1969) 23.)

[13] See M Brewer, T Clark & M Myck 'Credit where it's due? An assessment of the new tax credits' The Institute for Fiscal Studies (Commentary 86) (2001) 39 on the United Kingdom's Working Families Tax Credit (WFTC) scheme, which is a form of negative income tax.

[14] As at 1 December 2003, it appears that the government has rejected the recommendations of the Taylor Committee (V Taylor (Chair) *Report of the Committee of Inquiry into a Comprehensive System of Social Security for South Africa: Transforming the Present – Protecting the Future* RP 53/2002 (2001)) with regard to the BIG. There appears to be some confusion with regard to the operation of a minimum income and income tax. Since I envisage a guaranteed minimum income integrated within a comprehensive income tax system, and not a separate benefit, any such objections derived from confusion are easily countered.

Indubitably, South Africa cannot afford, at present, to institute the kinds of welfare measures that have evolved over many years in Western countries. However, the expectations of the constitutional community are not extravagant. For instance, the plaintiffs in *Grootboom*[15] sought a level of assistance from the state that would have been considered derisory in developed countries. Crucially, a guaranteed minimum income would act as a safety net against extreme poverty, not as a guarantee of luxury. The virtually blank slate of social security in South Africa permits the institution of a basic comprehensive social safety net afresh, without the concerns of causing current beneficiaries to be worse-off.

(ii) Stigma

Advanced welfare states commonly face the problem of overcoming the stigma of benefit receipt and a consequent lack of take up. The paradox of needy people being unwilling to register for certain benefits, for which they are eligible, tends to occur when some benefits require means-testing but others do not. (Australian experience suggests that if means testing is the norm for deciding eligibility for tax credits or benefits, then, stigma ceases to be an issue.[16]) This is most undesirable. As Galbraith observes, 'Those in need have enough to suffer without being socially stigmatised'.[17] However, since South Africa has no history of general social security, it is unlikely that social stigma will present significant obstacles to the successful implementation of a guaranteed minimum income.

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[15] *Government of South Africa* v *Grootboom* 2001 (1) SA 46 (CC)

[16] Anon. 'The tender trap' *The Economist* 3 August 2002

[17] JK Galbraith *The Good Society: The Humane Agenda* (1996) 27

Furthermore, means testing beyond that necessary to establish actual income will not be relevant to a constitutional scheme of taxation.[18]

Beyond these implementation and technical calibration problems, the prime objection to a guaranteed minimum income lies with the prospect of its giving rise to a disincentive to work.[19]

(iii) Guaranteed minimum income and labour incentives

(aa) Constitution and free-riding

It is self-evidently unfair to one's fellow community members to free ride.[20] The expectations of the constitutional community encompass the rights, privileges and benefits of membership but also the concomitant duties and responsibilities of this inclusive belonging. An expectation that the community will support a member who is unable to find work is reflected by an expectation that such a person will seek work. Thus, there would be ethical objections if a guaranteed minimum income discouraged work. However, it is most unlikely that a guaranteed minimum income would have that effect.

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[18] Means testing may take into account putative income, for example, rent which could be earned from renting out a spare room. While this practice has its merits, I oppose imputation and propose that only taking actual income should be taken into account. (See Chapter 16, section III below for a discussion of imputation.)

[19] HM Treasury 'Tackling Poverty and Making Work Pay: Tax Credits for the 21st Century' Discussion paper (2000)

[20] I note that free riding is more easily condemned than identified.

(bb) Money and motivation to work

It is commonly assumed that a guaranteed minimum income is an inherent disincentive to work. Consequently, the principal concern in implementing such an arrangement lies in setting a minimum income level that eliminates poverty but maintains an incentive to work.[21] However, this concern is derived from an implausible premise that money is the only motivator for work.

Countering this assumption that work is a disutility, Will Hutton argues that work is a 'means of acting and interacting with the world that fulfils an individual's humanity' and concludes that 'Work is a supremely social act' which 'brings self-esteem' and 'sharpens the capacity to be and to do'.[22] His may be an idealised view of work that fails to acknowledge that many forms of labour are dangerous, arduous and dehumanising, nevertheless, it establishes the plausible proposition that a job is not a simple exchange of labour for a negotiated price. Management theorists have long discounted money as an employee motivator, recognising that financial rewards and incentives 'work largely negatively'.[23]

Research into happiness confirms this view and refutes the assumption that comprehensive, European welfare systems discourage labour and thereby cause unemployment. Jobs bring happiness, not compensation for unemployment.[24]

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[21] Baumol & Blinder (note 12 above) 810

[22] W Hutton *The State We're In* (1995) 231

[23] PF Drucker *The Practice of Management* (1955) (1970 reprint) 363
He continues: 'Discontent with financial rewards is a powerful disincentive, undermining and corroding responsibility for performance. But satisfaction with monetary rewards is not, the evidence indicates, a sufficient motivation. It motivates only where other things have made the worker ready to take responsibility'.

[24] BS Frey & A Stutzer 'What Can Economists Learn from Happiness Research?' *J of Economic Literature* Vol XL (2002) 402, 427

Despite financial compensation, people tend to suffer significant reductions in happiness from unemployment,[25] both when they are personally made jobless and when there is a high level of unemployment in their community.[26]

There can be little doubt that tax-benefit schemes can act as a disincentive to work. For instance, the psychological opportunity costs and utility trade-offs are particularly costly for working mothers.[27] Thus, tax-benefit programmes aimed at bringing women into the work force require careful calibration. Furthermore, the incentive effect of tax credit schemes in the advanced industrial economies is frequently complicated and opaque,[28] suggesting that beneficiaries may be ill-equipped to make rational economic decisions about a trade-off between work and leisure.

However, although anomalies in a complex system of taxes and benefits may occasionally give rise to significant material disincentives to work, particularly for those whose incomes straddle critical thresholds,[29] these anomalies are

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[25] R Di Tella, RJ MacCulloch & AJ Oswald 'The Macroeconomics of Happiness' (2001) Department of Economics, University of Warwick Working Paper 20

[26] Frey & Stutzer (note 24 above) 420

[27] A St Martin & P Whiteford 'More jobs and better pay' *OECD Observer* 26 September 2003 report that the United Kingdom's WFTC requires recipients to work at least 24 hours a week. There is a huge spike in the numbers of women who work this number of hours, indicating the strong opportunity costs they experience in working.

[28] See Brewer et al (note 13 above) 33 on the complexities of the WFTC.

[29] St Martin & Whiteford (note 27 above) observe that the WFTC has actually decreased the number of working- women. Since incomes are aggregated for calculating the WFTC, when a second spouse joins the workforce, benefits may be lost and the second spouse's income taxed at a high marginal rate.

manifestations of faulty benefit engineering, not faulty principle. Policymakers may assume that *rewarding* work is a normal element of the conception of the good life that most, if not all, people will seek.[30] Ultimately, as Galbraith concludes:

> That some will choose not to work must be accepted. Socially compensated idleness unquestionably affronts deep-seated social attitudes; public pressure may, indeed should, be exerted to get able individuals into the work force, the exercise of such pressure being undoubtedly enjoyed by some. Starvation is not, however, a tolerable sanction. Some abuse, as it will be regarded, is inevitable in this part of the welfare system and it must be tolerated.[31]

In South Africa, the prospect of a social grant engendering a disincentive to labour seems practically implausible. Propositions of free-riding and voluntary unemployment assume that jobs are available but unfilled, that there are able but unwilling candidates for those jobs. However, it seems likely that, because of the skills deficit there is a surplus of willing candidates unable to perform the

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[30] J Finnis *Natural Law and Natural Rights* (1980) 86

[31] Galbraith (note 17 above) 28
Similarly, Eduardo Matarazzo Suplicy, an economist and parliamentarian, who introduced legislation to establish a guaranteed minimum income to Brazil in 1991, questions:
'Will there be an incentive to idleness? What will we do with those that have an inevitable tendency to be lazy? We shouldn't worry so much about them. After all they will be few. There are many important activities, such as the nutrition of babies, taking care of the children and of the old that are so important and not always paid by the market...it is part of the human nature that people want to progress. Well, if we allow those who are rich to receive an income even without working, why shouldn't we allow everyone, rich and poor, to have a modest basic income?'
EM Suplicy 'Legitimizing basic income in developing countries: Brazil or the answer is blowin' in the wind' Paper presented at a forum of the Basic Income Grant Coalition at the NGO Global People's Forum, Johannesburg, 28 August 2002.

available jobs. Consequently, the principal effect of a guaranteed minimum income would be mitigation of quotidian struggle, not vitiation of a work ethic.

IV CONCLUDING COMMENTS

I have not considered the budgetary implications of a guaranteed minimum income but note that R100 per month is broadly accepted as reasonable and feasible within current budgetary constraints by supporters of the BIG (including the fiscally responsible Democratic Alliance). In the advanced welfare states, the prospect of increasing income tax rates to support a negative income tax scheme has presented a powerful counter argument. (A negative income tax tends to bring a larger number of people into the benefit net in order to smooth the transition from full benefit to no benefit.[32]) A prudent and honest government must consider reasoned arguments for and against a guaranteed minimum income.[33] Nevertheless, the pertinent question for the constitutional community is not whether it can afford a guaranteed minimum income but whether the fundamental constitutional respect for human dignity can be realised without such a measure.[34] Other than a guaranteed minimum income, there is no obvious alternative means of eliminating extreme poverty and its attendant humiliation.

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[32] Baumol & Blinder (note 12 above) 809

[33] Sean Archer, for instance, raises concerns about the financial and administrative feasibility of a Basic Income Grant in South Africa. See S Archer 'Social and Economic Rights in the South African Context and the Role of a Basic Income Grant' Paper presented to Basic Income European Network, 9th International Congress, Geneva, 12-14 September 2002

[34] I outline certain of the long-term economic benefits of a state guaranteed minimum income in Chapter 21, section VII below. My comments are based on the finding of the Taylor Report. See Taylor Report (note 14 above) Chair) Chapter 5.

CHAPTER 13 FREEDOM AND A CONSTITUTIONAL SCHEME OF TAXATION

I INTRODUCTION

The scope of a constitutional conception of freedom is wide, and, when the context requires, incorporates awareness of autonomy and negative liberty.[1] For instance, the historical denial of individual identity, manifest in the ways Blacks and women have experienced taxation,[2] brings urgency to the issue of individuation or autonomous treatment of taxpayers.[3] However, the pressing freedom issue lies with bio-liberty, specifically the liberation of all members of the constitutional community from corporeal need. A constitutional tax system must be enabling, raising sufficient revenue to fund the programmes that may liberate all community members from extreme material need, particularly income poverty.[4] Fundamental bio-liberty will be realised through the guaranteed minimum income element of a reformulated comprehensive income tax. This is the crucial positive manifestation of bio-liberty but there is also a negative aspect.[5]

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[1] See Chapter 5 above for a discussion of freedom under the constitutional dispensation.

[2] See Chapter 2, section II above for an outline of certain discriminatory provisions that have featured historically in South African taxation.

[3] See Chapter 17 below for a discussion of the taxpaying unit.

[4] Revenue targets must spring from honest and prudent budgeting to meet the needs of the constitutional community. Government's efforts to meet its constitutional obligations should not be guided by antecedent revenue yield.

[5] I have identified bio-liberty as being concerned, firstly, in a positive sense, with the maintenance of physical and psychological integrity (freedom from corporeal need) and, secondly, in a negative sense, freedom from infractions against the body. See Chapter 5 above for a discussion of a conception of freedom appropriate for the constitutional community.

The weight of these different freedom concerns will be reflected in a constitutional scheme of taxation.

II NEGATIVE BIO-LIBERTY

Numerous rights and freedoms are pertinent to the dialogue between the taxpayer and the collection agency, particularly when the taxpayer is suspected of having committed a tax-related crime.[6] These specific provisions reflect the traditional liberal project of establishing 'inviolable' individual rights but are ancillary to a substantively just scheme of taxation. A more general and contemporarily relevant freedom concern lies with bio-liberty, in a negative sense. A breach of such negative bio-liberty will occur when the intensity or techniques of intrusion or coercion employed under a scheme of taxation cannot be justified. Naturally, with regard to a constitutional scheme of taxation, the criteria for justification are provided by the Constitution.

(a) Intensity of taxation

(i) A community's experience of intense taxation

The possibilities for tax intensity may not be obvious from the texts of national legislation but are remarkable when revealed by sociological investigation.

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[6] For instance, the just procedures for arrest and trial set out in section 35 of the Constitution of the Republic of South Africa Act 108 of 1996 (Constitution).

However, the courts have taken a robust line in ensuring the fiscus is not prejudiced by individual taxpayer's challenges to illiberal provisions contained in tax statutes. See, for instance, *Hindry* v *Nedcor Bank Ltd* 1999 (2) SA 757 (W) and *Metcash Trading Ltd* v *Commissioner, South African Revenue Service* 2001 (1) SA 1109 (CC). These decisions may be distinguished from *First National Bank of SA Ltd t/a Wesbank* v *Commissioner, South African Revenue Service* 2002 (4) SA 768 (CC), which did not concern a challenge by a taxpayer to a draconian provision, rather a challenge by an innocent third party to arbitrary deprivation of property.

Patrick Harries compiled a taxonomy of levies payable during the 1980s by the members of the Pakuri community in Giyani (an area of the then quasi-autonomous political subdivision of Gazankulu) that recorded an arresting instantiation of the operation of bio-power in a tax system.[7] According to his analysis, taxes levied in Giyani included:

- Gazankulu Special Tax (R2,50 per annum);
- income tax; and
- sales tax.

In addition, taxes payable to the tribal chief comprised the following:

- 'an annual employers' tax of R1 paid by all migrant workers;
- a dog tax, dependent on the sex of the animal (R1 per male, and R2 per female);
- customary levies (male and female circumcision ritual levies of R6,50 and R10 respectively);
- Gaza herbalists fee of R15 and R10 paid respectively by specialist and practising diviners;
- cost of a complaint before tribal court, R16,50 with half of all fines accruing to the tribal account;
- special levies (decided by the chief's council) accrued to the chief;[8]
- tribal levy of R14 per annum for local administration costs;
- a *khonza* fee of R20 payable by all immigrants and R20 *valelisa* fee for those wishing to depart;
- a tax on wood fuel, with heavy fines for evasion;

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[7] P Harries 'A Forgotten Corner of the Transvaal: Reconstructing the History of a Relocated Community through Oral Testimony and Song' in B Bozzoli (ed) *Class, Community and Conflict: South African Perspectives* (1987) 93

[8] For example, in 1984 a special tax was levied in order to fund the purchase of a motorcar for chief Makuleke. See note 7 above.

- whilst there was no thatching fee in place at that time, a 20c tax on each pole cut from the bush for construction of rondavels and cattle pens was payable.

Further, a levy was demanded by Ximoko, a traditionalist political party, and regarded as a tax by those required to pay.

The magistrate, in turn, collected for the tribal account:

- R1 on agricultural plots;
- R2 on residential stands;
- 25c per capita dipping fee for cattle;
- 20c per capita grazing fee for cattle;
- R1 labour bureaux registration tax.

In addition, licence fees for cars and businesses were payable.

(ii) Tax metastasis

As extreme an example as it may be, this taxonomy demonstrates how specific levies and charges on a broad range of activities can metastasise into a totalising interference in people's bodies and lives. The Giyani scheme of taxation is a model of intensity in taxation, self-evidently unjustifiable in constitutional terms, (although one unlikely to be repeated). Nevertheless, this example provides a warning, particularly with regard to minor taxes, such as user charges, which, in aggregate, can require an unjustifiably intense monitoring, measuring and charging of people's activities and existence.

(b) Coercion in taxation

(i) Coercion: the example of the natives tax

A stark example of unjustified coercion in taxation is provided by the natives tax.[9] Under that tax, a taxpayer who lacked funds was presented with the coercive alternatives of obtaining work in the cash economy or facing the prospect of prosecution: the latter option normally resulting in incarceration with hard labour.[10] In this way, a causative nexus may be discerned between the imposition of a tax and a coercion to work. Although not a tax directly imposed on income, the natives tax gives some meaning to Nozick's famously hyperbolic proposition that a tax on labour 'is on a par with forced labour'.[11] There is no contemporary tax arrangement in South Africa that bears comparison to the disciplinary rigour of certain forms of Black taxation. The disregard for personal

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[9] See Appendix below for an overview of the Natives Taxation and Development Act 41 of 1925. Behaviour modifying taxes are, by design, coercive. I consider this type of tax in Chapter 20 below.

[10] Factual inability to pay was not generally a sufficient excuse. In terms of section 4 of the Natives Taxation and Development Act, a taxpayer could only be excused if factually indigent and unable to work through good cause. It was held in *R* v *Mxonywa* 4 SATC 105 1928 EDL 26, for example, such 'good cause' did not necessarily include being imprisoned during the period of assessment.

[11] R Nozick *Anarchy, State and Utopia* (1974) (1993 reprint) 169
There is another reason why Nozick would be averse to a tax on labour. J Locke *Two Treatises of Government* (1690) (Everyman ed 1924) (1990 reprint) 130 argued: 'Whatsoever, then, he removes out of the state that Nature hath provided and left it in he hath mixed his labour with it, and joined to it something that is his own, and thereby makes it his property'.
In other words, interference with labour (in the unrealistic sense that Nozick conceives it) interferes in the process of property acquisition. Although a right to income is property in the modern conception, Locke would not have conceived of remuneration as property.

liberty manifest in the Giyani tax structure or the natives tax are unlikely to be repeated but, in a time of expanded expectations for freedom, its denial, in some form or other, may be envisaged.

(ii) Coercion and income tax

Returning to Nozick's proposition that income tax is equivalent to forced labour, modern income taxes do not coerce people into working in a way that even the most fanciful imagination could compare to corvée. (However, in the absence of a social security safety net, people must, in a capitalist economy, work or obtain money in other ways in order to survive.) With regard to labour, income tax merely claims a portion of the consideration exchanged for labour performed. If I do not work, or work for no reward, no income tax is payable. It may be inferred that Nozick sought to link a tax on labour with physical coercion, which faces universal opprobrium. Had he proposed that a tax on labour is tantamount to theft of property, it would be more coherent logically. Income tax is only levied once labour has been exchanged for quantifiable reward, and is charged against the value of that reward. However, such a proposition is easily dismissed as ethically implausible.[12]

(iii) Preference and coercion

When a preference is conferred on a particular activity or good, an opposite coercive force against participation in the activity or consumption of the good not preferred may be discerned. For instance, if good A is exempt from excise but a substitute good B is subject to excise, a consumer is indirectly coerced into consuming good A. Thus, while the justifiability of a preference is principally considered in the light of the equality, the conferral of a preference can be

[12] Nozick (note 11 above) did not accept the empirically verifiable proposition that wealth is socially produced or that labour is invariably a cooperative activity.

considered from the perspective of coercion. An instantiation of this may be discerned in a proposal made by the Australian Labor Party with an aim to making Australia's value-added tax (VAT) equivalent, goods and services tax (GST), fairer for lower income groups. This proposal entailed zero-rating long-term rents for residential trailer parks. Such accommodation will be used by some members of lower income groups but insignificantly by members of higher income groups. Clearly, this measure would privilege certain status-holders (those who live in trailer parks) but not other low-income families who meet their accommodation needs, say, by sharing a house. It is then suspect from the perspective of horizontal equity. However, less obvious, the proposal has a coercive element, since it presupposes and consequently directs how poor people *ought* to meet their accommodation needs. Furthermore, it is not far-fetched to suggest that such an initiative may have the socially segregative effect of coercing low-income families away from formal housing where schools, hospitals and other social infrastructure may be expected.

(c) Intrusion in taxation

Stephen Moore proposed the introduction of federal VAT in the United States partly because it would be considerably less intrusive for individuals than the current income tax.[13] This seems, at first blush, to be indisputable, although, for the many South African taxpayers, who are subject to the Standard Income Tax on Employees (SITE) only,[14] there can be little practical difference, from a perspective of intrusion, between income tax finally withheld at source and a

[13] S Moore 'The Economic and Civil Liberties Case for a National Sales Tax' before the Hoover Institution conference 'Frontiers of Tax Reform' National Press Club Washington, DC, 11 May 1995

[14] In terms of the Fourth Schedule to the Income Tax Act 58 of 1962, SITE operates as a final withholding tax on remuneration. Many other taxpayers are not required, in practice to render an annual tax return (Form IT12) or must render a simplified version.

comprehensive consumption tax. Naturally, the American experience of intrusiveness on the part of its revenue collection agency cannot be directly transposed onto South Africa, but nor can its likely correspondence be denied, however less pronounced for most taxpayers it is likely to be. Nevertheless, the processes of audit and investigation required by income tax administration are an unavoidable fact of modern economic life and are normally far less intrusive than certain horizontal interactions and processes, such as applying for a job, seeking credit or taking out an insurance policy. What is frequently presented as an egregious manifestation of state control is, in reality, a caricature, taken out of the context of complex, modern organisational systems and their informational demands. (This consideration has even greater relevance for public corporations. Besides other reporting requirements of government, the informational demands of private bodies, for instance, stock exchanges, credit rating agencies and investment analysts are surely as demanding as those of a revenue collection agency.) The structures and mechanisms of taxation tend to mirror economic developments and, if these give rise to complex transactions and arrangements, then, by necessity, tax provisions and requirements will be similarly complex and require concomitant, sophisticated processes of verification.

While alert to unjustified infractions of negative bio-liberty, the real and pressing concern for a constitutional scheme of taxation lies with the position of those whose bio-liberty is denied because of material lack and poverty.

III AUTONOMY AND TAXATION

(a) Autonomy and tax default

Any notion that a person may enjoy the freedom to be left alone to disobey those of the community's tax laws with which she does not agree may be dismissed outright.[15] Democratic structures exist for promoting political views and interests,

[15] Langa DP observed in *City of Pretoria* v *Walker* 1998 (2) SA 363 (CC) [65]:

and the judicial process permits challenging laws that contravene basic rights.[16] It is an inevitable consequence of situation in the constitutional community that its laws must be obeyed. Whatever one's conscience may suggest, there can be no 'contracting out' in whole or part from constitutional duties.[17]

(b) Tax evasion and avoidance

Tax evasion, whether motivated by conscience or greed, is a crime, and must be treated as such. Conversely, tax avoidance may be morally repugnant but is not a crime. As the Court observed in the English case of *Vestey's (Lord) Executors*

'The kind of society envisaged in the Constitution implies also the exercise of responsibility towards the systems and structures of society. A culture of self-help in which people refuse to pay for services they have received is not acceptable. It is pre-eminently for the courts to grant appropriate relief against any public official, institution or government when there are grievances. It is not for the disgruntled individual to decide what the appropriate relief should be and to combine with others or take it upon himself or herself to punish the government structure by withholding payment which is due.'

[16] The robust approach to freedom of religion and law breaking demonstrated in *Prince* v *President, Law Society of the Cape of Good Hope* 2002 (2) SA 794 (CC) indicates that religious objections to taxpaying, for instance, on the grounds of the way in which the revenues are spent, would not be successful.

[17] Paying taxes to fund belligerent activities on the part of government is problematic for pacifist religious groups and others opposed to war. A Peace Tax Bill, which is regularly but ineffectually introduced to the United States Congress, would permit taxpayers to assign the defence portion of their taxes to supporting peace work and social services. See G Smith 'The Noble Tradition of American Tax Resistance' *AlterNet* 7 April 2003.
This desire for hypothecation may be distinguished from the more fundamentally dissenting approach of HD Thoreau *The Variorum Civil Disobedience* (1849) (1969 reprint) 359 who declared: 'it is for no particular item in the tax-bill that I refuse to pay it. I simply wish to refuse allegiance to the State, to withdraw and stand aloof from it effectually. I do not care to trace the course of my dollar; if I could, till it buys a man or a musket to shoot one with, - the dollar is innocent, - but I am concerned to trace the effects of my allegiance.'

v *Inland Revenue Commissioners*: 'Tax avoidance is an evil, but it would be the beginning of much greater evils if the courts were to overstretch the language of the statute in order to subject to taxation people of whom they disapproved'.[18] The legal rules that support contracts, and allow individuals to order their affairs, are manifestations of community cooperation. Complex legal arrangements, entered into to avoid tax, abuse civic privileges and should be rigorously countered. It is, therefore, incumbent on the legislature to combat schemes of avoidance through appropriately drafted measures that conform with the rule of law.[19] The pertinent constitutional issue with regard to tax avoidance, is not one of freedom, but lies in ensuring that the law is constructed and administered in such a way as to ensure that all community members make a fair contribution to the fiscus.[20] This is fundamentally an issue of equality.

(c) Possibilities for autonomy

Despite these basic restrictions on autonomy, neither the unavoidable prescriptions of the Constitution nor an existential fact of interdependence excludes the possibility of some degree of autonomy of individuals or groups within a scheme of taxation. As Sachs J urged in *Ferreira*, the incorporation of interdependence into the idea of constitutional freedom 'should be accomplished in a manner which reinforces rather than undermines autonomy and upholds rather than reduces the value of maximising effective personal choice.'[21]

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[18] 1949 1 All E R 1108, cited by AP De Koker & G Urquhart *Income Tax in South Africa* (1992) para 26.1

[19] See Chapter 8 above for a discussion of the rule of law as it may apply to a constitutional scheme of taxation.

[20] After the Bill of Rights, the Courts have taken a robust line in ensuring the fiscus is not prejudiced by individual challenges to tax provisions. See note 6 above.

[21] *Ferreira* v *Levin NO* 1996 (1) SA 984 (CC) [251]

(i) Rules within the community's rules

In a classical sense, autonomy or self-governance does not connote insularity and boundless licence, after all, when territories are described as being autonomous it is understood that the degree of self-governance they enjoy is limited. Comparably, within the framework of the greater community's laws and norms, individuals and groups of individuals may exercise autonomy to the extent that they are free to create and abide by their own rules within the greater community's rules, provided their private rules do not transgress the general laws.[22] Members of a religious community may, for instance, adhere scrupulously to dietary restrictions and demand the same of their fellows, but the state will not enforce these rules. Conversely, the tenets of a religious community may in good faith permit, or even require, behaviour, such as the consumption of marijuana, which is forbidden by the state.[23]

(ii) 'Private taxes'

With specific regard to taxation, it is self-evident that a member of the constitutional community is not at liberty to decide her own income tax burden once income has accrued. If, for instance, the additional rules of her religious community require her to pay a tithe to her church – what may be loosely described as a 'private tax' - this duty to a select community does not substitute

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[22] The principle that the law should apply generally to citizens is crucial to a polity that privileges human dignity and equality. See, for instance, *Christian Education South Africa* v *Minister of Justice* 1999 (1) SA 6 (CC) [52]. This may be compared with the approach of the United States Supreme Court in *Wisconsin v Yoder* 406 US 205 (1972) that, put simply, the state's right to educate all children was found to be subordinate to the rights of certain parents' to deny their children modern education.

[23] See Chaskalson CJ, Ackerman and Kriegler JJ in *Prince* (note16 above) [142].

her obligations to the greater community.[24] Fundamentally, the state does not conceive this private obligation in the way of a tax. Yet, for the following reasons, this is an incomplete description of the way in which national taxation interacts with private taxes:

(aa) Community institutions and private rules

First, if the requirements of private law relating to obligations are met, the state will generally permit the use of the general community's judicial institutions to enforce the private tax obligation.[25]

(bb) Deduction of tithes

Second, even jurisdictions that scrupulously separate church from state commonly permit contributions to religious organisations to be deducted from the tax base for the purposes of national tax calculation.[26] In such a way, an autonomous private tax can substitute a citizen's economic obligation to the

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[24] Title 26 USC 1402 (h) authorises the (United States Federal) Secretary of Health, Education, and Welfare to exempt members of 'a recognized religious sect' existing at all times since December 31, 1950, from the obligation to pay social security taxes if they are, by reason of the tenets of their sect, opposed to receipt of such benefits and agree to waive them, provided the Secretary finds that the sect makes reasonable provision for its dependent members.

[25] In nineteenth century Massachusetts, and presumably elsewhere, a church taxed each member of its congregation, with the taxes being billed and collected by town officials. Thoreau was wrongly prosecuted for non-payment of a tithe to a church of which he was not an attendant. See Thoreau (note 17 above) 366 note 34.

[26] Section 18A of the Income Tax Act permits an individual to deduct against her income tax liability the amount of her payments to a public benefit organisation which does not exceed the greater of R1 000 and five per cent of her taxable income. Paragraph 5 of the Ninth Schedule to the Income Tax Act includes the promotion and practice of religion as a public benefit activity.

greater community, expressed through national taxes. Therefore, to this very limited extent, community members do enjoy some licence to construct autonomous tax arrangements.

(d) Autonomy and ethical motivation

A final point on autonomy and taxation is that autonomy connotes more than space to construct private taxes. It also implies an internal ethical motivation to obey rules, a 'freedom to do what is right'.[27] In physiological terms, an autonomic action is one that occurs because of internal stimuli. Autonomy in taxation in this sense is an individual's ethical drive to contribute to the community. Taxation is, of course, reliant on such an autonomic compulsion on the part of each taxpayer to contribute. Members of the constitutional community should not be ethically docile, paying taxes simply because that is what the law decrees, and sanctions are feared. Members should comply with constitutional tax laws and pay willingly because their autonomic ethical motivations urge them to do this. Such an ideal assumes a genuinely participative and representative democracy; one in which the governance conducted and laws crafted really do correspond with the general will or ethical imagination of the community.

IV CONCLUDING COMMENTS

A scheme of taxation will be most loyal to the Constitution when it liberates the dispossessed from economic serfdom. Such freedom will be ensured through the guarantee of a minimum income to all community members. In the light of this overriding concern, other freedom considerations become secondary. Nevertheless, respect for autonomy and negative bio-liberty is important. A constitutional scheme of taxation may contribute to their actualisation.

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[27] Lord Acton, cited by R Harries *Is there a Gospel for the rich? The Christian in a capitalist world* (1992) 99.

CHAPTER 14 EQUALITY AND A CONSTITUTIONAL SCHEME OF TAXATION

I INTRODUCTION

Together with respect for human dignity and freedom, a constitutional scheme of taxation must manifest a search for equality.[1] Consequently, policy decisions relating to what should be taxed, who should bear the tax, and the means of taxation must all be informed by a consideration of equality.

Modern tax structures invariably incorporate equality, normally expressed as equity,[2] as an informing value.[3] Naturally, taxes primarily informed by concerns for equality are radically different in structure and consequence from those that are not so informed. Consequently, when looking to other jurisdictions for guidance, it is necessary to consider whether their taxes have been informed by equality in the pervasive way required by the Constitution.

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[1] Section 1 of the Constitution of the Republic of South Africa Act 108 of 1996 (Constitution). See Chapter 6 above for a discussion of a constitutional conception of equality.

[2] Equality in taxation is generally informed by the propositions of vertical and horizontal equity. (See, for instance, CS Shoup *Public Finance* (1969) 23.) Vertical and horizontal equity in taxation corresponds with the Aristotelian conception of justice. (See Chapter 6 above for a discussion of Aristotelian justice.) The major alternatives to equality as a fundamental tax principle, are 'optimal tax theory' and the 'benefit principle'. Broadly speaking, the former privileges economic efficiency over equity, and the latter seeks to import market principles to taxation. (See Chapter 18, section VIII below for an outline of optimal tax theory and Chapter 20, para II (a) below for an outline of the benefit principle).

[3] See Chapter 11, section I above for an outline of common tax criteria.

Before turning to specific aspects of equality in taxation in subsequent chapters, in this chapter, I outline certain basic ideas relating to equality and sketch a narrative of wealth to illuminate relevant issues.

II INCLUSIVE EQUALITY

A constitutional scheme of taxation should include all members of the constitutional community in a consideration of equality. A focus on equality within a select section of the community, for instance, those earning more and less than certain amounts, will be insufficient.[4] An holistic and integrated assessment of the wealth or relative economic well-being of community members must be carried out with the aim of establishing the extent to which each member of the constitutional community is able to contribute fairly to the fiscus during a period of assessment. Such an exercise will permit a proper consideration of distributive justice so that everyone in the community may enjoy and bear their due benefits and burdens made possible by living in community .

Crucially, everyone should be seen to contribute and benefit under a constitutional scheme of taxation. It is axiomatic, if not always obvious, that everyone benefits from the public finance system, and, indeed, with the current emphasis on indirect taxes, it is likely that everyone also contributes to the fiscus. However, contribution by way of indirect taxes is invisible. A person who earns less than the income tax threshold may pay a far higher proportion of her disposable income in taxes than a high earner, who pays a large amount of income tax.

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[4] One of my prime concerns with the current income tax structure is that it is informed by a selective and introspective approach to equality. In effect, it concerns itself with issues of equality relating to those whose annual taxable incomes fall between R30 000 and R255 000. The positions of those community members whose taxable incomes fall outside these parameters are not taken into a consideration of equality. See sections 5 and 6 of the Income Tax Act 58 of 1962, read with Schedule 1 to the Exchange Control Amnesty and Amendment of Taxation Laws Act 12 of 2003.

Example

A has an income after income tax of R20 000. She spends all of her income and pays value-added tax (VAT) at 14 per cent on all of her expenditure.

B has an income after income tax of R100 000. She spends R20 000 of her income and pays VAT at 14 per cent on that expenditure.

A will pay VAT at an effective rate of 14 per cent of her disposable income, whereas B will pay VAT at an effective rate of 2,8 per cent of her disposable income.

Under the current system, the disproportionate sacrifice of the low-income taxpayer goes unnoticed. Such failure to credit contribution should be addressed under a constitutional scheme of taxation.

Equality concerns for a constitutional scheme of taxation lie in three areas, namely:

- The timing of a tax;
- The tax base; and
- The rate of tax.

I will consider these issues in the following chapters.

In order to illuminate this discussion of equality in taxation, I have outlined below a 'wealth narrative'.

III A WEALTH NARRATIVE

(a) Stages in the wealth narrative

(i) Stage 1 Acquisition

At the first stage of the narrative, a taxpayer acquires wealth.

(ii) Stage 2 Saving or consumption

Having acquired wealth, she may consume or save it, wholly or in part.

(iii) Stage 3 Transfer

At the final stage of the narrative, her death, the taxpayer must transfer any wealth not previously consumed to another person or forfeit to the state. (For simplicity's sake, I have not taken into account inter vivos transfers of wealth.)

(b) Taxes and the wealth narrative

Taxes may apply at each of these stages of the wealth narrative, so that, in terms of practical tax systems, the following may occur:

(i) Stage 1

Depending on the way it is classified, income tax, capital gains tax, or inheritance tax may apply to the wealth when it is first acquired.

(ii) Stage 2

A consumption tax, typically a comprehensive tax on goods and services, such as VAT, may apply to any wealth consumed.[5] Additionally at stage 2, a wealth tax may apply to wealth accumulated rather than consumed.

(iii) Stage 3

An estate tax may apply to wealth transferred to another person by way of a bequest.

(c) Common taxes and the wealth narrative

How do various theoretical and practical systems work in relation to the wealth narrative?

(i) OECD norm and South Africa

Under the current South African scheme, which broadly corresponds with an Organization of Economic Cooperation and Development (OECD) norm,[6] active

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[5] There is no fundamental legal distinction between consumption and investment, since both are transactions in terms of which goods and services (corporeal or incorporeal) are exchanged. However, a concrete distinction can be drawn between (a) consuming/investing wealth and (b) refraining from consuming/investing wealth already held. In the case, no exchange takes place with another person. The existence of an exchange is central to practicable tax systems. (See Chapter 19 below for a discussion of the compatibility of value-added tax (VAT) and constitutional principles.) Nevertheless, it would be idle to suggest that there is no difference between consuming and investing in the minds of policy makers – or indeed the general public - and I will respect the normal distinction.

[6] The United States federal tax system is distinguishable from the OECD norm by virtue of its lack of a national, general consumption tax. See para (c)(ii) below.

income[7] is fully taxed on acquisition at stage 1 but certain types of passive income are subject to preferential exclusions. Bequests are received free of any tax in the hands of the beneficiary. Consumption is taxed at stage 2 but accumulated wealth is not taxed. Any wealth that remains unconsumed when the taxpayer dies is taxed on transfer at stage 3. Since any wealth acquired by a person during her lifetime must be consumed or transferred on death, if not before, all wealth that a person acquires will be taxed eventually under the current South African scheme. Although this is a gross simplification, which does not reflect practice, if all wealth is taxed eventually, the principal equality concerns would lie with timing.

(ii) United States tax system

The United States federal tax code provides an example of a practical tax system that does not capture income at each stage of the wealth narrative. Under that system, income is taxed on acquisition at stage 1 and transfers are taxed at stage 3.[8] Since there is no intermediate taxing of consumption, at stage 2, this arrangement effectively privileges consumption over saving.

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[7] 'Active income' refers to remuneration and profits from a trade or profession, whereas 'passive income' includes dividends, interest, rents and royalties. The distinction is not always valid but is useful.

[8] KC Messere *Tax Policy in OECD Countries: Choices and Conflicts* (1993) para 1:E

(iii) Flat taxes

Various so-called 'flat tax' proposals have gained popularity, particularly in the United States, in recent years.[9] The Hall-Rabushka model would only tax income that is consumed, at stage 2. Under the Nunn-Domenici proposal, active income only would be taxed on acquisition at stage 1. There would be no other taxes. (In each case, saving is privileged over consumption. Additionally, passive income is privileged over active income.

IV IMPLICATIONS OF THE WEALTH NARRATIVE

(a) Theoretical interchangeability of income and consumption taxes

This simplified wealth narrative illuminates an important phenomenon, which, at first face, may appear counterintuitive. In theory, taxes on income and consumption are interchangeable: only their practical implementation creates a radical difference. Thus the 'progressive expenditure tax', originally suggested by

[9] According to JM Bickley 'Flat Tax Proposals and Fundamental Tax Reform: an Overview' (2003) Issue Brief for Congress, there are 11 tax reform proposals currently under consideration by the United States legislature that promote some form of 'flat tax'. The Dorgan, Gephardt, and Snowbarger proposals seek ways of simplifying administration of the tax, whilst retaining - if modifying - the extant tax base. However, the Armey, Crane, English, Linder, Shelby, Souder, Specter, and Tauzin proposals seek to change, implicitly or explicitly, the tax base from income to consumption. It is this latter group of proposals that I contemplate when using the term 'flat tax'. These proposals may be subdivided into two broad types, namely the Hall-Rabushka model (after the Hoover Institution researchers, who first formulated the plan) and the Nunn-Dominici model (after two former legislators who championed that proposition). Under the Hall-Rabushka model (broadly followed by Armey, Linder, Shelby, Specter and Tauzin) the tax base would be derived from consumption only. Under the Nunn-Dominici model (broadly followed by Crane, English and Souder) only active income would be subject to income tax.

John Stuart Mill and still supported by many tax theorists, is also known as the 'lifetime income tax', 'consumer income tax' or 'personal consumption tax'.[10]

(b) Equivalence of consumption to income less savings

Since a person's income must either be consumed or saved,[11] consumption is, therefore, the difference of income less savings.[12] If, as under the flat tax proposals, savings were wholly exempted from tax, income and consumption would coincide. Therefore, the informing logic of a tax on consumption can be seem as the desire to exempt of savings from taxation. Unless savings are exempted from the tax base, a consumption tax cannot be distinguished from a tax on income, other than with regard to the timing of its incidence.[13]

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[10] Messere (note 8 above) para 1:E observes that the personal consumption tax proposal is preferred by most public finance academies; and has been recommended by tax reform commissions in Ireland, Sweden, the United Kingdom, and the United States. The base of this tax would be 'consumer expenditures, represented by total income plus transfers and bequests minus savings'.

[11] If 'I' is income; 'C' is consumption; and 'S' is savings; this may be expressed as:
$I = C + S$

[12] $C = I - S$

[13] It is only once all taxpayers have lived their lifetimes under a consumption tax regime (the 'steady state' in economic parlance) that an income tax becomes equivalent to a consumption tax. It is only then, under unrealisable theoretical conditions that income and consumption will coincide.
See MJ Hamond 'The Failings of the Flat Tax' (1996) Progressive Policy Institute *Talking Points.*

(c) Occurrence of double taxation if income and consumption are taxed

If consumption is income (less savings) but at a different stage of the wealth narrative, a system that employs an income tax and VAT taxes income twice – firstly when it is acquired, and secondly when it is consumed.

(d) Fundamental policy choice between taxing income and consumption

If double taxation of income and consumption to be avoided, a policy choice must be made between a tax on income and a subsequent tax on consumption.[14] A constitutional scheme of taxation that wishes to avoid double taxation,[15] must incorporate the choice that is more consonant with constitutional values.[16]

Because of the way that real world taxes operate, considerable equality issues may arise because of the type of tax chosen. Nevertheless, this essential similarity between income and consumption taxes implies that similar measures of equality may be applied to both. Critique may be expressed in the same language of justice, so that it is a valid exercise to apply the norms of equity that inform income tax to consumption taxes. Specifically, if ability to pay is the proper criterion used to assess the equity of income tax, then, ability to pay should also be the criterion used to assess the equity of VAT.

[14] Because of their relationship, income can be a determinant of consumption for the purposes of a consumption tax and vice versa. In practice, however, VAT is seen as filling a gap in the income tax net and so acts as a supplement to income tax.

[15] See Chapter 15, section V below for a discussion of double taxation.

[16] Taxes on accumulated wealth, being taxes on accumulated income that has not been consumed, fail to tax wealth when it is consumed. See Chapter 16, section X below for a discussion of wealth taxes.

V CONCLUDING COMMENTS

Equality in taxation does not imply an equalisation of contributions or outcomes, simply that community members should contribute fairly to the fiscus. Nevertheless, perhaps to avoid concerns for levelling, it is common to substitute 'equity' for 'equality', and I will follow this convention. It seems implausible that any rational person may object to an equitable tax contribution.[17]

In the following chapters, armed with the insights provided by the wealth narrative, I consider equity in relation to: timing; the tax base; the taxpayer; and tax rates.

[17] My conception of equity is one that seeks to be loyal to constitutional values. Naturally, a different conception of equity could lead to a very different scheme of taxation.

CHAPTER 15 EQUITY AND TIMING

I INTRODUCTION

In addition to certain technical issues of timing, which I consider last, the principal issue considered in this chapter is whether the timing of tax incidence may have implications for equity. For instance, one important consideration is whether deferring tax until wealth is consumed confers unjustified advantages to certain members of the community. A related issue I consider is that of double taxation, whether it is acceptable to tax wealth at more than one stage in the wealth narrative.

II TAXATION AS A MONETARY CALCULUS

If taxation were purely a monetary matter, government might levy tax at that stage of the wealth narrative[1] when the time-weighted value of money would present the greatest yield. For instance, government might favour a consumption tax if it expects the present value of the consumption tax collected in the future to exceed the value of income tax collected now. Similarly, if government is able to borrow money at a rate lower than that at which deferred revenues are likely to appreciate, it might defer the collection of revenue.

To incorporate equality concerns, tax rates could be structured in a way that takes account of the time-weighted financial benefits of deferral. In this way, the tax paid to the fiscus on R1 transferred on the death of the taxpayer, could have a similar present value to the tax paid in respect of R1 consumed now. However, in practice, tax systems tend to penalise consumption and privilege deferred transfers.

[1] See Chapter 14, section III above for a description of the wealth narrative.

III OPTION OF DEFERRAL AND NAKED PREFERENCE

Since the principal benefit to be obtained by choosing to save (then later transferring wealth accumulated in this way to another person) is one of tax deferral, a pertinent equality inquiry lies in whether allowing the option to defer tax liability confers a naked preference to one particular group in society. Returning to the wealth narrative, the receipt of a bequest demonstrates how inequity can, indeed, arise where this option is extended.

(a) The example of bequests

The receipt of a bequest is invariably an accident of birth or life, and, certainly, in the former case, if not in the latter, a person born into wealth will enjoy a greater chance of inheriting wealth than someone who is born into poverty. This phenomenon gives rise to certain consequences relevant to a consideration of a person's economic well-being or wealth. These consequences include:

(i) Exemption from income

The value of the bequest, although it enhances the beneficiary's current wealth, is invariably not included in her taxable income. Although this additional wealth will ultimately be taxed on consumption or transfer, there is an immediate benefit conferred on the beneficiary relative to someone whose active earnings provide similar economic benefit. By treating differently people similarly situated (and a similar amount of income is the most obvious indicator of similarity for tax purposes) the principle of horizontal equity in taxation is breached and, more importantly, the constitutional equality guarantee.[2]

[2] Section 9 of the Constitution of the Republic of South Africa Act 108 of 1996

(ii) Compounding effect of exemption

Second, in subsequent years, if two people earn the similar amounts of income, it seems likely that the one who has previously inherited wealth will have a greater opportunity to save, rather than consume, and thus continue to defer tax liability. The beneficiary of the bequest may have immediately consumed the bequest and paid consumption tax roughly coterminous with the time her peer paid income tax. Even if this were the case, she would have enjoyed an option to consume (with tax consequences) or to save (without incurring a tax liability), which was not extended to her peer, who had no choice but to pay income tax in respect of her active earnings. Presuming, however, that the beneficiary invested the inheritance, this will produce further wealth, which is taxed preferentially. The benefit of an inheritance is not, therefore, once off but is likely to have a compounding effect, continuing to increase year-to-year, and so indirectly impacting on future wealth acquisitions and increasingly exacerbating inequality.

(b) Historical wealth privilege

Because of the advantages described above, failure to tax transfers when they are acquired confers an unreasonable and unfair benefit on the wealthy. Moving from the theoretical to the practical, we know that, historically in South Africa, opportunities to acquire wealth have generally been unfairly denied to Blacks. Consequently, a current privileging of the wealthy indirectly perpetuates certain of the historical privileges that the Constitution considers abhorrent.

(c) Privileging of passive income

Even if the possibility of inheritances is ignored, a failure to tax passive income in full, a common tax policy, will have similar effects to those described in (a) above.

Vertical inequalities also arise when passive income is not taxed in full. Low earners typically consume a greater proportion of their incomes than higher

earners and so any choice that the former may be supposed to enjoy between consuming and refraining from consuming is limited, if not wholly illusory. A higher earner, having a greater opportunity to save and thereby generate investment income will be advantageously treated if that passive income is not fully taxed.

IV NEED AND ABILITY

Although certain of the social ills manifest in South Africa will only be remedied progressively and in the long-term, the Bill of Rights demands immediate action on basic human needs – food, shelter, and medical care. Constitutional government cannot weigh up a life lived over 70 years and calculate that the person lived 30 years homeless and without adequate food, but 40 years with adequate food and a roof over her head and conclude that, in the preponderance, she enjoyed shelter and adequate food. Government must consider whether here and now the basic human needs of the constitutional community are met. A corresponding approach should be adopted with regard to a constitutional scheme of taxation so that it should be asked how a member of the constitutional community is currently able to contribute to the fiscus. That question cannot be answered by an assessment made over her lifetime or rectified by way of an agterskot payment to public funds on death. Just as a person does not need to be housed by the state when she currently has a home, so a person, who is currently able to contribute to the fiscus, must do so currently. Next year, her circumstances may be such that she must turn to the state to provide shelter; next year, her contribution to the fiscus may be greater or lower. Need and ability are mirror images within the schema of distributive justice, and just as they must be considered holistically, so they should be considered synchronically.

V DOUBLE TAXATION

(a) Double taxation and the wealth narrative

Wealth may be taxed at more than one stage in the wealth narrative. For instance, a person may be taxed on wealth acquired at stage 1 and then charged estate tax when it is bequeathed to another person at stage 3. Yet, claims for this so-called economic double taxation are dubious and it may be argued that the phenomenon will only ever occur under restricted circumstances since, once money enters an individual's pool of wealth, it commingles with her other funds and loses its specific identity.[3]

(b) Double taxation and dividends

A claim of double taxation is frequently made when a company distributes its taxed profits by way of dividends to its shareholders who are also taxed. Yet the taxation of profits in a company's hands and the subsequent taxation of dividends in a shareholder's hands are further removed from a charge of double taxation than the income and estate tax argument inasmuch as the tax incidence falls on two different persons. A shareholder has no entitlement to the company's profits, merely an expectation that the company, if is profitable, may pay dividends. Conversely, when income, net of income tax, is accumulated, then subjected to an estate tax on death, the same person (in a loose sense) is taxed twice. If the taxation of profits and dividends is considered objectionable, then other common arrangements must also be objectionable. The taxation of, say, my income, and the subsequent payment of value-added tax (VAT) when after tax income is consumed must be much closer to double taxation since the same person bears

[3] In order to identify a particular item of money and trace its history, policymakers would probably need to turn to some accounting solution such as 'LIFO' (last in, first out) or 'FIFO' (first in, first out) but such a solution would not have any general legal validity. Accounting norms do not apply to everyone's lives in the way of general laws.

the tax and the flow of income to consumption is discernible. Furthermore, the subsequent taxation of the profits of the retailer, whose goods I purchase with my net income, might also be considered double taxation.

(c) When double taxation is objectionable

Arguments identifying double taxation tend to be selective and without solid foundation. Besides, manifestations of economic double taxation are very common in tax systems and are not generally considered objectionable. 'Equity, in the context of taxes, is about whether taxpayers in similar circumstances pay similar amounts of tax and about how the burden of taxes is borne by different income groups, not about the number of times a particular type of income is taxed'.[4]

Nevertheless, economic double taxation should be considered objectionable under a constitutional scheme of taxation when it offends constitutional principles, as it will do if it is incoherent or arbitrary; or has an unfair and disproportionate impact on one section of the community. Additionally, there are likely to be pressing transparency concerns, particularly if double taxation masks inequalities: for instance, how VAT distorts the equity measures of income tax in a way that is not readily visible. Because of these concerns, rather than an acceptance of populist arguments or any objection to double taxation as such,[5] double taxation should be eliminated as far as possible from a constitutional scheme of taxation.

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[4] J Friedman & R Greenstein 'Exempting corporate dividends from individual income taxes' Centre on Budget and Policy Priorities, Washington (2003) 17

[5] The adduction of economic double taxation has considerable rhetorical value, as T Nagel & L Murphy *Myth of Property* (2001) have observed with regard to various Bush administration proposals.

(d) Juridical double taxation

As a final point, economic double taxation is normally distinguished from 'juridical double taxation', which is manifest when the same taxable item is taxed more than once under similar conditions by different taxing authorities.[6] For example, when an item of income, whose source is located in Australia, is paid to a South African resident, it is likely to be taxed at similar times in both Australia and South Africa.[7] However, the elimination of juridical double taxation (the objective of bilateral double taxation agreements) is not an ethical imperative but a matter of removing barriers to cross-border trade and investment.

VI TECHNICAL CONSIDERATIONS OF TIMING

(a) Period of assessment

There is broad agreement that the fairest period for assessing a taxpayer's ability to contribute to the fiscus is her lifetime.[8] However, such a project is a practical impossibility. (Although a lifetime period of assessment is not feasible, a lifetime consideration of certain types of income is not unknown. Concessions provided in

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[6] See, for instance, A Ogley *The Principles of International Tax: A Multinational Perspective* (1993) 31.

[7] A jurisdiction employing a pure source-based system of taxation will only seek to tax items of income whose predominant cause is located in that territory. The place of residence of the taxpayer is irrelevant. A jurisdiction employing a residence-based system will principally seek to tax all income that accrues to its residents, where the source is located. A source-based system may be said to have focus on the taxable thing, whereas a residence-based system has a focus on the taxpayer.

[8] KC Messere *Tax Policy in OECD Countries: Choices and Conflicts* (1993) para 1.E

respect of lump sum benefits paid by approved retirement funds, for instance, are conferred on a lifetime basis.[9])

Under the extant South African income tax system, various types of income may be taxed at average rates, thus enjoying exceptional advantages.[10] A farmer, for instance,[11] may be able to spread exceptional income over more than one tax year but a salesperson in employment who enjoys exceptional commission in particular year has no such opportunity. To remove such naked preferences, the period of assessment for a constitutional scheme of taxation should be one year, although benefits would be paid, and, if necessary, reviewed, monthly or bi-weekly. Objections to an assessment period of a year are only likely to be raised in respect of exceptional amounts, which, under the current system, receive special averaging treatment, and for receipts of capital amounts that are currently untaxed.

(b) Inflation and capital gains

There is a broad acceptance of the proposition that any taxable item whose real value has been significantly eroded by inflation should enjoy the benefits of indexation. It is irrelevant whether the item is one traditionally classified as capital or as revenue: the pertinent issue is the period over which an inflationary increase in value becomes significant or non-trivial. Traditionally income tax does not take into account the possibility of a devaluation of a taxable item,

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[9] Second Schedule to the Income Tax Act 58 of 1962

[10] Tax privileges attaching to retirement fund membership have perhaps been free from critical reappraisal because of the lack of welfare benefits. Once a guaranteed income for all is instituted, these frequently arbitrary preferences may be eliminated, a considerable step toward equality through the removal of naked preferences.

[11] Section 5(10), read with the First Schedule to the Income Tax Act

presumably because any decrease in real value during the period of assessment is considered trivial or administratively too cumbersome to accommodate. Such an assumption is not always valid. Clearly, during periods of high inflation, an item may lose more of its real value during a single year of assessment than over several years of low inflation. Nevertheless, it seems to be a reasonable stance that indexation should apply to items whose change in value extends beyond the tax year. For example, if the change in the real value of a taxable item is taken into account over 18 months, the six months that exceed the tax year should be eligible for indexation.

(c) Receipt or accrual

Tax should be triggered by first entitlement to a taxable item, in line with the existing income tax concept of an amount being taxed on the first of its receipt or accrual.[12] Coherent legalism requires that 'entitlement' to a taxable amount should carry the normal legal meaning.[13]

VII CONCLUDING COMMENTS

Under a constitutional scheme of taxation, wealth will be taxed when it is first acquired. Deferring tax liability confers an unjustified advantage on those most able to make economic choices. This preference for taxing income will also be reached from a consideration of the equitable tax base.

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[12] *SIR* v *Silverglen Investments (Pty) Ltd* 1969 (1) SA 365 (A)

[13] *CIR* v *People's Stores (Walvis Bay) (Pty) Ltd* 1990 (2) SA 353 (A)

CHAPTER 16 EQUITY AND THE TAX BASE

I INTRODUCTION

The consideration of timing in the previous chapter has partly anticipated the composition of the equitable tax base. Deferring taxation until wealth is spent or transferred confers unwarranted advantages on the wealthy. Therefore, income or the new wealth a person acquires represents her ability to contribute to the fiscus during the period of assessment, and constitutes the equitable tax base. The crucial issue to be resolved relates to what manifestations of new wealth should be included as income. Few problems are raised in enunciating an equitable principle of income; considerable problems lie in capturing all manifestations of income in a practicable system.

II DEFINING 'INCOME'

(a) Income as tax base

Adam Smith prescribed that tax should be levied on the 'revenue which [the subjects of every state] respectively enjoy under the protection of the state'.[1] Since his time, income has been received as the 'natural' tax base. Income provides an indicator of a person's economic welfare, under the protection of the state; it 'connotes, broadly, the exercise of control over the use of society's scarce resources'.[2] Therefore, the income a person enjoys by virtue of the constitutional state will form the base for a constitutional scheme of taxation.

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[1] A Smith *An Inquiry Into the Nature and Causes of the Wealth of Nations* (1776) (1952 reprint) 361

[2] H Simons *Personal Income Taxation: The Definition of Income as a Problem in Fiscal Policy* (1938), non-paginated extract in G Cooper, R Krever & R Vann *Income Tax: Commentary and Materials* 4 ed (2002)

(b) Traditional distinction between capital and income

In line with international practice, South Africa has traditionally drawn a distinction between receipts and accruals which are classified as revenue in nature and those which are capital in nature:[3] the taxable fruit (revenue) of the exempt tree (capital) being the classic metaphor.[4] A strict division between revenue and capital is, however, artificial and insufficient, so that the crucial term 'gross income' has been framed, by piecemeal additions, so as to include certain items whether or not they are classifiable as capital.[5] Although economists had since the 1930s been cognisant of the unfairness of a strict revenue approach to income,[6] it was not until the publication of the report of Canada's Carter Commission that there was a general acceptance that 'a buck is a buck',[7] that a distinction between capital and revenue profits in taxation is counterproductive and arbitrary. This logic has led to the broad annexing of capital gains as income,

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[3] An item must be either revenue or capital although a receipt may have discrete capital and revenue elements (*Tuck* v *CIR* 1988 (3) SA 819 (A)). Although I refer to items as being capital or revenue in nature, an item is not inherently one of the two; its classification is decided by the intention of the taxpayer (*Matla Coal* v *CIR* 1987 (1) SA 108 (A)). The intention of a taxpayer with regard to a receipt has no bearing on the economic benefits the receipt brings to her.

[4] Pitney J in *Eisner* v *Macomber* 252 US 189 (1920), 206
Steyn CJ defined 'capital' in *Smith* v *SIR* 1968 (2) SA 480 (A), 488 as 'money and every form of property used or capable of being used in the production of income or wealth'.

[5] See definition of 'gross income', section 1 of the Income Tax Act 58 of 1962. Annuities, for instance, which comprise both discernible revenue and capital elements (under the traditional distinction) are included in gross income.

[6] Notably, Robert Haig, Henry Simons and Georg von Schanz.

[7] *Report of the Royal Commission on Taxation* (1966)

including, lately, in South Africa.[8] The annexing of capital gains to traditional income leads toward the ideal of comprehensive income but is incomplete.

(c) Concept of comprehensive income

Robert Haig identified personal income as 'the money value of the net accretion to one's economic power between points in time'.[9] In adopting this broad definition he established that it is not how an item of wealth is classified (income, capital gain or capital transfer) which should concern policymakers, but rather how, as a matter of measurable fact, a citizen is able to contribute to the fiscus during the relevant period of assessment. Moreover, this ability is best gauged by an assessment of the change in her economic well-being or wealth between points of assessment. While Haig established the principle, Henry Simons indicated a method of measuring the change in economic well-being. He proposed that an estimation should be made of '(a) of the amount by which the value of a person's store of property rights would have increased, as between the beginning and the end of the period, if he had consumed (destroyed) nothing, or (b) the value of rights which he might have exercised in consumption without altering the value of his store of rights'.[10] In effect, then, the estimate of income

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[8] The relevant Eighth Schedule to the Income Tax Act and related provisions came into force on 1 October 2001.

New Zealand is the notable example of an Organization of Economic Cooperation and Development (OECD) member country that does not levy a specific tax on capital gains. However, as in South Africa before the introduction of capital gains tax, various capital gains are deemed revenue in nature for the purposes of New Zealand income tax, so that there is a de facto, limited capital gains tax.

[9] RA Epstein 'Taxation in a Lockean World' in J Coleman & E Frankel Paul (eds) *Philosophy and Law* (1987) 49, 60

[10] Simons (note 2 above)

requires a calculation of a person's consumption and accumulation during the period of assessment.

(d) Haig-Simons formulation and tax base

The combined Haig-Simons formulation of income enjoys broad acceptance amongst policymakers,[11] and coincides with the conception of income for a constitutional scheme of taxation. However, the formulation is an ideal and Simons recognised that certain manifestations of income could not be captured by a practicable administrative system. For instance, he considered the taxing of certain perquisites to be 'insoluble and certainly not amenable to reasonable solution on the basis of simple rules which could be administered by revenue agents'.[12] The pertinent issue is, then, to ascertain which elements of economic well-being can feasibly be included in the base for a comprehensive income tax.

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[11] National Treasury supports the principle of comprehensive income but appears to attribute the idea to the contemporary economist Parthasarathi Shome. (See National Treasury Tax Policy Chief Directorate 'Capital Gains Tax Briefing to the Portfolio and Select Committees on Finance 24 January 2001'.)

The Australian Commonwealth Treasury explicitly follows comprehensive income as an ideal, defining it as 'the sum, over an annual period, of the taxpayer's current revenue less current costs, plus the net change in the value of the taxpayer's assets and liabilities'. This is identified as the 'SHS' formulation, after Georg von Schanz, Robert Haig and Henry Simons. (See The Commonwealth Treasury 'Methodology' *Tax Expenditure Statement* (2003) para 3.1.)

See Chapter 18, section IX below for an outline of optimal tax theorists' critique of the Haig-Simons model.

[12] Simons (note 2 above)

Ironically, the problem of perquisites Simons considered intractable has been greatly solved through fringe benefits taxation.

III IMPUTATION OF INCOME

(a) Why impute income?

An ideal of comprehensive income includes certain forms of unrealised increases in wealth (imputed income) in the tax base along with realised gains and earnings; the rationale being that unrealised gains contribute to a taxpayer's economic well-being in a similar way to actual receipts.

(b) Example of shares

A discernible but unrealised augmentation of wealth may be seen in relation to the example of shares. If a taxpayer owns shares that increase in value during the period of assessment, her measurable wealth increases, whether she holds the shares or realises the profit by selling them.[13] Under traditional income tax systems, such increments in wealth are not taxed until they are realised.[14] However, if the taxpayer does not sell the shares or only sells when there is a decrease in price, the changes in wealth on a year-to-year basis will never be taxed in her hands. This represents a concession that is only likely to benefit the very wealthy, that is, those who can afford not only to purchase shares but also to hold them permanently. Conversely, a person whose increments in wealth are represented by remuneration will be fully taxed. This is patently unfair – particularly in South Africa, where domestic dividends are currently tax exempt. It may be asked why such an egregious manifestation of inequality, which arises when unrealised gains escape being taxed, generally goes unchallenged.

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[13] Epstein (note 9 above) 63

[14] This consideration does not apply to a wealth tax. I examine the possibility of a wealth tax (in section X below) but my current concern lies with identifying the components of income.

(c) Liquidity concerns

Issues of liquidity raise obvious objections to taxing unrealised gains. In an extreme scenario, a taxpayer may feel compelled to sell, say, the shares she holds in order to meet her tax liability relating to the hitherto unrealised increase in share value. Liquidity may, however, only be raised as a practical objection and not as a point of principle. A taxpayer is expected to arrange her affairs so that she is able to meet her tax obligations. Liquidity is a potential problem for any form of taxation unless, as the Employees' Tax system seeks to achieve,[15] final tax liability is settled at source. Therefore, liquidity cannot constitute a special concern for taxing unrealised gains. Besides, a commercial solution will inevitably be found where a taxpayer has liquidity problems: for instance, shares may be ceded in securitatem debiti to a bank which will extend a loan to cover the tax due in respect of an unrealised increase in value.[16]

(d) Valuation difficulties

Valuation difficulties, particularly with regard to interests in closely held corporations, may militate against the taxation of unrealised gains. However, any such technical difficulties are overstated. Interests in closely held entities are regularly measured for commercial purposes, for instance, when setting a value of shares in a private company under a shareholders' buy-and-sell agreement.

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[15] See Part II of the Fourth Schedule to the Income Tax Act. Employees' Tax is commonly referred to as pay-as-you-earn (PAYE).

[16] A crucial policy concern is more likely to lie with the deductions an investor might claim should her investments give rise to an unrealised loss in a particular year. Should there be a general market crash and a subsequent depressed economy, tax revenues could fall dramatically.

Generally, when something is potentially tradable, even if not at arm's length, a reasonable value can be set for tax purposes.[17]

(e) Requirements inclusion in tax base

(i) Capable of valuation

This proposition establishes the first criterion for taxing an unrealised increment in wealth, specifically, before an item may be taxed, it must be quantifiable in monetary terms. This requirement is, perhaps, self-evident but provides an important tool for engaging with theoretical propositions for the tax base that I will consider presently.[18]

(ii) Tradability

The second criterion may be illustrated by the example of a member's pension interest. Like shares, the value of a pension interest may increase annually, thus enhancing a person's economic well-being. Furthermore, the interest has a readily determinable value, as it may be calculated and divided as patrimonial property on divorce.[19] Although the pension fund member has no immediate right

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[17] See, for instance, section 5(1)(f)bis of the Estate Duty Act 45 of 1955 in relation to the valuation of unlisted shares.

The valuation problem for taxation can only lie in fixing a value to something that cannot be bought and sold.

[18] See *CIR* v *Butcher Bros (Pty) Ltd* 1945 AD 301.

[19] Section 7(7) of the Divorce Act 70 of 1979

The value of the pension interest does not represent a share in the assets of the pension fund (they are solely the fund's property) rather it represents the notional value of the spes that a benefit will be paid on the occurrence of certain defined events which are identified in the rules of the fund.

to pension benefits, the derivative nature of the value of her pension interest cannot be a deterrent to its being taxed. However, the pension fund member may not trade her pension interest or use it as security to otherwise obtain money to meet a potential tax liability.[20] This quality of tradability distinguishes the example of the shares from that of the pension fund interest. This establishes the second relevant criterion: as well as being measurable, the manifestation of wealth must be tradable.

In the specific instance of the pension interest, there is no inherent reason why this particular manifestation of wealth should not be marketable or otherwise dealt with. Simply, a statutory provision has been introduced to prevent assignment or other dealings with pension interests in order to promote the socially valuable goal of protecting members' retirement benefits. The relevant law might be changed so that the a pension interest could become tradable but, as long as the law remains as it is, the principle of legal coherence engenders the expectation that the legal qualities of an arrangement will be reflected in its tax treatment.

IV NON-TRADABLE MANIFESTATIONS OF ECONOMIC WELL-BEING

There are, however, situations when discernible increases in economic well-being are inherently non-tradable.

(a) Example of tenure

Epstein provides the examples of a professor obtaining tenure and a judge being appointed permanently to the bench,[21] identifying the permanence of their

[20] Section 37A of the Pension Funds Act 27 of 1956

[21] Section 177 of the Constitution of the Republic of South Africa Act 108 of 1996 (Constitution) entrenches the principle of tenure for judges.

appointments as the potentially taxable fair market value of the future income stream that attaches to that employment.[22] Yet, even if it assumed that the remuneration of a judge or a professor does take into account their enjoyment of tenure, there is no predominant causal connection between tenure being granted and an economic benefit. It is generally believed that conferring tenure to judges and professors is socially valuable, as it tends to promote independent thought and action on the bench and in academia. Although it seems that the judge and the professor may obtain some enhanced economic well-being from the permanence of their appointments,[23] relative to a similarly remunerated person in a comparable occupation, no market value can be plausibly placed on that tenure because it is something that is eminently non-tradable.

It is the very nature of tenure (an actionable restriction on the behaviour of others) that brings its value. Moreover, it is the quality of non-transferability that brings a benefit but primarily to society, rather than the incumbent.

What accrues to the judge and professor from the permanence of their appointments is better identified in psychological terms, such as peace of mind or utility, or in social terms, such as status or kudos, rather than any direct economic

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[22] Epstein (note 9 above) 66

Presumably, the reasoning in this regard is that without tenure, the judge or professor would command higher remuneration. The difference between actual remuneration and the hypothetical remuneration without tenure would be the taxable value of tenure.

[23] All things being equal, a person who enjoys a guaranteed income, such as a tenured professor, presents a lower risk to a bank when borrowing money than does a person without a guaranteed income. That lower risk may translate into a lower rate of interest. However, it is fanciful to propose that any such indirect benefit of tenure can be taxed.

benefit.[24] These phenomena are neither objectively measurable nor tradable: utility is internal to an individual and kudos is a sentiment held by others that relates an individual.

(b) Grounds for imputation

Imputation should only apply, therefore, to something that is concrete in legal and economic terms, so excluding theoretical propositions, for instance, that the utility gained through leisure time (or any other failure to maximise economic returns) ought to be taxed.

V POSSIBLE MANIFESTATIONS OF UNREALISED ECONOMIC WELL-BEING TO BE INCLUDED IN THE TAX BASE

(a) Owner occupied housing

A commonly encountered theoretical proposition calls for a notional rent to be imputed to owner-occupied houses that would then be taxed as income.[25]

(i) Neutralising privilege

This proposal may hold rhetorical appeal in jurisdictions, such as the United States, where homeowners are granted relief against income tax for interest payments in respect of mortgage bonds. This puts mortgaged homeowners is a

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[24] These intangible social benefits (enhanced respect from members of the community) may also accrue to, say, a doctor who chooses to work for the state rather than in the private sector. It seems, then, following the imputation logic, that a doctor who accepts lower earnings in the state sector should be punitively taxed to 'equalise' her position with a higher earning (and higher tax paying) peer in the private sector.

[25] Although I describe imputation of rent to owner-occupiers as a theoretical proposition, according to Cooper et al (note 2 above), between 1916 and 1923, Australia included such notional income in its income tax net.

privileged position relative to tenants, debt-free homeowners but not lessors. (This last category of taxpayers may deduct mortgage interest as such interest is incurred in the production of taxable income.) By imputing and then taxing a notional rent, there would be symmetry between deduction and accrual in the way that there is for a lessor who incurs interest in order to produce taxable rental income. Nevertheless, there is no generally recognised principle that might demand such symmetry.

Discounting the prospect of simple political patronage, when governments confer tax privileges on homeowners, they do so in order to promote a generally valued social goal of broad home ownership. It would be counterintuitive to confer, then, neutralise, the benefit by taxing it, as the proponents of imputation propose. If privileging of homeowners in this way is considered objectionable, the preferable policy choice must surely be to refrain from privileging mortgaged homeowners in the first place. (Under the constitutional dispensation, if homeowners were found to enjoy an unfair advantage, we would expect a proportionate and rational programme to promote equality through removing unwarranted privileges and enhancing the position of those previously disadvantaged. We would not expect a measure aimed at maintaining the position of tenants but handicapping owner-occupiers.)

(ii) Practical effects of rent imputation

The arguments for imputing rent to homeowners are not only put forward in relation to systems that confer tax concessions to mortgaged homeowners. Proponents argue that the taxable rent that any homeowner is 'excused' by virtue of living in her own home should be imputed as income in order to equalise her position with that of tenants who live in a house owned by someone else and pay rent. Yet, most tax systems permit a deduction of interest incurred in the production of taxable income. Therefore, the mortgaged homeowner, like the lessor who rents out property for profit, is likely to be permitted to deduct the

interest and so would be in a roughly tax neutral position. This is because interest incurred could be set-off against the imputed rent. Furthermore, in practice, it seems that many homeowners would simply mortgage their properties in order to be able to set deductible interest off against taxable imputed rent, so defeating the gambit.

If the imputed rent proposition is so unpersuasive, it may be asked why such a torturous argument continues to feature in debate on tax policy.

(b) Use of own labour

(i) Lockean conception of neutrality

Richard Epstein derives the general imperative for imputation from the specific Lockean conception of neutrality, which requires that a tax system 'should preserve the relative priorities that individuals attach to various activities' and 'also keep[s] their relative wealth constant'.[26] In other words, the homeowner's investment in her home (incidentally from after tax moneys) goes untaxed whereas the person who rents property and invests the presumed difference between rental and mortgage interest will be taxed on her investment. He goes further, and argues that 'all imputed income falls within the taxation base, as the principle of tax neutrality opposes any differential tax cost on market income that will bias individuals toward nonmarket uses of their own labour'.[27] Pursuing this line of reasoning, he suggests that the value of services that a taxpayer performs for her own benefit about the home should be brought into the tax base. This

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[26] Epstein (note 9 above) 55

The usual understanding of tax neutrality is that given by Messere Appendix A in descriptive rather than prescriptive terms, that, 'the situation in which tax considerations do not affect or hardly affect economic and social decisions'.

[27] Epstein (note 9 above) 61

even less plausible proposition is not founded on any ground firmer than a particular ideologically animated ideal.

(ii) Neutrality and the Constitution

The constitutional community is not part of 'a Lockean world' and so there can be no expectation of tax neutrality in South Africa beyond that required by the Constitution. There may be cogent economic arguments in support of tax neutrality; however, a rational and proportionate partiality is wholly compatible with the Constitution. Indeed, given an existing condition of gross inequality, there is an urgent expectation that taxation will indeed change the relative wealth positions of members of the constitutional community. Clearly, the call for neutrality derived from Lockean premises does not have a purpose of eliminating pre-existing inequality but of preserving it. Calls for imputation based on Lockean neutrality have no cogency in the constitutional community. Even if there were compelling constitutional grounds for generally taxing imputations, as Epstein concedes, 'the problems of monitoring and evaluation doom from the start the enterprise of taxing imputed income'.[28] It seems that the pursuit of this particular conception of neutrality would require a constant and invasive surveillance and measurement of an individual's activities. Government surveillance of its citizens in such a way – if it were attainable - would be repugnant and would indubitably constitute an unjustified infraction of bio-liberty.

[28] Epstein (note 9 above) 62

VI IMPUTATION AND THE RULE OF LAW

(a) Legal coherence

A fundamental ground for opposing theoretical imputations is provided by the principle of legal coherence.[29] Returning to the example of the imputation of rental to a homeowner, there is, and can be, no rental contract between a householder and herself. Imputation of rent to an owner-occupier does not amend the terms of a contract, for instance, by setting a price for an exchange not at arm's length or altering the timing of an accrual. Rather, it seeks to fly in the face of common sense to fabricate an arrangement that is impossible in law.[30] The law recognises the legal event of a tenant paying rent to a lessor but does not recognise a person's living in her own house as a similar legal event. And, therefore, the first arrangement, being recognised as a legal event (and also an economic transaction) may give rise to an incidence of tax but the principle of legal coherence demands that the second arrangement should not. The interest of the general law in a person's affairs is normally triggered only when certain events occur, such as a person's participation in a transaction. As a species of the genus of a community's law, we expect taxation to manifest similar characteristics so that, in accordance with the general law, it demonstrates an interest in a person's affairs or refrains from doing so.

(b) Legal efficiency

In addition to manifesting legal coherence, a constitutional scheme of taxation should be legally efficient, so that taxpayers recognise the ethical and rational

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[29] See Chapter 8, section IV above for a discussion of the principle of legal coherence.

[30] An essential element of a contract is the existence of two contracting parties. See JTR Gibson *South African Mercantile Law* 6 ed (1988) 10

anchoring of the relevant tax laws.[31] Such recognition springs primarily from lived experience. Modern taxation is a function of a monetary-based economic exchange system. Consequently, unless the transfer of something quantifiable from one person to another occurs, there is no expectation of taxation. And so, as with the imputation of legally impossible events, the idea of comparing and 'taxing' accordingly two sets of utility or happiness, which cannot be quantified in monetary terms, is chimerical and must be rejected.

(c) Expectation of accrual

It is submitted that taxpayers have an expectation of accrual before they will be liable for tax.[32] I wish to revisit the example of a member's pension fund interest to illustrate this expectation.

Given that a member is unable to deal in any way with the interest,[33] it is a reasonable expectation on her part that the value of the pension interest should not be taxed in her hands until there is a transfer of ownership from the fund to her or her beneficiary. This expectation is manifest throughout commercial and proprietary arrangements. However, the fact that this expectation and its concretisation in the principle of accrual are well established does not imply that it

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[31] See Chapter 9, section 6 above for a discussion of legal efficiency.

[32] The phrase 'accrued to', which is not defined in the Income Tax Act but crucial to the meaning of 'gross income', has been the subject of considerable judicial consideration. Following the Court of Appeal's approval of the *Lategan* principle, in *CIR* v *People's Stores (Walvis Bay) (Pty) Ltd* 1990 (2) SA 353 (A), the basic meaning of 'accrual' is accepted as entitlement. I do not refer to an expectation of accrual here in any technical sense. I simply propose that taxpayers do not expect to pay tax until they have a right to a particular taxable item.

[33] In terms of section 7(8) of the Divorce Act, the share of the pension interest divisible as patrimonial property on divorce is not payable to the non-member ex-spouse until a benefit accrues to the member ex-spouse.

may pass without critical consideration. Nevertheless, the challenges of establishing a tax system that does not reflect taxpayers' experience and expectations are likely to be insurmountable.

VII IMPUTATION IN PRACTICABLE TAX SYSTEMS

Imputation in practicable tax systems falls into two distinguishable categories.

(a) Valuing problematic transactions

The first category sets a price for a problematic transaction. This may occur when there is a non market disposition: examples include a transfer of an asset for less than market value between connected persons, and the situation where the economic substance of a transaction is different from its legal substance, as may be the case with no coupon bonds.[34] It is a well-established principle that the law may intervene to alter the terms of a contract where there is good cause.[35] If, for instance, to protect the fiscus, tax legislation imputes a market price to a

[34] In terms of this arrangement, an investor purchases a bond, which, instead of paying interest (a coupon) over its currency, has a purchase price less than the redemption price: for example, a bond purchased now for R90 might pay R100 on maturity. The discount represents the consideration paid to the investor for lending the money to the bond issuer but this was not obvious in the common law and there was confusion as to whether the consideration was taxable. Section 24J of the Income Tax Act was introduced, therefore, to spread the consideration over the term of the bond for taxation purposes. In this way, a measurable increment in wealth is apportioned at times other than those agreed between the relevant parties. (No coupon bonds of this nature preceded the introduction of capital gains tax as a popular investment vehicle for individuals.)

[35] Notwithstanding the principle of freedom of contract, most common law systems permit some form of equitable remedy with regard to unconscionable terms, and unfair contract terms legislation is normal.

transaction between connected persons,[36] there can be no sustainable objection. Nevertheless, there is an expectation that this power will be exercised sparingly, normally only when an arrangement or practice may result in a significant loss to the fiscus.

(b) Fictitious transactions

The second category of practical imputation includes transactions deemed to have occurred but which have not taken place. For instance, a person who changes fiscal residency may be deemed to have disposed of her assets for the purposes of capital gains tax.[37] As with an imputed notional rent to a home owner-occupier, this type of imputation is problematic in a *Rechtstaat*, as it does not simply change the terms of an existing legal agreement but acts as though a particular arrangement exists when it does not. Yet, without such a deeming provision and its consequent imputation, the potential would exist for an exceptional loss to the fiscus. In the example of deemed disposal for the purposes of capital gains tax, a person could fully avoid tax liability by emigrating before disposing otherwise taxable items.

The conflict between expectations that, on the one hand, the fiscus will be protected, and, on the other hand, that legal coherence will be respected is more apparent than real. For instance, protection of the capital gains tax base does not require a deemed disposal when none takes place. Quitting the commonwealth can be structured as a taxable event in itself. The problem here does not spring from principle but drafting, and is easily rectified.[38] I do not suggest that all

[36] See, for instance, section 4 of the Value-Added Tax Act 89 of 1991.

[37] Paragraph 12(2) Eighth Schedule to the Income Tax Act

[38] Before the introduction of a residency based income tax system, various source deeming fictions were required to disguise what was really a hybrid source-residency system. Once residency was introduced as a criterion of taxability, these fictions were no longer necessary.

imputations can be so readily squared with legal coherence. Nevertheless, it seems that commonly practised forms of imputation are acceptable for a constitutional scheme of taxation.

VIII CAPITAL GAINS

(a) Objections to taxing capital gains

(i) Alleged advantaged for wealthy

Capital gains tax (CGT) is levied on profits realised on disposal of certain types of property. In practice, this tax presents considerable scope for both tax deferral and the neutralising of liability by setting-off gains against losses. Consequently, a person who is sufficiently wealthy so as not to need to dispose of taxable property or has a sufficient variety of property to be able to set losses off against gains will not incur a CGT liability during her lifetime. This credible phenomenon is commonly adduced by opponents of CGT to demonstrate its costly futility and prompted the Margo Commission to oppose its introduction.[39] However, data from the United States indicate that the wealthy, whether or not it is their full due, do pay the bulk of CGT.[40]

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[39] C Margo (Chair) *Report of the Commission of Inquiry into the Tax Structure of the Republic of South Africa* (1987) para 12.34

[40] Treasury (note 11 above) reported that, in 1993, the highest earning 0,6 per cent of United States taxpayers accounted for 62,4 per cent of the United States' capital gains tax yield.

(ii) Economic opposition

Although governments appear to be wary of CGT due to concerns of dampening enterprise and hence growth,[41] the inclusion of capital gains in the comprehensive income tax net cannot be characterised as equity arguments for and economic arguments against. Equity arguments against CGT, albeit unpersuasive ones, include: 'bunching' of gains; inflation; double taxation; unexpectedness of reforms; and volatility of asset prices.[42] Conversely, economic arguments in favour of CGT include: neutrality; prevention of misallocation of resources from tax preference; reduction of arbitrage; prevention of tax avoidance and evasion; lowering of tax on other items of income and a consequent encouragement of economic growth.[43]

(b) Importance of eliminating distinctions

Capital gains are simply a form of income and must be included in a scheme of income tax that tends to comprehensiveness. Consequently, a comprehensive income tax is fundamentally weakened when capital gains are not treated in the same way as other items of income. This unwarranted distinction has been adopted in South Africa.[44] The differentiation drawn between capital and revenue

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[41] P Singleton 'Should New Zealanders Be Burdened with an Even More Comprehensive Capital Gains Tax?' (2003) Vol 9:1 *New Zealand J of Tax Law and Policy* 42, 51

[42] P Kenny 'Capital Gains Taxation for New Zealand: Fairer and More Efficient' (2001) Vol 7: 4 *New Zealand J of Taxation Law and Policy* 265, 272

[43] Ibid 274

[44] In terms of South African CGT provisions, 25 per cent of the value of a capital gain is taxable at marginal income tax rates. In effect, CGT rates range from 4,5 per cent to 10 per cent, whereas income tax rates range from 18 per cent to 40 per cent. Clearly, it is highly advantageous for a taxable amount to be classified as a capital gain rather than revenue.

profits permits a considerable arbitrage opportunity by ensuring a taxable receipt or accrual is classified as capital rather then revenue. National Treasury, fully aware of this failing, reported that it was 'ultimately decided that the change from a zero rate to a full inclusion rate was simply too disruptive in the current business environment and could dissuade foreign investment in an international environment where capital gains are typically subject to preferential treatment'.[45] This concern may be valid but once more raises the fundamental question why the same scheme of taxation, and particularly the same legislative message, should be addressed to both resident individuals and corporations that may be multinational enterprises.

The base for a comprehensive income tax must, save for a triviality exemption,[46] include all capital gains, since they provide similar economic benefits as those manifestations of wealth, traditionally characterised as revenue. Once items of wealth have been included in the ambit of comprehensive income, no preference should be shown to any particular item.

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[45] Treasury (note 11 above)

[46] The value of disposals of personal-use assets is excluded from a computation of capital gains in terms of para 53 of the Eighth Schedule to the Income Tax Act. Although personal-use assets may have considerable value in aggregate, I assume their disposal is trivial and will not give this issue further consideration.

IX WEALTH TRANSFERRED

(a) Norm of tax incidence falling on transferor

It is not readily explicable, beyond historical accident,[47] why, when wealth is gratuitously transferred between persons, tax should normally be borne by the transferor but not the beneficial recipient, except as a default means of ensuring tax payment. Arguments for estate taxes (typically relating to issues of equality, democracy and economic efficiency) overwhelmingly consider the position of the beneficiary in relation to other members of society and not the transferor.[48] A revised motivation might lie with conceiving the disposal of wealth as an act of consumption on the part of the transferor that is subject to a specific consumption tax.[49] However, this must be an ex post facto rationalisation since estate taxes have not been constructed on such a premise.[50]

The Haig-Simons formulation of income requires all transfers received to be treated as taxable income in the hands of the beneficiary. This seems

[47] I speculate that one reason may be that estate taxes, which particularly lend themselves to the application of utilitarian theory, were instituted before broad base income taxes. Significantly, progressive rates of death duty, which incorporated the marginal sacrifice proposition, were instituted before progressive income taxes. See UA Hicks *Public Finance* 3 ed (1968) 131.

[48] See, for instance, the Responsible Wealth website.

[49] See T Blumkin & E Sadka 'Estate Taxation' (2001) Center for Economic Studies & Institute for Economic Research Working Paper No 558 3.

[50] The 'warm glow' presumed to be enjoyed by a testatrix because of the knowledge that the bequests she has made will be actuated after her death, may confer utility or happiness to her but not something quantifiable in monetary terms. In general terms, consumption implies an exchange, a price, and the obtaining of something measurable from a transaction party. Consequently, it is not readily apparent why the granting of a bequest should be conceived in terms of consumption on the part of the transferor.

unarguable.[51] No counter-principles, other than established practice, and any compelling motivation of public policy that might oppose such inclusion, are obvious. A beneficiary's economic well-being is augmented by a gift or inheritance in precisely the same way as if she had become entitled to a lump sum of earned income, which would certainly have been taxable. There is an overwhelming equality imperative that bequests or any receipt of measurable wealth should be taxed in the hands of the beneficiary.

(b) Potential for double taxation

If an estate tax were to operate in addition to a comprehensive income tax, the bequest would be taxed once in the hands of the decedent and immediately afterwards, perhaps simultaneously, in the hands of the beneficiary, giving rise to the appearance of a particularly harsh form of 'double taxation'. (As I argued earlier,[52] plausible double taxation occurs only in the most restrictive of

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[51] J Rawls *A Theory of Justice* (1972) 278 observed that 'The unequal inheritance of wealth is no more inherently unjust than the unequal inheritance of intelligence', provided that the resultant inequalities do not offend his take on justice. While he did not, of course, imply the following conservative argument, if financial and genetic bequests are similar, financial inheritances should no more be subject to a tax than genetic inheritances. However, inherited wealth is inherently different from a genetic bequest of, say, athletic ability. The latter is no more than a potential that may or may not be realised. Furthermore, an endowment of this nature is neither quantifiable in monetary terms nor tradable. There is nothing government can or should do to equalise genetic inheritances. Nevertheless, it may seek to mollify the unequal effects of unequal genetic inheritances. However, government can and should take effective action to negate the disproportionate economic benefits conferred by bequests of wealth: both the event of financial inheritance and its consequences.

[52] See Chapter 15, section V above for a discussion of double taxation.

circumstances.[53]) Nevertheless, the likely connection between the taxpayers; the discernible trail of the bequest; and the timing of the two tax charges make it likely that this taxing of the transferor and beneficiary would be perceived as an unacceptable form of double taxation.[54]

There can be no question, under a constitutional scheme of taxation, of refraining from taxing bequests in the hands of beneficiaries in order to alleviate this double taxation. A constitutional scheme of taxation must concern itself with the year-to-year needs and abilities of the members of the constitutional community, and, without seeking to court bad taste, it may be said that the decedent has neither. But the beneficiary does, on the one hand, have ongoing needs which may be claimed against the state and, on the other hand, the ability to contribute to the fiscus.

The relevant policy choice lies, therefore, between double taxation and refraining from taxing deceased estates.

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[53] For example: A is an employee of a company. In compensation for her efforts, she is awarded shares in her employer. She will pay income tax on the value of the shares on accrual. When she dies, the value of the shares will be potentially subject to estate duty. There is a perceptual connection between two incidents of taxation and a specific item. However, unless her estate consists only of those shares, it is impossible to attribute estate duty to any particular component of her taxable estate.

[54] According to T Nagel & Liam Murphy *Myth of Property* (2001) SEVEN 2, the Bush administration opposition to estate tax ostensibly springs from an opposition to double taxation. While the concatenation of income tax and estate tax generally has no greater to claim to double taxation than other arrangements, not considered objectionable, because the United States does not have a comprehensive consumption tax, estate tax must prejudice savings relative to consumption. To that extent, American estate tax concerns do have cogency, although opposition arguments would be more plausibly expressed in terms of equality. Nevertheless, the obvious way to achieve equal treatment of savings and consumption lies with introducing a federal VAT, not with scrapping estate tax.

(c) Reasonable policy choice

The simple formulation of income indicates that the value of a person's estate on her death is represented by accumulated income that has not been consumed.[55] A tax on the deceased estate is, then, simply a tax on accumulated savings, a wealth tax payable on death. (The reasons for and against a wealth tax are canvassed in the following section. The difference between a wealth tax and an estate tax is that, under the latter arrangement, capital gains not realised previously will be taxed in the hands of the decedent.)

If an estate tax is seen as an agterskot payment to the fiscus, a making good of any shortfall in tax paid during the taxpayer's lifetime, it will have particular appeal in a system which taxes income and consumption but privileges savings. However, under a comprehensive income tax, all income would be taxed equally and so, bearing in mind a final reckoning of capital gains on death, there would be no shortfall to make good. In the steady state, there could be no justification for the coexistence of an estate tax and a comprehensive income tax.

A post apartheid government might consider retaining estate duty along with a comprehensive income tax as a punitive measure against wealth that it considers to have been accumulated under an unjust system. It would then need to decide how long before any unjustly obtained wealth might work its way through the system and so no longer be worthy of punitive taxation. However, even if there were grounds for such a punitive approach, it would be an impossible task to separate justly from unjustly accumulated wealth. Estate duty (and donations tax) should be abolished, therefore, coterminous with the institution of a comprehensive income tax.

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[55] $I = C + S$ (See Chapter 14, section 3 above for the derivation of this formula). If the value of the estate is 'E', then, $E = \sum I - \sum C = \sum S$.

X STORES OF WEALTH OR WEALTH CONSERVED

(a) Potential gap in the tax net

A general tax on consumption is not compatible with a comprehensive income tax, as it causes income consumed to be taxed twice, without good reason.[56] Refrainment from taxing consumption should not, however, create a gap in the tax net, since a person whose wealth is derived from capital would pay income tax on her capital gains when she disposed of a portion of her capital in order to consume. Nevertheless, an assessment of the annual change in a taxpayer's economic well-being is not complete if stores of wealth are not taken into account. Consequently, following the Haig-Simons rationale, a comprehensive income tax should include all increases in stores of wealth (realised or not) on a year-to-year basis. Yet, it seems that policy concerns relating to the allowance of deductions of unrealised losses outweigh the benefits of taxing unrealised gains.

(b) Tax on static wealth

(i) Independence from comprehensive income tax

Notwithstanding the concerns expressed above, a tax on static wealth, independent of a comprehensive income tax, could be levied. Such a tax would take a snap shot of a person's store of wealth at a point in time, analogous to an accountant's balance sheet, and use her aggregate wealth assessed in this way as the basis for assessment.

[56] See Chapter 19 below for a discussion of VAT.

(ii) Double taxation

Such a tax on static wealth would not relate to changes in wealth from year-to-year. Therefore, if additional to a comprehensive income tax, it would cause new wealth accruing in the period between points of assessment to be double taxed. To alleviate this double taxation, an amount to compensate for comprehensive income tax could be deductible against the wealth tax or vice versa. If these are independent taxes, calculation of a fair deduction may seem problematic. Yet, wealth and income are obviously related. Since each year's income consists of amounts consumed and amounts saved during the period of assessment,[57] a taxpayer's store of wealth must be the cumulative sum of savings, alternatively cumulative income less cumulative consumption.[58] Consequently, a wealth tax, which is no more than a tax on cumulative savings, privileges consumption.

While I am opposed to a general tax on consumption, principally on the grounds of equality, there are no good reasons for privileging consumption over saving. Equal treatment of consumption and saving, derived from the recognition that consumption is not a social mischief worthy of penalisation is enough. Conversely, there are no good reasons to penalise savings and it would be contrary to accepted wisdom to do so.

(c) Appropriateness of a wealth tax in South Africa

(i) Symbolic value in an unequal society

A tax on wealth has considerable symbolic value, particularly for a country such as South Africa where fundamental socio-economic problems are greatly

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[57] $I = C + S$

[58] If wealth is represented by 'W', $W = \sum S$ or $\sum I - \sum C$.

attributable to an extraordinarily skewed distribution of economic assets.[59] Conversely, a wealth tax effectively validates both the economic and legal arrangements that gave rise to the taxable wealth, and the retention of the post-tax wealth. To that extent, a wealth tax is conservative and should bring confidence and certainty of possession to those whose wealth is taxed. This is particularly significant when wealth has been accumulated under conditions of injustice.

(ii) Wealth tax was not imagined

A national tax on existing stores of wealth, levied at moderate rates, seemed, have been a compelling policy choice immediately after the establishment of democracy in South Africa. Indeed, the Truth and Reconciliation Commission recommended an investigation into the feasibility of such an arrangement and finally recommended a wealth tax on businesses.[60] However, the Katz Commission advised against a wealth tax, concluding that a capital transfer tax would function as an adequate substitute.[61] Nevertheless, it was primarily a lack

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[59] V Taylor (Chair) *Report of the Committee of Inquiry into a Comprehensive System of Social Security for South Africa: Transforming the Present – Protecting the Future* RP 53/2002 (2001) para 2.8.1

[60] See DM Tutu (Chair) *Truth and Reconciliation Commission* Final Report, Volume 5, Chapter 8 para 39 and Volume 6, Chapter 5 'Report of the Reparation and Rehabilitation Committee: Reparations and the Business Sector' 143.
Since my current concern lies with individuals rather than corporations, through which trade tends to be conducted, I will not consider this recommendation further.

[61] This proposition is theoretically correct. A person's estate is equivalent to her cumulative savings or wealth. However, even at a theoretical level, the benefit conferred by the ability to defer tax is significant and frequently unfair. Under the tax system that the Commission actually considered, capital transfer taxes have been 'voluntary'. It was, therefore, implausible to have suggested that a wealth tax was unnecessary in the light of the existence of a capital transfer tax.

of confidence in the capacity of the collection agency that motivated the Commission's recommendation, rather than considerations of social justice,[62] or the effectiveness of wealth taxes. (In this latter regard, there is evidence to suggest that wealth taxes can, in practice, lead to greater concentrations of wealth, particularly amongst families.[63]) Undoubtedly wealth taxes are technically problematic and give rise to administrative challenges. Nevertheless, a tax system should be constructed to reflect the community's ethics and not the collection agency's perceived inadequacies.

It is not immediately obvious why a wealth tax should have failed to gain persuasive popular support. Expectations may have been manipulated by the media;[64] possibly, the Katz Commission's investigations came psychologically too soon after the tectonic political changes brought about by democracy; or arguably the paradigmatic imagination can only envisage national taxes being paid when transactions or particular legal and economic events occur.

(iv) Objections to wealth taxes

Alan Tait of the International Monetary Fund concludes that a lack of interest in wealth taxes is general and attributable to the following factors:

(aa) low economic priority;

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[62] MM Katz (Chairperson) *Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa* (1994) Fourth Report para 7.1.11

[63] M Lamont *Finance Week* 23 April 1992

[64] For an article typical of those that were published in the mainstream South African press at the time of the Katz Commission's relevant recommendations, see L Roberts 'Spectre of crippling wealth tax is laid to rest – for now' *Business Times* 11 October 1996.

(bb) low yield (the maximum yield from wealth taxes was around two per cent of tax revenue, recorded by Japan);
(cc) the need to tax the wealthy more comprehensively than the poor has become moot with the establishment of the welfare state;
(dd) low political priority (most countries want to encourage enterprise which is widely assumed to be hampered by taxes on wealth);
(ee) divergence between academic proposals and political plausibility;
(ff) experience of inflation in the 1970s in the West;
(gg) practical considerations, notably those relating to valuation and avoidance schemes (bearer bonds in civilian jurisdictions and offshore trusts in common law jurisdictions).[65]

(d) Wealth tax and a constitutional scheme of taxation

Whatever the policy motivations for shrinking from taxing stores of wealth, I do not consider that it would be fruitful to pursue the matter further here, given that my proposals to do not include a tax on static wealth. I do not propose such a tax on the same grounds that I do not support capital transfer taxes, that is, in my view it is more equitable to tax the beneficiary of comprehensive income effectively but at only one stage of the wealth narrative. This is, of course, a steady state argument made with an eye to the future. South Africa's material inequalities are not derived simply from disparities in income but arise from a more general historical pattern of unequal distribution of social and economic assets. A moderate wealth tax was apt and morally persuasive, and certainly

[65] AA Tait 'Net wealth, gift and transfer taxes' in S Cnossen (ed) *Comparative Tax Studies: Essays in Honor of Richard Goode* (1983) 139

deserved further investigation at the time democracy was instituted, but, it seems that moment has now passed.[66]

XI CONCLUDING COMMENTS

Although this examination of the tax base has been necessarily lengthy, if selective, the principle is simple. A person's ability to contribute to the fiscus during the year of assessment springs from her increase in economic well-being during that period. No tradable manifestation of economic well-being should be excluded from the tax net unless it is trivial or incapable of measurement.

[66] Local land taxes may appear to be novel wealth taxes but they are no more than the well established, rates and taxes levied on immovable property from which agricultural land has traditionally been exempt. Furthermore, it would be inaccurate to describe the demutualisation levy as a wealth tax. Although the subject of the tax was a capital distribution, demutualisation shares represented undistributed, accumulated profits. (See Demutualisation Levy Act 50 of 1998.) The levy in substance is better compared with the secondary tax on companies and its underlying strategy nimble opportunism on the part of the government.

CHAPTER 17 EQUITY AND THE TAXPAYING UNIT

I INTRODUCTION

Having established the timing and tax base, the next issue of equity to be considered is the tax unit. Two basic issues are relevant here. The first issue relates to the question whether couples should be taxed jointly or as individuals.[1] The second issue relates to the scope of fiscal residency.

II INDIVIDUAL AS THE TAXPAYING UNIT

(a) History of tax unit in South Africa

Traditionally, South Africa taxed married couples as a single income tax unit but, following the recommendations of the Margo Commission, instituted the individual as the income taxpaying unit.[2] The use of an individual as the

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[1] There appears to be little appetite in South Africa for taxation at a group or community level. Even under the natives tax (see 'Appendix' below for an outline of the Natives Taxation and Development Act 41 of 1925), at a time of strong 'tribal' identity, tax liability was individuated. Groups of people can possibly effect joint taxation by way of a trust, since a trust is a discrete taxable unit under South African income tax law. (See definitions of 'person' and 'taxpayer', section 1 of the Income Tax Act 58 of 1962.)

[2] For tax years ending on or before 28 February 1988, any income earned by a married woman was deemed to have been received by or accrued to her husband. (See AP De Koker & G Urquhart *Income Tax in South Africa* (1992) para 15-20). Following recommendations made by the Margo Commission (C Margo (Chair) *Report of the Commission of Inquiry into the Tax Structure of the Republic of South Africa* (1987)) separate taxation of spouses was gradually introduced, and, save for certain anti-avoidance measures, full separation of income was achieved in 1995. The current system is essentially one of separate taxation, and is generally indifferent to the marital regime of taxpayers (Section 7(2) of the Income Tax includes anti avoidance measures relating to income arising from inter-spousal donations, and excess income arising from a trade carried on jointly. Section 7(2A) of the Income Tax Act provides that income from jointly held fixed property is taxable in equal shares, whereas other forms of income are generally taxed separately as trade income in the hands of the relevant spouse.)

taxpaying unit reflects the individuated rights established by the Constitution[3] and counters a history of patriarchy in income tax.

(b) Opposition to status quo

One might expect little opposition to the principle of an individual as the taxable unit. However, the progressive WBI has advocated a reversal of this principle and the deeming of the household to be the taxpaying unit.[4] The recommendation was made to counter the perceived advantage enjoyed by two income households, over single income households, which are generally financed by women. While the WBI's concern in this regard is important and worthy of government intervention, the proposed remedy cannot be supported for the following reasons:

(i) Equality infringement

First, it is likely that the equality guarantee would be breached by such an arrangement.[5]

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[3] Constitution of the Republic of South Africa Act 108 of 1996 (Constitution)

[4] T Smith 'Women and Taxation in South Africa' IDASA Women's Budget Initiative (2001) 28 recommends that:
'The current system of separate taxation of spouses in the same household needs to be reviewed. The current system seriously disadvantages households with only one income-earner in terms of the higher amount of tax they are required to pay compared to two-income households. Consideration needs to be given to the feasibility of re-introducing some kind of system of joint taxation for households in which both spouses earn an income'.

[5] Certainly, it seems likely that section 9(3) of the Constitution would be breached if the tax unit were to be a married couple, and probably if the tax unit were a domestic partnership.

(ii) No actionable preference

Second, any advantage enjoyed by two-income couples is an accidental practical advantage, rather than a preference conferred directly or indirectly by law. Consequently, it is difficult to understand how such an advantage should be considered actionably unfair.

(iii) Historical lessons

Third, the history experience of treating married couples as a taxable unit indicates the ill-advised nature of the proposal. As was argued at the time of joint taxation, it is morally suspect for a tax system to discourage marriage, and, updated for the present, it is socially undesirable for the tax system to encourage people to live apart.[6]

[6] The transition arrangements bridging joint and separate taxation (see note 2 above) gave rise to certain remarkable anomalies that made a mockery of the government's professed moral preference for marriage. Since the preferential rates for married persons were derived from, inter alia, the right to claim a child rebate, divorced or unmarried persons who both partially supported the same child could each be treated as a married person. A widow and widower living together in a 'common law' union would both have been treated as married persons. Initially, members of the only class of persons who could not qualify as married persons were married women.

(iv) Legal incoherence

Fourth, income earned by a married person may legally be hers alone, not giving rise to a joint entitlement.[7] Joint taxation may be opposed, therefore, on the grounds of legal coherence.[8]

(c) Tax unit and a constitutional scheme of taxation

When a tax system confers a benefit on a caregiver, such as under an earned income tax credit scheme, and there is more than one caregiver involved, it is equitable to consider the aggregate income of both caregivers in respect of a particular child. However, this does not necessitate joint taxation of the caregivers.[9] Under a constitutional scheme of taxation, every child should be

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[7] The WBI proposal, if given effect, would revive certain difficulties experienced before 1988. Where spouses had excluded community of property and the accrual system, there was no doubt under the common law that income did not accrue jointly. However, it was uncertain, under the common law, whether income earned by a spouse married in community of property accrued jointly to her and her spouse or whether it accrued first to her before commingling with communal property. Issues such as these would be more complicated in a time when many people form domestic arrangements that have uncertain legal status and consequences. See, for instance, *Satchwell* v *President of the Republic of South Africa* 2002 (6) SA 1 (CC).

[8] See Chapter 8, section IV above for a discussion of the principle of legal coherence.
Section 7(2A)(b) of the Income Tax Act deems income arising from fixed property held in community and non trade income to accrue jointly in equal shares to spouses. The WBI concern, however, lies with the dispossessed not members of the property owning classes.

[9] Joint taxation of couples discourages married women from entering the workforce. See A St Martin & P Whiteford 'More jobs and better pay' *OECD Observer* 26 September 2003 (no constant pagination). Such a consequence is economically inefficient from the perspective of the general community. Furthermore, exclusion from the workforce has a negative impact on the economic positions of the women directly affected and denies them the broad empowerment that often accompanies employment.

eligible for a guaranteed minimum income, set off against any income she might have, but paid to her principal caregiver in a fiduciary capacity. As this guarantee would be payable for the benefit of the child, the position of the caregivers would not be relevant.

III PIERCING THE CORPORATE VEIL

Notwithstanding the basic principle of legal coherence,[10] special consideration must be given to juristic and quasi-juristic persons.[11] Certain private companies, close corporations and trusts, being owned or controlled by an individual, (effectively her alter ego) can be used to avoid a personal income tax liability or to obtain an unfair tax advantage. Therefore, when establishing tax liability, it may be necessary to look through the 'corporate veil' to the controllers and interest-holders in the entity.[12]

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[10] See note 8 above.

[11] The definition of 'person', given in section 1 of the Income Tax Act, includes trusts and deceased estates. These arrangements are not recognised as persons under modern South African law. (See *CIR v Friedman NO* 1993 (1) SA 353 (A) and *Estate Smith v CIR* 1960 (3) SA 375 (A) respectively.)

[12] Ottolenghi 'From peeping behind the corporate veil, to ignoring completely' 1990 *Modern LR* 338, 349 (extract in R Grantham & C Rickett *Company and Securities Law: Commentaries and Materials* (2002) 237) identifies four categories of disregarding the corporate veil. In his schema, my proposal is 'peeping behind the veil', that is considering the position of the interest-holders, rather than generally disregarding corporate personality.

IV SCOPE OF FISCAL RESIDENCY

(a) Fiscal residency

A country, such as South Africa, whose economic system is integrated into the world economy, must have a residency basis of income tax.[13] Comprehensive income includes all amounts of income that accrue to a fiscal resident wherever their sources may be located. Consequently, the criteria for establishing fiscal residency are crucial.

(b) Determinants of fiscal residency

South Africa currently employs an exceptionally undemanding conception of fiscal residency derived from ordinary residence (domicile), alternatively generous time-based objective criteria.[14] This may be compared to New Zealand, whose concept of 'enduring relationship' is sufficiently stringent to deem parents of children being educated in New Zealand to be fiscal residents. While this may appear overly ambitious, from a policy perspective, it is preferable to set as wide a fiscal residency net as possible and then allow treaty obligations to exclude people in respect of whom a treaty party country has a more compelling claim.[15] Under a constitutional scheme of taxation, then, any person who enjoys the

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[13] See Chapter 15, section V, note 14 above for a discussion of the distinction between source and residency bases of taxation.

[14] Definition of 'resident', section 1 of the Income Tax Act

[15] Article 4 of the Organization for Economic Cooperation and Development (OECD) Model Tax Convention on Income and Capital (as at 28 January 2003) provides a tie-breaker algorithm to be used when a taxpayer is prima facie a fiscal resident of both treaty parties.

benefit of constitutional protections should be a fiscal resident.[16] Since 'aliens have the same rights under the Constitution as citizens, unless the contrary emerges from an analysis of the Constitution',[17] all citizens, wherever they may be, and anyone physically in the Republic should be considered a fiscal resident. However, for practical purposes casual visitors and persons who prove that they are fiscal residents of a treaty party country should be excluded.

V EXITS FROM THE COMMONWEALTH

(a) Withholding taxes

Jurisdictions normally supplement income tax paid by fiscal residents through withholding taxes charged against a range of payments made to non-residents. However, at present, South Africa only taxes royalty payments to non-residents.[18] Parallel to the broadening of the tax base for residents, it may be expected that withholdings should be extended to all amounts paid to non-residents that have a source located in South Africa.

(b) Exit taxes

Wealth generated within the constitutional community should be taxed on its exit to compensate the commonwealth for the future taxes foregone by its export. This principle is already established. In terms of current capital gains tax provisions, capital gains are deemed to have accrued in respect of the property

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[16] This proposition revisits Adam Smith's basic principle that enjoyment of the protection of the state should determine taxability – both in determining the tax base and fiscal residency. See Chapter 16, section I above.

[17] Booysen J in *Patel* v *Minister of Home Affairs* 2000 (2) SA 343 (D) 349I

[18] Section 35 of the Income Tax Act

of residents who emigrate.[19] Additionally, an exchange control charge is levied at a rate of 10 per cent of the value of that part of the exported property of an emigrant that exceeds the maximum standard foreign investment allowance.[20] It is not necessary to consider whether the current exemption and rate are reasonable: setting the rate is the prerogative of the government of the day. The capital gain tax trigger and the exchange control charge should, however, be integrated within a comprehensive income tax net, with rates and allowances being consonant with the overall system. The exit tax should apply to all capital transfers that are permanently exported from the commonwealth, including bequests to non-residents.[21]

VI CONCLUDING COMMENTS

The tax system cannot solve all of society's problems. Therefore, it is unrealistic to expect taxation to correct accidental inequalities that do not have a legal source, such as the economic benefits enjoyed by two-income households over one-income households. Once a constitutional scheme of taxation has delivered a minimum income,[22] other interventions will remain necessary to assist the financially weakest in society. Conversely, the important principles served by individuated taxation should not be jeopardised by imprudent short-term measures.

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[19] Paragraph 12(2) Eighth Schedule to the Income Tax Act

[20] The allowance is currently R750 00 for an individual and R1 500 000 for an (undefined) family unit. See South African Reserve Bank *Exchange Control Manual* (2003).

[21] In terms of this proposal, the capital gains and transfers of an emigrant would be taxed in her hands, whereas a withholding would be effected against bequests or gifts made by residents to non-residents.

[22] See Chapter 12, section II above for a discussion of the merits of a state guaranteed minimum income.

Equity between fiscal residents and non-residents is an aspect of equality that receives scant attention. Yet, it is inappropriate for a tax system to pursue a scrupulous equality between residents but to extend egregious tax privileges to non-residents. A constitutional scheme of taxation will rectify the current scheme's inattention to equitable treatment of non-residents relative to residents.

CHAPTER 18 EQUITY AND RATES OF TAX

I INTRODUCTION

Having applied a constitutional conception of equity to possible tax arrangements, it has been established that:

(a) Timing

The timing of the tax should be determined from the first acquisition of new wealth.[1]

(b) Tax base

The tax base should comprise comprehensive income.[2]

(c) Tax unit

The taxpayer should be an individual who enjoys constitutional protection.[3]

It remains to consider an equitable scheme of rates for a constitutional scheme of taxation. In practice, this requires a selection between progressive (graduated) and proportional (single, flat) rates.[4]

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[1] See Chapter 15 above for a discussion of equitable timing.

[2] See Chapter 16 above for a discussion of the equitable tax base.

[3] See Chapter 17 above for a discussion of the equitable tax unit.

The investigation conducted in this chapter does not have a purpose of excavating inherent justness in progressive or proportional tax rates but in deciding which is more appropriate for a constitutional scheme of taxation. Constitutional taxation aims to give effect to the differing abilities of different community members to contribute to the fiscus during a year of assessment. Once all other relevant factors have been taken into account, tax rates should be selected which most rationally and proportionately further that aim.

II IDEOLOGICAL PREFERENCES

(a) Modern preference for progression

Before the ascendancy of neo liberalism in the 1980s, there was a broadly held sentiment that higher levels of income ought to be taxed at progressively higher rates. Although the structure of rates, particularly the highest marginal rate, could

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[4] A Smith *An Inquiry Into the Nature and Causes of the Wealth of Nations* (1776) (1952 reprint) 375 observed that 'In the disorderly state of Europe during the prevalence of the feudal government, the sovereign was obliged to content himself with taxing those who were too weak to refuse to pay taxes. The great lords...refused to subject themselves to any constant tax, and he was not strong enough to force them'.

Unemployment insurance contributions, which may be seen as a form of tax (they are paid into the National Revenue Fund), are explicitly regressive, inasmuch as contributions are capped at a certain level of earnings. (See section 6 of the Unemployment Insurance Contributions Act 4 of 2002.) However, such 'taxes' are better viewed from a perspective of insurance, with 'premiums' being paid for likely benefits.

It is not feasible to apply explicitly regressive rates to a comprehensive tax base.

be a conflict issue, the principle of graduation was not.[5] Even though progression in taxation may be rhetorically linked to socialism,[6] and Marx did, indeed, famously prescribe 'a heavy progressive or graduated income tax',[7] it was the United Kingdom under a Liberal government which introduced clearly defined progressive taxation to the Anglophone world in 1894.[8] Graduation gained momentum after the First World War until reaching its apotheosis in the 1970s when rates of income tax in several countries approached 100%.[9] Since then, income tax rates have generally decreased. Nevertheless, the basic principle of

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[5] CS Shoup *Public Finance* (1969) 22

J Rawls *A Theory of Justice* (1972) 279 describes the choice between progressive and proportional tax rates as a 'political judgment and not part of a theory of justice'. This statement is disputable. First, it implies that political judgment is not founded on any theory of justice, which is improbable. Second, since the constitutional conception of justice incorporates equality, the rate structure that is more effective in promoting equality (taking into account other constitutional requirements) will be the more just.

[6] See, for instance, FA Hayek *Law, Legislation and Liberty* Volume 2 *The Mirage of Social Justice* (1976) 150

[7] K Marx & F Engels 'Manifesto of the Communist Party' in *Selected Works* (1968) (1977 reprint) 31, 52

[8] UA Hicks *Public Finance* 3 ed (1968) 131

According to FA Hayek *The Constitution of Liberty* (1960) 310, Prussia introduced a progressive income tax in 1891.

[9] The Institute for Fiscal Studies databases record that, between 1974 and 1979 in the United Kingdom, the highest marginal rate of income tax was 83 per cent, augmented by a 15 per cent surcharge applicable to investment income.

progression, particularly in income tax, has been maintained by ideologically disparate governments.[10]

(b) Alternative support for proportionality

The alternative to progression - a proportional rate of contribution - does enjoy support; indeed, there is venerable authority in its favour. Adam Smith, for instance, favoured proportional contribution but significantly, he had in mind a tax base that comprised revenues from land only.[11] Such a tax would necessarily have applied exclusively to the relatively wealthy.[12] Comparably, Thomas Hobbes and John Locke, who proposed proportional rates, contemplated taxes on consumption, not income. (The Lockean conception of neutrality, requiring a tax to leave citizens in the same relative positions as they were before it is levied,[13] informs the flat tax movement.)

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[10] An egregious example of a retreat to regression is provided by estate duty rates. Under the current arrangement, the portion of an estate, if any, which remains dutiable after the deduction of the spousal concession and abatement is subject to a flat rate. Yet, from April 1955 to March 1988 graduated rates ranging from 10 per cent to 35 per cent applied to the dutiable portion of a deceased estate. Following recommendations made by C Margo (Chair) *Report of the Commission of Inquiry into the Tax Structure of the Republic of South Africa* (1987), a flat rate was introduced. From March 1988 to March 1996, a rate of 15 per cent applied; from March 1996 to October 2001, 25 per cent; and, from October 2001 to the present, a rate of 20 per cent has applied.

[11] E Roll *A History of Economic Thought* (1973) (1989 reprint) 71. Smith (note 4 above) 376 referred to an ideal tax being levied on 'ground-rent'.

[12] See N Chomsky *Power and Prospects: Reflections on Human Nature and the Social Order* (1996) 77 for a counterblast to the neo liberal adoption of Adam Smith, out of his pre-capitalist environment and without his deep sense of human worth.

[13] See RA Epstein 'Taxation in a Lockean World' in J Coleman & E Frankel Paul (eds) *Philosophy and Law* (1987) 39, 55.

If these examples imply that progression in taxation is a recent idea, it may be noted that Jean-Jacques Rousseau, who also favoured consumption taxes, argued that rates of tax should be calculated in a 'compound ratio to the differences of [the taxpayers'] positions and the superfluity of their possessions'.[14]

Until quite recently, direct taxation has been elitist, a concern only of the wealthy. For instance, as late as 1939, less than one-fifth of the United Kingdom's working population was subject to income tax.[15] Consequently, it would be convenient to dismiss the notion of national government being financed by proportional consumption taxes as a pre-capitalist curiosity. Yet, various proposals for some form of a flat tax gained considerable publicity in the 1990s, particularly in the United States, although none has yet been taken up.[16]

III FLAT TAXES

(a) Ideological aims of flat tax proponents

Unscientific a proposition as it may first appear, the conceptions of social justice held by proponents of graduated taxes tend to be consistent with constitutional ideas of social justice, whereas flat taxes tend to be espoused by anti-

[14] J-J Rousseau 'A Discourse on Political Economy' in *The Social Contract and Discourses* (trans GDH Cole, revised JH Brumfitt & JC Hall, 1973) (1992 reprint) 128, 162

[15] J Plender 'Revolutionary Forces Which Will Destroy Income Tax' *Financial Times* 27 November 1993

[16] An indication of the imaginative entrenchment of progression in income tax, David Bradford's radical proposal for a flat rate, cash flow based 'X-tax' retains graduated rates in respect of individual income. See DF Bradford 'International Taxation in an X-Tax World' (2002) 3, revised version of a paper presented at Brooklyn Law School International Tax Policy Symposium, 'International Tax Policy in the New Millennium', 9-10 November 2000.

government libertarians. This is logical. If tax rates are flattened, lower rates may be increased (although political feasibility dictates that any increase cannot be too high) but higher rates must decrease. If the less well off are not to suffer unacceptably from a flattening of rates, either the tax base must be broadened or the revenue collected must fall. Since the major flat tax proposals exclude investment income (both income received from investments and income from any source that is invested), if a flat tax were introduced, government revenue would fall dramatically. The counter argument that, notwithstanding a flattening of rates and a narrowing of the scope of the tax base, the increased earnings of 'incentivised' workers will make up the shortfall is simply implausible. At first face, a country's structure of taxes does not dictate yield or, indirectly, the scope of government action. These are determined by the amounts of tax raised. Nevertheless, flat tax proponents clearly discern a link between a single rate tax on consumption and the amount of revenue government can practically raise. Since the maximum yield from value-added tax (VAT) in Organization of Economic Cooperation and Development (OECD) countries is around 20 per cent of revenues, a massive decrease in government revenue would result from an economically developed country scrapping income tax. It is unsurprising to learn that proponents of flat taxes tend to harbour the ulterior motive of reducing government reach by damming the flow of taxes into the fiscus.[17]

(b) Incompatibility of flat taxes with constitutional governance

A flat tax would be inconsistent with constitutional expectations for the following reasons:

[17] See S Moore 'The Economic and Civil Liberties Case for a National Sales Tax' before the Hoover Institution conference 'Frontiers of Tax Reform' National Press Club Washington, DC, 11 May 1995.

(i) Discrimination against consumption

First, a flat tax would unjustifiably discriminate against consumption.[18]

(ii) Unacceptable reduction of revenues

Second, the reduction in revenues that would result from a flat tax would restrict the capacity of government to fulfil its constitutional obligations.

While the narrowing of the tax base, which is the real purpose of flat tax propositions, disqualifies a flat tax in the constitutional context, a single rate, applied to a comprehensive income tax base, cannot be dismissed as being inherently inappropriate for a constitutional scheme of taxation.

IV SINGLE RATES AND EQUITY

(a) Single rate progression

The Margo Commission, when considering the merits of a single rate of tax, paradoxically presented one of its virtues as lying in its progressive effect.[19] The Commission argued that a 'respectable degree of progressivity' could be achieved by combining a constant marginal rate with an exempt income band. It provided the example of a single rate of 20 per cent imposed on all income over an exemption level of R500, such that a taxpayer earning R1 000 would pay at an effective rate of 10 per cent of income, whereas one earning R10 000 would pay at a rate of 19 per cent. Nevertheless, whether or not such an arrangement would give rise to a 'respectable degree of progressivity' depends on the amount

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[18] See Chapter 19, section IV below for an explanation why consumption taxes are discriminatory in an impoverished society.

[19] Margo Report (note 10 above) para 6.98

of exempted income and is a matter of mathematical legerdemain. Using the Commission's exemption level but with more realistic income levels, a person having a modest income, say R15 000 a year would pay at a rate of 19,33 per cent; a middle income earner, say of R80 000 a year, at 19,88 per cent and a person with a high income, say R500 000 a year, would pay at a rate of 19,98 per cent. The progression is negligible, with little more than one half a percentage point separating the tax rates of the modest and high earners.

(b) Equity without progression

Nevertheless, the single rate proposition can inform a generally fair tax model if progression, which implies taking equality seriously, is not the predominant policy concern. If, for instance, it is determined that all of a person's human needs can be comfortably met by an annual income of R15 000, this amount may determine the level of exemption. In such a case, the three rates, for the income levels used above, would now become: zero per cent, 16,25 per cent and 19,4 per cent. Progression is, however, a secondary effect here. The purpose of such an arrangement would be to ensure that lower income groups are not unduly impacted in absolute terms. However, differentiation between the moderately well off and the wealthy would not be a concern. Such an approach is a reasonable means of engaging with equality and need in certain areas of public policy, for instance, the provision of water. While I am opposed to the practice, modern income tax systems frequently employ a small number of different rates, presumably in the ostensible interests of simplicity. (However, a single rate of tax does not deliver simplicity to income tax. The tax base, not the tax rate, principally determines simplicity.[20]) The United Kingdom employs three individual income tax rates, New Zealand four, and South Africa six. However, the calculation of the tax base necessarily remains complex.

[20] See Chapter 11, section II above for a discussion of tax rates and tax simplicity.

(c) Single rates and distributive justice

A single rate fails to take account of different people's differing abilities to contribute to the fiscus. Distributive justice requires that those similarly situated should be treated similarly, and we have been attentive to such horizontal equity in scrupulously ensuring that as many manifestations of economic well-being as is feasible are taken into account in computing the tax base. However, the second, vertical imperative, that those differently situated should be treated differently, is also a crucial equality concern. It would be incongruous, then, if a tax system were to be attentive to horizontal equity but demonstrated insensitivity to vertical differences by imposing a single rate. The fundamental claim of graduated taxes is that they provide a mechanism of delivering vertical equity.

V PROGRESSION AND REGRESSION IN PRACTICAL SYSTEMS

Tax commentators, whether progressive or conservative in outlook, tend to see progressive and proportional taxes as different arrangements that can happily coexist, rather than mutually exclusive choices.[21] The introduction of progressive rates of income tax was seen as a way of ensuring universal contribution whilst offsetting the effects of regressive taxes, such as excise. It was deduced with typical Victorian confidence that 'any desired distributional result could be obtained by a compensatory structure of taxes in which the faults of one [imperfect tax] would be offset by the virtues of another'.[22] Utilitarian policymakers believed that 'This discovery finally made it possible to resolve the dilemma between the principles that all should contribute to the expenses of government (on political and moral grounds), and that the poor should be exempt (on humanitarian and utility grounds)'.[23]

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[21] See, for instance, Hicks (note 8 above) 132 and Hayek (1960) (note 8 above) 307.

[22] Hicks (note 8 above) 132

[23] Ibid

Remarkably, even Hayek, who expressed outrage at progressive rates of income tax, accepted that progression in direct tax rates was necessary in order to balance the effective regression of non-graduated indirect taxes.[24] However, this concession should be treated with caution since it implies that effectively regressive taxes should be normal, with progression relegated to a secondary role of mitigating the impact of the norm.[25]

Contemporary tax systems tend to be predominantly progressive, whereas flat tax and, to a lesser extent, proponents of single rates seek to make tax structures overwhelmingly regressive. An aim of a constitutional scheme of taxation should be a pervasive equality, with regression being countenanced rarely and always for good reasons.

VI PROGRESSION AND RATIONALISM

In *Walker*,[26] the Constitutional Court, having noted various manifestations of cross-subsidisation, including income tax, concluded that cross-subsidisation was consistent with the equality provision, and 'an accepted, inevitable and unobjectionable aspect of modern life'.[27] I would go further, progressive tax rates are not only constitutionally compatible, they are a constitutional imperative. Holistic equality requires full inclusion, and consideration from horizontal and vertical perspectives. A comprehensive income tax base (including those who have little or no income) delivers justice horizontally; progressive rates are the

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[24] See note 21 above.

[25] In Chapter 19 below, I demonstrate the regressive effect of VAT and its negative impact on progression in income tax.

[26] *City Council of Pretoria* v *Walker* 1998 (2) SA 363 (CC)

[27] Langa J in *Walker* (note 26 above) [62]

best means of delivering justice vertically. It would be offensive to constitutional rationalism[28] to accept the rationale of the comprehensive tax base but to refrain from fully pursuing justice through progression in rates.

However, the traditional justification for progressive rates, the marginal sacrifice proposition, is suspect, and the principle of progression needs to be reaffirmed in a contemporary, constitutional environment.

(a) Marginal sacrifice proposition

(i) Marginal sacrifice and distributive justice

Distributive justice, in its crudest expression, delivering what is due to a person,[29] appears so frequently across time and cultures that for practical purposes it may be said to be 'natural' to human society. Actors in every culture or paradigm seem to provide their own take on distributive justice. In the nineteenth century,[30] utilitarian theorists claimed to reanimate distributive justice in relation to taxation by ensuring that taxpayers made an equal sacrifice of utility in the payment of income and estate taxes. It is this proposition of a fair distribution of marginal sacrifice that has informed progressive taxes since then. Moreover, it is this theory's obsolescence, as a tool of cultural technology, that makes a contemporary justification of progressive taxation necessary.

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[28] See Chapter 2, para II (e) above for an outline of the constitutional embrace of rationalism.

[29] The take on distributive justice of Justinian and Ulpian. See HR Hahlo & E Kahn *The South African Legal System and Its Background* (1968) 9.

[30] Roll (note 11 above) 319 attributes the first enunciation of a theory of utility to the Abbé Condillac in 1776 but indicates that it was WS Jevons and FY Edgeworth, in particular, whose work towards the end of the nineteenth century was instrumental in promoting marginal utility theory in practical government policy.

(ii) Marginal sacrifice and taxation

There are three major equal sacrifice propositions - equal absolute sacrifice, equal proportional sacrifice, and equal marginal sacrifice - each with different aims and outcomes.[31] The general goal is to leave intact the relative positions of all taxpayers as they were before taxation by equalising the 'pain' or disutility that they incur by paying tax. This equalisation of 'pain' does not lead to equalised economic outcomes, nor will it lead to a maintenance of relative wealth positions but does ensure an equal burden because taxpayers' relative utilities are maintained.

Example

A has an income of R1 000 which is assumed to provide 20 units of utility. Because of the assumption of decreasing marginal utility, B, who income is R2 000 obtains only an additional 10 units of utility from her additional R1 000 of income, that is, for her slice of income in excess of R1 000, R1 brings only five units of utility. Consequently, the slice of income in excess of R1 000 may be taxed at twice the rate of the slice below R1 000 without affecting their relative utilities. Therefore, if the first R1 000 of income is taxed at 10 per cent and the second R1 000 at 20 per cent, A will pay R100 and sacrifice two units of utility and B will pay R300 and sacrifice three units of utility. Their starting positions for

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[31] BP Herber *Modern Public Finance* (1983) 120

Just as there has been no take up in modern national tax systems for a flat contribution from all citizens (the natives tax was, of course, precisely this, hence its repugnance to generally accepted tax principles) so no country has sought to impose a system based on equal marginal sacrifice and its requirement of equalisation of post-tax incomes. Hayek (1960) (note 8 above) 310 cites a narrowly defeated proposal of the National Planning Commission of India for an annual cap of $6 300 on all income and $4 300 for salaries. This does not, however, imply an equalising of incomes and, in 1960 values, an annual income of $6 300 would have beyond the experience and imagination of most citizens of India.

income were R1 000 and R2 000 (ratio of 1:2), with their finishing positions R900 and R1 700 (ratio of 1:1,9). Their starting positions for utility were 20 and 30 (ratio of 1:1,5) and their finishing positions 18 and 27 (ratio of 1:1,5).

Had a flat rate of 20 per cent applied, their final utilities would have been 16 units and 25 units respectively so that the utility ratio would have moved from 1:1,5 to 1:1,16. This arrangement would unnecessarily and inefficiently favour B.

(iii) Plausibility of marginal sacrifice proposition

Despite its general reception in validating graduated taxes, the marginal sacrifice proposition, as a means of justifying the ability to pay principle, is suspect:

(aa) Assumptions regarding economic actors

First, in broad terms, neoclassical economic theory implausibly assumes the participation in economic decision-making of a 'homo oeconimicus', a prudent head of household, who is possessed of sufficient knowledge to make, and actually makes, rational and informed economic decisions, free from the influence of others. No account is taken of the possibility of supra-individual phenomena, such as 'herd'[32] behaviour or the operation of social systems.[33] Increasingly, this neoclassical view of economic behaviour is being displaced by a behaviourist view that recognises that people do not always behave rationally – or rather not in accordance with a particular take on rationality that implies

[32] See S Freud 'Group Psychology and the Analysis of the Ego' (1921) *Civilization, Society and Religion* (1908-33) (trans J Strachey, 1961) (1991 reprint) 91, 148 for the classic description of the human 'herd instinct'.

[33] P Ormerod *Butterfly Economics: A New and General Theory of Social and Economic Behaviour* (1998) 57

economic solipsism.[34] Yet, marginal utility theory assumes that an economic actor is able to and does actually measure and react to changes in her aggregate utility to various stimuli, such as earnings being subjected to a changed rate of tax. These assumptions are improbable for the degrees of accurate measurement they infer.

(bb) Assumption of homogeneity of utility

Second, when setting income tax rates, an assumption is made that the utilities of different individuals are similar within a particular income band, with no differences in utility arising when items of income are acquired in different ways. In this way, wages earned in pursuit of an arduous and hazardous occupation are taken to deliver similar utility to a recipient, as a similar amount of passive investment income does to a different recipient.

(iii) Marginal sacrifice and scientism

Essentially, utility-based theories fail 'to take seriously the differences between persons'.[35] In practice, so many variables apply to different individuals' circumstances that the idea of finely measurable schedules of utilities, informing particular rates of tax for particular slices of income, is fanciful. Indeed, it may be ventured that, despite claims for a foundation in measurement of individuals'

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[34] Anon. 'Behaviourists at the gates' *The Economist* 10 May 2003 describes how economic actors really behave in eth following terms: 'They may avoid slight risks, and yet take wild gambles. They may fail to save for the future, although they have the means to do so and a good prospect for a long life. They may not be able to choose how to spend their money in a way which maximizes their "utility"...people are not entirely selfish. Parents seem to give up a lot for their children. People give money to charities, churches and buskers with no apparent gain to themselves'.

[35] MJ Sandel 'Introduction' in *Liberalism and its Critics* (1984) 3

utilities, ability to pay, in practice, applies to the income and not to the circumstances of the person who receives the income. And so, if two people, however different their circumstances, have in common similar levels of income during the measurement period, they will be subject to similar rates of income tax. Therefore, the amount of income is seen to be of principal relevance in practice. Such an arrangement does not take into the circumstances under which income is acquired or the differing utilities derived by different recipients. However, this does not imply bad governance. It is the only practicable way of engaging with the distribution of economic well-being in a specific period and frees an objective assessment of that economic well-being from any pretence of measuring utility.

Ultimately, then, the equal sacrifice proposition can only indicate the desirability of differentiated treatment of taxpayers through graduated tax rates in the broadest of terms. No credible nexus can be drawn to connect estimates of marginal utility with specific tax rates and bands of taxable income. Since positive economics cannot provide an answer for the ability to pay concept, policy makers must rely on 'normative value judgements, collectively reached by society through the political process'.[36] Nevertheless, 'The problems of empirical proof of the basic tenets of the ability-to-pay principle have not precluded Western society from reaching a value-judgment consensus in support of it'.[37]

(b) Independence of progression from marginal sacrifice proposition

If the equal sacrifice proposition is scientistic and rationality is expected in constitutional laws, we must consider whether progression is justified in a constitutional scheme of taxation.

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[36] Herber (note 31 above) 119

[37] Ibid 122

(i) Sentiment for progression precedes utilitarianism

As a preliminary point - not offered as justification - the sentiment for progression in taxation precedes the ascendancy of utilitarian policymaking at the end of the nineteenth century. William Pitt's innovative income tax of 1797-1816, for instance, took cognisance of family circumstances through a system of rebates, with lower incomes being subject to a preferential rate.[38] Ursula Hicks describes the introduction of progressive taxes to Britain as 'no more than logical extensions of the traditional tax ideals'.[39] To reiterate, the marginal utility proposition can be understood as a paradigmatically confined attempt to justify the 'natural' moral prescription of distributive justice. Actors in every paradigm employ the cultural technology available to them to justify distributive justice anew.

(ii) Happiness research

(aa) Confirmation of marginal sacrifice proposition

Contemporary happiness research provides a more appropriate technology for our times, as it considers individuals as socially situated and not, improbably, as economic and social monads.[40] Nevertheless, this developing area of investigation confirms the broad conclusions of marginal utility theory.[41]

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[38] Hicks (note 8 above) 122

[39] Ibid 129

[40] See, in particular, the work of Andrew Oswald of the Economics Department of the University of Warwick.

[41] BS Frey & A Stutzer 'What Can Economists Learn from Happiness Research?' *J of Economic Literature* Vol XL (2002) 402, 405

Therefore, as marginal utility theory would predict, happiness is not dependant on income beyond a certain level.[42] Although increases in general happiness in the community are linked to increases in national wealth, such gains in well-being wear off over time as people become habituated to the increases, even if gains do not dissipate completely. Conversely, losses in general happiness are high in periods of economic recession, and the psychological effects of unemployment, in particular, are considerable. Well-being for individuals, from physical, psychological and social perspectives, is a far more significant determinant of happiness than income.[43]

(bb) Happiness and tax policy

A further observation of happiness research, and one crucial for tax policy, is that when income is taxed, it is not the amount of income a person retains but the amount she retains relative to others which is important to her. If, therefore, a redistributive tax policy is able to maintain income rankings, but reduces the absolute differences between income recipients, subjective well-being is little affected, and presumably, work incentives are not reduced.[44] If, for instance, a manager's status is maintained (including by way of higher remuneration) in relation to that of a shop-floor worker, then, the gap between the two can be closed in terms of economic outcomes without impacting on the manager's general happiness.

By referring to happiness research, comparable conclusions to the marginal sacrifice proposition may be drawn but from the employment of current cultural

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[42] R Di Tella, RJ MacCulloch & AJ Oswald 'The Macroeconomics of Happiness' Department of Economics, University of Warwick Working Paper (2001) 20

[43] Anon. 'Subtract rows, add sex' *The Economist* 27 July 2002

[44] Frey & Stutzer (note 41 above) 411

technology. Therefore, justification for progressive rates is provided in a way that does not appear scientistic to a contemporary observer.

VII EFFECTIVE GOVERNANCE AND ECONOMIC EFFECTS OF PROGRESSION

Progressive rates of income tax are 'the most effective instrument for achieving a greater measure of income equality'.[45] Such a convergence of economic outcomes not only promotes distributive justice amongst those taxed but is also a significant policy tool in the reduction of general poverty.[46] Furthermore, progressive taxation has specific economic benefits.[47] Generally speaking, then, social justice is eminently compatible with economic efficiency and, conversely, economic efficiency makes the delivery of measures for the promotion of social justice possible. Nevertheless, prudent government must be alert to any potentially deleterious economic effects of its equity policies.[48] A crucial concern in this regard is whether progressive rates of income tax may discourage labour and enterprise.

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[45] JK Galbraith *The Good Society: The Humane Agenda* (1996) 65

[46] See Chapter 6, section VII above for a discussion of the effectiveness of a convergence of economic outcomes in reducing general poverty.

[47] See Chapter 6, section VIII above for a discussion of the economic benefits of an equitable distribution of income.

[48] See Chapter 6, section VI above for a discussion of how once-off wealth equalisation is likely to be sufficiently economically inefficient so as to destroy the wealth generation mechanisms that allow progressive, sustainable redistribution.

(a) Laffer curve

(i) Assumption that taxes are a disincentive

There is a commonly held view, graphically represented by the Laffer curve,[49] that high rates of tax depress initiative. However, this concern does not specifically relate to progression in taxes. A flat rate of tax on consumption could have the same effect if it is high enough. Nevertheless, in practice, meaningful progression requires a significant difference between the lowest and highest rates, implying that the highest marginal rate will always be significantly higher than a likely flat rate. Additionally, notwithstanding an exempted level of income or consumption, political feasibility prevents a single rate of tax being set too high in relation to the less wealthy, meaning that the rate at which the wealthy pay tax will be lower than they might expect under a progressive system. Consequently, a practical choice lies between a low flat rate (20 per cent is the most popular rate suggested) and a 'high' top marginal rate (40 per cent appears to be the current norm – even though, rates of up to 98 per cent were politically feasible in

[49] JK Galbraith *The Culture of Contentment* (1992) 104 describes the formulation of the Laffer curve in the following terms:

'Proceeding from the undoubted circumstance that if no taxes are levied, no revenue will be collected, and that if taxes absorb all revenue, no income will be produced, Professor Laffer united the two undoubted truths with a freehand curve that showed that with increasing tax rates, aggregate revenues will first rise then fall.'

the 1970s)[50]. It may be assumed, therefore, that proponents of the Laffer curve do not envisage a flat tax depressing initiative.[51]

(ii) Role of ideological information

Ultimately, it seems to be a matter of ideological faith, demonstrated by an acceptance or rejection of the Laffer curve, whether one believes that progressive rates of income tax discourage labour and enterprise or encourage them. Accordingly, Hutton, a proponent of social market policies, describes the Laffer curve as 'a theory that had no empirical or theoretical support',[52] and Galbraith as an 'exiguous cloak' which usefully disguised its 'real purpose,

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[50] I am sceptical of both the hypothesis that underpins the Laffer curve and the proposition that a rate of, say, 40 per cent should be the frontier of a highest marginal tax rate. (Under the 2003-04 schedule of income tax rates, the highest marginal rate of 40 per cent is reached at an income of R255 000 per annum. See sections 5 and 6 of the Income Tax Act 58 of 1962, read with Schedule 1 to the Exchange Control Amnesty and Amendment of Taxation Laws Act 12 of 2003.) From a utilitarian perspective, it is inconceivable that a person who enjoys an income of R255 001 should gain the same marginal utility from her last rand of income as a person who earns many times that income from her last rand of income. Nevertheless, there is a paradigmatic conviction, exemplified by the hypothesis underpinning the Laffer curve, that high marginal tax rates suppress initiative. The composition of the schedule of tax rates is a government prerogative and should be the last concern in constructing a tax system. The first step is to calculate the financial needs of a prudent and honest government in meeting its constitutional and political obligations. The tax base has been established (see Chapter 16 above) and, therefore, a fair pattern of rates must be applied to that tax base in order to raise sufficient revenue to meet expenditure needs. It is also reasonable to assume that a broader the tax base renders the prospect of lower rates of tax more likely.

[51] Although the hypothesis is applied to levels of tax and popularly to the highest marginal rate, there may be a plausible relational disincentive: 'why must I pay at this rate when someone else pays at a lower rate?' *City Council of Pretoria* v *Walker* 1998 (2) SA 363 (CC) provides an instantiation of the potentially damaging effects of misguided perceptions of horizontal equity.

[52] W Hutton *The World We're In* (2002) 103

namely to lower taxes on the affluent'.[53] Conversely, there is, it seems, broad consensus among American tax economists that the theory describes a verifiable phenomenon.[54]

I observed above that happiness research indicates that it is the relative effect of progressive tax rates that is important for taxpayers' happiness, not the absolute effects. Taxpayers are more concerned about fair outcomes than rates.

(b) Impact of marginal tax rates on propensity to work

It is significant that the debate on tax rates tends to focus on the level of marginal rates at the top of the scale. Yet 'evidence that low rates are necessary at high income levels to encourage effort is sparse. Instead, high income earners or self-employed people may have a target after-tax income and if the marginal rate is lowered so that this target is reached with less effort, they may in fact increase their leisure rather than their work'.[55] Conversely, tax incentives may be effective

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[53] JK Galbraith *The World Economy Since The Wars* (1994) (1995 reprint) 232.
Galbraith (1992) (note 49 above) 104 suggests that: 'It is not clear that anyone of sober mentality took Professor Laffer's curve and conclusions seriously.'

[54] J Fox 'The Tax-Cut Plan; He's Gotta Have It!' *Fortune* 30 December 2002

[55] P Hyman *Women and Economics: A New Zealand Feminist Perspective* (1994) 171
Taxi drivers are commonly assumed to hold a target income. Once this is reached, they are assumed to stop working for that shift, whatever the circumstances. Empirical study of the economic behaviour of taxi drivers has supported the target income proposition. However, H Farber 'Is Tomorrow Another Day? The Labor Supply of New York Cab Drivers' NBER Working Paper 9706 (Reported in Anon. 'Taxes and taxis' *The Economist* 28 June 2003) concludes that higher returns encourage greater effort at times of high opportunity but also the taking of more leisure at other times. This indicates that, although a simple proposition of target income may not be plausible, lowering tax rates does not necessarily cause people to increase effort in a sustainable way.

in encouraging lower paid women, whose claims for attention outside of the market, notably caring for children, the elderly and sick, to stay in the workforce.[56] This may be so, but the income tax system is a blunt policy instrument for achieving such goals and the challenges faced by working caregivers are better tackled where the problems really lie, for instance, by ensuring there is adequate and affordable child care, and legislating for flexible working hours.

(c) Impact of tax rates on economic performance

Hutton argues that 'there is some evidence that the higher the overall tax burden the better economic performance as a result of public infrastructure',[57] and while, in theory, tax yield is unconnected to the type of tax structure which raises it, in practice, high revenue yields generally imply progressive taxes. Furthermore, his returns to the crucial point, that it is the integrity structures of society which are important in determining national economic success and not particular economic polices.[58] Consequently, provided that strong national integrity structures are in place, constitutional government, which is conscious of the economic effects of its actions, may effect tax policies, including progressive rates, which are ethically informed but do not conform with dominant neo liberal dogma.

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[56] Hyman (note 55 above) 182

[57] Hutton (note 52 above) 216

[58] See Chapter 9, section IV above for a discussion of W Easterly & R Levine 'Tropics, Germs and Crops: How Endowments Influence Economic Development' (2002) NBER Working Paper 7946 and their study of the reasons for the economic success of certain ex-colonies.

(d) Tiebout hypothesis

(i) Scope of horizontal view

If taxpayers perceive the justice of tax rates by considering their position relative to others, the scope of their relational contemplation will have an important impact on their perceptions. If taxpayers adopt a close view, looking no further than the position of their fellow community members, then, no policy concerns are raised. However, if it the scope of their contemplation extends beyond the immediate tax community, then, the prospect arises of open-ended comparison and potential discontent. According to the Tiebout hypothesis, which has been highly influential in public finance literature, dissatisfied taxpayers will 'vote with their feet' so that households will sort themselves among jurisdictions according to their preferences for the mix of taxes and public expenditures.[59] Contemporary taxpayers certainly have access to broad tax information relating to jurisdictions other than their own, although they are unlikely to have a full grasp of general socio-economic experience, including differing impacts of public expenditure.

(ii) Assumption of incomplete rationality

Paradoxically, the Tiebout hypothesis assumes people to be rational (searching out and processing fiscal information from other jurisdictions) and yet make *life* decisions based on that restricted selection of information that applies only partially to their lives.

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[59] E Janeba & G Schjeldrup 'The Future of Globalization: Tax Competition and Trade Liberalization' Background paper to World Bank's *World Development Report 2003* (2002) 8

(iii) Tiebout hypothesis in practice

Despite its broad reception in public finance literature, there is little evidence that the hypothesis actually has any impact on people's migration decisions, even locally.[60] Nevertheless, it seems likely that the prospect that the Tiebout hypothesis could be valid has contributed to a general lowering of tax rates across the world.[61]

VIII IMPUISSANCE OF PROGRESSION

(a) Progression and common sense

As a matter of fact, those with higher incomes can afford to pay more in tax and yet still enjoy an adequate standard of living than those with lower incomes. Being deprived of income at the margin is simply 'less painful for the rich than for the less affluent'.[62] Opposition to graduation in income tax must, therefore, be

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[60] PW Rhode & KS Strumpf 'A Historical Test of the Tiebout Hypothesis: Local Heterogeneity From 1850 – 1990' (2000) NBER Working Paper 7946 27 conclude that: 'Regardless of the underlying mechanisms, it is clear that in aggregate the forces driving individual location decisions are neither consistent with nor simply independent of Tiebout motives...While Tiebout predicts that heterogeneity across communities should increase, we find the opposite for a wide variety of local policy outcomes, elections, and demographic measures.'

[61] It is plausible that the migration of corporations, particularly multinational enterprises (MNEs), is significantly affected by tax rates. If tax is just one cost of production, then, all things being equal, corporations will migrate to jurisdictions with lower tax rates. Where individuals and corporations are taxed within the same system, lowering tax rates for corporations is likely to impact on the tax rates for individuals, if only to prevent arbitrage. I conclude in this regard that the fundamental differences in the activities of individuals and corporations, and government's incompatible objectives for each support a policy of taxing individuals and corporations under different systems.

[62] Galbraith (1996) (note 45 above) 30

couched in terms of psychological or utilitarian disincentives, since, until a marginal rate of 100 per cent is reached, a person with a higher income is always financially better off, other factors remaining equal, than a person who has a lower income. Yet, the preponderance of utilitarian and broader psychological evidence supports graduation.

(b) Limitations of progression

Graduated tax rates have become a cornerstone of equitable tax strategy and must be incorporated into a constitutional scheme of taxation. Nevertheless, their limitations should be recognised.

(i) Limited equalisation effects

Practicable progression does not deliver equalised post-tax incomes or even a close convergence of economic outcomes, and, perhaps, achieves no more than providing a potent egalitarian gesture.

(ii) Necessity of holistic assessment

Fundamentally, contribution fairness can only be assessed properly by considering the burden of all taxes within a fiscal system. An income tax that is a model of progression can be undermined by regressive taxes within the composite tax system.[63] Furthermore, tax contribution is but one, albeit a major, element of the public contribution-benefit system. It is feasible, if unlikely, that a system of tax contribution has a regressive effect overall, but is compensated by a progressive redistribution mechanism. Conversely, a contribution system, which is a model of progression, could be rendered nugatory by unjust

[63] See Chapter 19, section VI below for a demonstration of the way in which VAT undermines progression in income tax.

government spending patterns. 'What matters is not whether taxes – considered in themselves - are justly imposed, but rather whether the totality of government's treatment of its subjects, its expenditures along with its taxes, is just.'[64]

To return once more to the leitmotiv of fractals: constitutional arrangements, including a scheme of taxation, are expected to display self-similarity; one part of the structure should resemble the whole.

(iii) Narrow practical scope

Finally, progression in income tax tends to have a narrow scope. On the one hand, it fails to include for due equitable consideration those who fall below the tax threshold, and, on the other hand, by concentrating on the circumstances of middle-income earners, fails to consider properly the prospect of equal contribution by the wealthy. Dennis Davis, for instance, having examined the prospects for post-apartheid taxation concluded that the income tax system could be 'rendered more equitable and legitimate', and could 'support new economic initiatives toward social justice' by easing the burden on middle-income earners.[65] But such a focus on the on the middle-classes 'provides protective cover for the rich', and any easing of the tax burden for the benefit 'of the middle class extends on to the very affluent'.[66]

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[64] T Nagel & L Murphy *Myth of Property* (2001) TWO 22

[65] D Davis 'Taxation in a post-apartheid South Africa' in R Schrire (ed) *Wealth or Poverty: Critical Choices for South Africa* (1992) 105, 119

[66] Galbraith (1996) (note 45 above) 62
As may be observed in relation to the current income tax rates, government appears to have no interest in the vertical equity between a person whose income is R255 001 a year and one whose income is any amount above this. (See note 50 above.)The emphasis on equity between low and middle-income earners has led to indifference toward the massive variance in circumstances of upper-middle and high-income earners.

The guaranteed income element[67] of a constitutional scheme of taxation will bring everyone into a consideration of contribution and benefit but it will always be unlikely that proper consideration will be given to the relationship between the moderately well off and the very wealthy. A constitutional scheme of taxation must incorporate the proven advantages of a progressive tax structure but should be alert to its shortcomings.

IX CONCLUDING COMMENTS: A PROGRESSIVE, COMPREHENSIVE INCOME TAX AND THE 'SOCIAL PLANNER' OR 'OPTIMAL TAX' THEORY

(a) Purported outmodedness of Haig-Simons model

The Haig-Simons approach to identifying taxable income has been pejoratively characterised as a one dimensional accounting exercise that simply estimates a person's economic well-being without taking account of utility and behavioural responses to taxation.[68] Furthermore, since government cannot tax what it cannot observe, it can never tax income comprehensively.[69] These perceived failings in the comprehensive income concept have 'led to a rejection of the Haig-Simons approach in mainstream public economics',[70] although it generally remains the basis for ideal tax policy.[71] In place of a theory of comprehensive income, the so-called optimal tax or social planner theory has taken precedence.

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[67] See Chapter 12, section II above for a discussion of a state guaranteed minimum income.

[68] W Hettich & SJ Winer 'Rules, Politics and the Normative Analysis of Taxation' in R Wagner & J Backhouse (eds) *Handbook of Public Finance* (2002) 13

[69] G Cooper, R Krever & R Vann *Income Tax: Commentary and Materials* 4 ed (2002) 45

[70] Ibid 46

[71] See, for instance, the Commonwealth Treasury of Australia 'Methodology' *Tax Expenditure Statement* (2003) Chapter 3.

(b) Preliminary observations

Before outlining the optimal tax theory, I wish to make two preliminary observations:

(i) Full implementation not envisaged

First, policy planners who pursue comprehensive inclusion are under no misapprehension that full inclusion is possible. Henry Simons himself, describing his attempts to include certain perquisites in his scheme, conceded that 'The problem is clearly hopeless'.[72] Nevertheless, the Haig-Simons model represents a best attempt at conceptualising a fair tax base.[73] The ideal of full inclusion provides a valuable reference point for considering why certain manifestations of economic well-being might be excluded under a practicable system.

(ii) Haig-Simons insufficient model

Second, the Haig-Simons model is primarily concerned with horizontal equity, that is, ensuring that those enjoying similar levels of economic well-being are treated similarly. It is not concerned with vertical equity, the differential treatment of those differently situated, which is actuated in income tax through progressive rates.[74] Consequently, it is feasible that a horizontally equitable tax base could

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[72] See H Simons *Personal Income Taxation: The Definition of Income as a Problem in Fiscal Policy* (1938) non-paginated extract in Cooper et al (note 69 above).

[73] See note 71 above.

[74] An urgent concern for Henry Simons (note 72 above), when identifying comprehensive income, lay in promoting neutrality in order to exclude government influence on the market. Progressive taxation has the specific purpose of intervening in market allocations.

be combined with a vertically inequitable rate structure. (Indeed, many modern tax systems, by employing a decreasing number of tax brackets, have moved in that direction.[75]) Although Cooper et al may suggest that optimal tax theorists are opposed to the Haig-Simons model, their real opposition lies against progressive rates.[76]

(c) Optimal tax theory

Optimal tax theorists seek to integrate the efficiency and equity aspects of public sector or welfare economics.[77] The theory holds that progressive income tax 'causes an allocational excess burden to the taxpayer in that it introduces work-leisure and other behavioural nonneutralities'.[78] Conversely, the distributional gains to recipients of benefits tend to decrease with progression. Consequently, in this view, '*the optimal income tax rate structure* is said to be that which would balance these allocational excess-burden and distributional-equity considerations at the margin. That is, the social optimum will be achieved when

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[75] See para IV (b) above.

[76] It is implausible that a comprehensive tax base may be opposed on any but the most eccentric of ethical grounds. Support from progressive commentators is forthcoming because a comprehensive tax base includes increments in capital along with earned income. Liberals support a comprehensive tax base because it promotes neutrality, inasmuch as citizens' pre-tax patterns of preferences are left intact. (See Chapter 16, para V (b) (i) above.) Opposition can be raised to comprehensive inclusion on the grounds of administrative cost, simplicity and intrusion but these are practical objections without ethical or ideological basis. However, there is considerable ideological opposition to graduated rates, and, like the hypothesis underlying the Laffer curve, this appears to be real animus held by optimal tax theorists in relation to progressive tax systems.

[77] Herber (note 31 above) 125

[78] Ibid

the marginal social cost of the tax burden from marginal income tax rates is equal to the marginal social gain of the individual of who receives the funds'.[79]

It is, then, a tax model that aims for a particular conception of equilibrium. Whether or not this equilibrium is 'optimal' is a matter of opinion. I use 'optimal' to describe the theory for convenience sake only.

Bernard Herber observes that, generally, an optimal tax structure will depend on factors such as the distribution of income-earning skills among the population, and patterns of work and leisure amongst workers.[80] Most pertinently, he concludes that optimal tax theory, 'in placing allocational considerations on an *equal basis* with the distributional equity goal, overrides the controlling premise of the ability-to-pay principle, namely, that *income differences* alone should dictate the pattern of progressive tax rates applied in pursuit of the vertical equity goal'.[81]

(d) Optimal tax theory and a constitutional scheme of taxation

(i) Coincidence of constitutional tax base with Haig-Simons model

My proposal for the base of a constitutional scheme of taxation broadly coincides with the Haig-Simons model. While I have described it as 'comprehensive', I make no claim to including all manifestations of economic well-being. In identifying the base for a constitutional scheme of taxation, I have omitted various manifestations of economic well-being that would fall with the scope of the Haig-Simons model. Essentially, I have restricted the tax base for a constitutional

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[79] Ibid 126 (emphasis in original)

[80] Ibid

[81] Ibid

scheme of taxation to new manifestations of economic well-being that are quantifiable in monetary terms and are tradable.[82]

(ii) Constitutional scheme of taxation and constitutional equality

The foundation for the constitutional scheme of taxation is the Constitution, principally its value of relational dignity or equality, not the Haig-Simons proposition. A constitutional scheme of taxation coincides in one important aspect with the Haig-Simons model. It may be vindicated but it is not validated by that model. The quest for a fair tax base lies in establishing a horizontally equitable distribution of burden. Practicable taxation, of the type I seek to promote, relates essentially to phenomena of economic well-being that have actually occurred. The only feasible way of assessing economic well-being is to consider the broadest understanding of income.

(iii) Nexus between contribution and benefit

Optimal tax theory crucially links revenues collected to benefits allocated. This nexus is extremely valuable as it promotes an holistic view of equity (even if that is not its intention) and effectively requires a series of positive and negative tax rates across the spectrum of differential income scales.[83] In effect, this is what I have proposed for the constitutional scheme of taxation.

Furthermore, optimal tax theorists' proposition that benefits should not be allocated in a way that is ineffective is also persuasive. To that extent, the constitutional scheme of taxation I propose resembles an optimal tax structure.

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[82] See Chapter 16, section III above.

[83] Cooper et al (note 69 above) 45

(iv) Incompatibility with constitutional values

Whatever its broad resemblance to a constitutional scheme of taxation, a scheme of optimal taxation is incompatible with constitutional values, as optimal tax theory holds that presumed efficiency gains can trump equity gains. In an extreme instantiation, if class A of citizens obtains greater utility from paying no tax than class B of citizens gains from being allocated a benefit, then, government should not levy tax on class A.[84] It is axiomatic that constitutional government could not rely on such a calculus in formulating its tax-benefit structures.

(v) Optimal tax theory and marginal utility theory

Fundamentally, optimal tax theory, as a manifestation of marginal utility theory, is founded on the implausible confidence that:

(aa) Measurement of marginal utility

An individual's utility and its response to certain stimuli can, on the one hand, be independently experienced and expressed by the taxpayer, and, on the other hand, accurately measured by government;[85]

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[84] There appears to be an assumption inherent in optimal tax theory commentary that an optimal tax system would see welfare benefits cut and not taxes raised. Yet under the constitutional scheme of taxation, the broad thrust of optimal tax theory may be relied upon to justify an increase in both taxes and benefits.

[85] P Kenny 'Capital Gains Taxation for New Zealand: Fairer and More Efficient' (2001) Vol 7: 4 *New Zealand J of Taxation Law and Policy* 265, 283 argues that optimal tax theory 'rests on two immeasurable and highly subjective factors – the quantification of the impact of tax reform on economic growth and a quantification of social welfare'.

(bb) Tax/benefit is the principal stimulus

The overriding stimulus to be taken into account is a financial contribution to or allocation from government;

(cc) Utility is homogeneous

Experiences of utility are sufficiently homogenous to permit formulation of an equilibrium policy;

(dd) Equilibrium is attainable

Either the optimum equilibrium is static or government tax/benefit distribution mechanisms are sufficiently nimble in their reactions so as to be able to conserve or recalibrate equilibrium; and

(ee) Policies are effective

Generally, policies lead to the results desired by policy planners.[86]

I rejected the marginal utility proposition as a justification for progressive rates:[87] it provides no more persuasive grounds for optimal tax theory.

(c) Concluding comments on optimal tax theory

Although optimal tax theory usefully critiques a bifurcated view of the tax-distribution continuum, it cannot provide the primary policy information for a constitutional scheme of taxation. This must be derived from the principles of

[86] See Chapter 9, section VIII above for a discussion of the effectiveness of government policies.

[87] See, section VI above.

social justice enshrined in the Constitution and not a particular theory of economic efficiency. Finally, it is implausible that, given the modest benefit system I have proposed, optimal tax theory can be relevant to a constitutional scheme of taxation in the way that it is assumed to apply to the advanced tax-welfare systems of Western countries.

PART FOUR

INDIRECT TAXES AND A CONSTITUTIONAL SCHEME OF TAXATION

INTRODUCTION TO PART FOUR

In Part Three, I argued that a constitutional scheme of taxation would be an integrated, comprehensive income tax-benefit system, with tax levied at progressive rates. Yet, the paradigmatic preference for indirect taxes, particularly value-added tax (VAT), requires an assessment of their compatibility with constitutional values.

Consequently, in this part, I firstly consider VAT and the extent to which its operation vitiates the overall equity of a modern tax system.

Secondly, I consider behaviour modifying taxes and their acceptability under the constitutional dispensation.

CHAPTER 19 VALUE-ADDED TAX: EQUITY AND WEALTH CONSUMED

I INTRODUCTION

Consumption taxes, notably value-added tax (VAT),[1] play an important role in modern public finance. Approximately one-quarter of South African tax yield is currently derived from VAT.[2] However, since income is the aggregate of consumption and savings,[3] a tax on consumption, levied in addition to income tax, penalises consumption and privileges savings.

In this chapter, I consider the constitutional acceptability of VAT, paying particular attention to the rationality of the tax[4] and whether a preference for savings can be justified under a constitutional scheme of taxation.

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[1] VAT is known as Goods and Services Tax (GST) in Australia, Canada and New Zealand.

[2] VAT yield in South Africa was 24,9 per cent of tax revenues according to National Treasury Tax Policy Chief Directorate 'Capital Gains Tax Briefing to the Portfolio and Select Committees on Finance 24 January 2001' and 26 per cent according to National Treasury 'A People's Guide...Budget 2003'.
The Organization of Economic Cooperation and Development (OECD) reports that all of its members, other than the United States, operate a VAT-style tax. Over the past 25 years, OECD members' yields from consumption taxes have risen from approximately four per cent to a stable average of 18 per cent of gross domestic product.

[3] $I = C + S$
See Chapter 14, section III above for the derivation of this formula.

[4] See Chapter 2, para II (e) above for an outline of the constitutional embrace of rationalism.

II BENEFITS OF VAT

(a) Paradigmatic coherence

There is a widely held belief that contemporary society, typified by descriptions such as 'postindustrial', 'multinational capitalist'; 'consumer', 'postmodern', 'post-Ford', or 'media' is distinguished by consumption, rather than production. Frederic Jameson, a prominent commentator on postmodernity, identifies 'planned obsolescence; an ever more rapid rhythm of fashion and styling changes; the penetration of advertising, television and media generally to a hitherto unparalleled degree throughout society'.[5] Although Jameson and other commentators on postmodernity tend only to claim to describe the West, it is not an experience that, modified as appropriate, is alien to postcolonial countries. The forces of neo-colonialism and globalisation have certainly influenced independent African states, and, perhaps, none more so than South Africa, which has been distinguished by its traditionally hegemonic, Western-oriented minority.

Therefore, it is plausible to argue that consumption has displaced production as a motif for modern society.[6] Consequently, taxes on consumption might be received as the appropriate means of raising government revenue. However, production, even of dematerialised goods, is necessarily antecedent to

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[5] F Jameson 'Postmodernism and consumer Society' in H Foster (ed) *The Anti-Aesthetic: Essays on Postmodern Culture* (1983) (1998 reprint) 111, 124

[6] The world's largest corporation (according to the *Fortune 500* ranking) is a discount supermarket chain. (See J Useem 'One Nation Under Wal-Mart' *Fortune* 3 March 2003) Such pre-eminence indicates the significance of consumption, in the West if not elsewhere.

consumption. (Incidentally, consumption taxes have historically passed through a cycle of assuming and losing the mantle of being 'natural'.[7])

(b) Simplicity, convenience and efficiency

Broadly speaking, consumption taxes are simple,[8] certain and convenient and, therefore, easily understood by taxpayers. (Although it may be argued that taxpayers do not actually comprehend consumption taxes. Since there is rarely a taxpayer-collection agency dialogue, consumption taxes are simply invisible to taxpayers.) Consumption taxes are also be assumed to be administratively efficient, although VAT has imposed considerable burdens on enterprises and has raised a lower proportion of national revenue than was predicted. In fact, VAT has raised proportionately less revenue that the simpler, general sales tax it replaced.[9]

Yet, even if the claims for VAT's simplicity and efficiency are accepted, when fundamental constitutional values are taken into account, VAT ill fits the constitutional dispensation. In addition to manifesting irrational preferences, VAT fundamentally challenges the horizontal and vertical equity of income tax.

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[7] UA Hicks *Public Finance* 3 ed (1968) 130 recounts, how under Lockean influence, consumption taxes were received as the 'natural' solution to public finance in the seventeenth and eighteenth centuries.

[8] VAT may be simple from the perspective of the consumer-taxpayer but not necessarily the vendor-tax agent. As Kriegler J noted in *Metcash Trading Ltd* v *Commissioner, South African Revenue Service* 2001 (1) SA 1109 (CC) [60], 'the scheme of VAT instituted by the Act [in South Africa] is a complex one'.

[9] The normal VAT yield of 25 per cent of total revenue compares unfavourably with the 25,9 per cent of total revenue raised by VAT's forerunner, general sales tax in 1989-90 (see note 2). VAT was expected to raise considerably more revenue proportionately than general sales tax.

III VAT AND RATIONALISM

(a) Consumption and the 'common pool'

(i) Consumption as the basis of all economic activity

The influential Meade Report observed that a strong case could be made for consumption as the tax base 'in that it levies a tax on the claims which a taxpayer makes at any one time on the community's resources which he uses up for his own consumption'.[10] The Margo Commission, following this lead, proposed that the 'consumption or expenditure concept is held in high regard by many on philosophical grounds and theoretical grounds because it reflects the belief that the satisfaction of human wants is the basis of all economic activity' and concluded that 'An equitable tax should therefore be based on what people take out of the economy...and not what they put in including saving'.

As a preliminary point, the Commission referred to 'economic' activity not 'human' activity, and it is trite that traditional economic measurements provide a woefully incomplete picture of productive human activity.[11] Nevertheless, taxation can only apply to actual economic events. Specifically, VAT relates to exchanges of those products of human activity that are generally quantifiable in money and tradable. The scope of taxation is narrow but inevitably so.

However, the characterisation of consumption as the end of all economic activity is unpersuasive and fails to take into account the multifarious psychological

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[10] Institute for Fiscal Studies *The Structure and Reform of Direct Taxation: the Report of a Committee Chaired by Professor J. E. Meade* (1978), non-paginated extract in TS Emslie, DM Davis & SJ Hutton *Income Tax Cases and Materials* 2 ed (1995)

[11] I Illich *The Right to Useful Unemployment and its Professional Enemies* (1978) (1996 reprint) 68

motivations that may motivate a person to participate in the economy. For instance, if consumption were the sole purpose of economic activity, no one would accumulate wealth beyond her foreseeable lifetime needs. Therefore, bequests would be accidental, as decedents may be assumed to have mismatched their incomes and consumption, thus creating a fortuitous surplus.[12]

If consumption is the principal purpose of economic activity, it is still the wealth at one's disposal at a particular juncture, whatever its source may be, which dictates one's ability to consume. Without such wealth, there can be no consumption. The accrual of wealth, whether one envisages it as an entitlement or conferral by society, precedes and is more fundamental to economic activity than consumption. Consumption is better viewed as a particular choice which production makes possible, rather than the end of all economic activity.

(ii) Is there a common-pool?

It is not obvious why consumption should be conceived as taking money out of a common-pool,[13] whereas an investment should be characterised as adding to it.

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[12] T Blumkin & E Sadka 'Estate Taxation' Center for Economic Studies & Institute for Economic Research Working Paper No 558 (2001) 3 note that utilitarian theory implies an estate tax at a rate of 100 per cent as an appropriate policy response to such a fortuitous surplus.

[13] J Rawls *A Theory of Justice* (1972) 278 suggests that 'a proportional expenditure tax may be part of the best tax scheme. For one thing, it is preferable to an income tax (of any kind) at a level of common sense precepts of justice, since it imposes a levy according to how much a person takes out of the common store of good and not according to how much he contributes (assuming that income is fairly earned)'.
However, if there is a system of distributive justice in place which the community approves (whether it is based on the market, status, difference principle or any other criterion) it seems only just to allow people to actuate their consumption desires using the funds which have been allocated to them. Taxing consumption could be an appropriate measure for fine-tuning the justice of the distribution, but, if income tax has already ensured a just distribution, as it is more capable of achieving, a consumption tax would simply distort just distributions.

Consumption no more depletes or complements a notional community store of wealth than does investment. (There is, of course, no common-pool, only an aggregate of stores of wealth. Individuals and institutions hold these stores, but individuals in turn, ultimately own the institutions themselves.) As one interface of an exchange transaction, consumption is neutral in relation to the (closed) commonwealth. A consumer may spend money but this passes to another member of the community, who must either consume or save the money received. The value of the 'common-pool' has not been reduced. Certain of its constitutive elements have been reallocated amongst community members, but it is difficult to understand why this should be considered socially undesirable or morally reprehensible. In the utilitarian conception, this exchange mechanism is extremely valuable for the community as it permits participants to maximise their own utilities and hence the aggregate utility of the community. Consumption taxes, which necessarily retard the free flow of the exchange mechanism, promote disutility amongst members of the economic community.

The pertinent issue here is not whether a particular tax depletes or supplements the notional, common-pool but whether it promotes or hinders the free flow or money and the operation of exchange mechanisms.

(iii) Can investment and consumption be distinguished?

If it were accepted that consumption indeed depletes a common-pool of wealth, the rationale that identifies consumption as a withdrawal of wealth should conceive of investment similarly. When I consume, say, by purchasing a

motorcar, I exchange money for a corporeal thing.[14] Legally, ownership of my money passes to the car vendor, with ownership of the motorcar passing to me. If, alternatively, I opt to save the money and, to this end, enter into an investment contract with a bank, the bank assumes legal ownership of the money and, in exchange, I will take ownership of an incorporeal thing, namely the obligation the bank owes to me to return an equivalent amount of capital with interest. (The bank does not hold my money in trust. By borrowing from me, the bank takes ownership of the money and provides a promise in exchange.[15]) This obligation has a readily quantifiable monetary value and, subject to any restrictive terms contained in the contract between the bank and me, I may deal with it in the same way as any other of my property.

The difference between the transactions, it seems, lies in no more than the fact that one thing consumed is corporeal and the other incorporeal. Presumably, through some historical development of moral perception, consumption of incorporeal property has become considered 'virtuous' and the consumption of

[14] A corporeal thing may atrophy over time and so lose value. To the extent of this atrophy, consumption of a corporeal thing may be viewed as a diminution of the commonwealth. However, the motorcar would equally lose value in the hands of the car dealer if I refrained from buying it. Therefore, the potential for atrophy of a corporeal thing cannot prejudice it in relation to an incorporeal thing. Furthermore, investments can lose value, sometimes spectacularly. I may choose simply to hoard my cash, a course of events that has no tax consequences. However, rendering the money inert must have the least social value. Hoarding may, in fact, be seen to be a reduction, if a temporary reduction, of the common-pool.

[15] See Chapter 8, para IV (b) above for a discussion of the legal similarity between insurance policies and bank deposits.

corporeal things worthy of mild opprobrium, particularly if the items consumed are deemed luxuries.[16] I will consider this paradox in the next section.

IV PREFERENCE FOR SAVING OVER CONSUMPTION

(a) Prejudice against consumption

Thomas Hobbes, preceding his commendation for funding the Leviathan by way of consumption taxes, questioned why it should be that 'he that laboureth much, and sparing the fruits of his labour consumeth little, should be more charged, than he that liveth idlely, getteth little, and spendeth all he gets; seeing that the one hath no more protection from the common-wealth, than the other?'[17]

While the contemporary reader might dismiss Hobbes's observations on taxation as anachronistic, pre-capitalist irrelevancies, they are, nevertheless, pertinent because they indicate stereotypes and scenarios taken out of context that continue to colour tax debate.[18]

Hobbes describes two economic actors: one, who labours diligently and is thrifty; and a second, who earns little from dilatory labour and spends all of whatever

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[16] Investment has not always received privileged tax treatment. For instance, in the 1970s, the United Kingdom levied a surcharge on unearned income (See Institute for Fiscal Studies databases.) South Africa privileges passive income by exempting a portion of income received as interest or foreign dividends, and fully exempting domestic dividends. (See section 10 of the Income Tax Act 58 of 1962.)

[17] T Hobbes *Leviathan* (1651) (1973 reprint) 184

[18] For instance, JK Galbraith *The Culture of Contentment* (1992) 101 quotes the following sentiments of George Gilder the influential author of *Poverty and Wealth* (1981): 'Material progress is difficult: it requires from its protagonists long years of diligence and sacrifice, devotion and risk that can be elicited only by high rewards'.

earnings she acquires. (The two qualities of each actor in this scenario are presumably not interchangeable.)

(b) Unfair preference for saving

Even assuming that Hobbes's proposal was plausible for his time,[19] in contemporary society, those who enjoy full employment and who earn sufficient income to invest a good portion of those earnings constitute the privileged members of society. Conversely, those for whom earnings are meagre, precarious and occasional, necessarily spend all they earn because they have no alternative.[20]

In other words, for many, and not only those in the developing world, a choice between saving and consumption is illusory. Taxes which privilege saving and so prejudice consumption are, in effect, behaviour modifying techniques applied to people who frequently cannot modify their behaviour. It must be unjust, then, for

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[19] JFC Harrison *The Common People: A History from the Norman Conquest to the Present* (1984) 207 sums up the life of ordinary contemporaries of Hobbes as one of 'want and hardship' - the socio-economic equivalents, perhaps, of the 'poore' and 'nasty' with which Hobbes (note 16 above) 65 typifies the 'natural condition' of man before the Leviathan.

[20] According to the Meade Report (note 10 above): 'A progressive expenditure tax (as it is usually called) falls more heavily than progressive income tax on the wealthy who are financing high levels of consumption out of capital resources.' This assumption is disputable. First, it seems ore likely that, in the absence of a progressive income tax, the wealthy would accumulate compounding stores of capital and so consume from the rent earned from that capital. Second, consumption among those without stores of capital is likely to be funded through credit. A pertinent question for policymakers is then whether consumption taxes curb excessive credit taking or simply cause consumers to become more deeply indebted to credit grantors in order to meet the consumption tax liability.

a tax system to penalise taxpayers for behaving in a particular way when their circumstances allow no alternative.[21]

Although the contemporary preference for consumption taxes appears to arise from the ascendancy of neo liberal ideology,[22] it might be ventured that consumption taxes are not an active policy choice but rather a residual default. In order to promote savings, consumption must be discouraged. If powerful interest groups become disenchanted with income tax,[23] then, invisible, regressive consumption taxes may be considered the 'lesser of two evils'.

In a constitutional context, it must be asked, therefore, whether a preference for savings is legitimate. If such a preference is legitimate, it must be further queries whether consumption taxes represent a rational means of promoting savings. (Since consumption taxes discriminate against those who are unable to save, those being the poorest members of society, it must further be question whether such discrimination is justifiable.)

(c) Preference for savings and rationalism

A government preference for saving is self-evidently legitimate, even if it may be misguided. (By discouraging consumption and so encouraging the wealthy to

[21] A behaviour modifying tax is inherently repugnant to the rule of law, when those affected have no opportunity to modify their behaviour. This correlates closely to Lon Fuller's anti-impossibility injunction. (See Chapter 8, section III above for a discussion of internal morality and tax laws.)

[22] If consumption taxes are not to offend a Lockean injunction that taxation should disturb citizens' patterns of preferences as little as possible, they must be applied to all forms of expenditure equally. Yet, radical liberal proponents of consumption taxes invariably exclude investment from the tax net, thereby massively skewing individuals' patterns of preferences.

[23] J Plender 'Revolutionary Forces Which Will Destroy Income Tax' *Financial Times* 27 November 1993

invest more, the number of transactions in an economy decreases. This may render the economy sclerotic, and by exacerbating concentrations of wealth, engender gross inequality in a society.[24]) Nevertheless, if the promotion of increased long-term savings is a legitimate policy goal, constitutional government should consider why people do not save. Once the reasons why people do not save are understood, government may establish programmes to encourage saving that represent a rational and proportionate response to the reasons for not saving. Seeking to coerce or cajole taxpayers into saving by way of consumption taxes or, worse, to punish consumers whose circumstances do not permit them to save is a politically immature and constitutionally offensive response.

There is considerable doubt whether taxation can influence patterns of savings. The OECD, for instance, has concluded that 'there is no clear evidence that the level of taxation...does generally affect the level of household saving'.[25] Obvious explanations for a low propensity to save include the fact that many people simply do not have the means to save, and those who do have the means are not sufficiently confident in the future to postpone present consumption. The OECD concluded that it was likely that factors, such as levels of lifetime income and demographics, have a greater effect on the levels of household saving than do taxes.[26] Generally, the prospect of social tranquillity is likely to be a far greater spur to financial planning for the future than any tax measures,[27] and this, in turn,

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[24] See Chapter 6 para VII (c) above for a discussion of economic sclerosis and wealth condensation.

[25] Quoted by Treasury (note 2 above).

[26] Ibid

[27] World Bank *World Development Report 2003: Dynamic Development in a Sustainable World* (2002) 194 concluded that: 'The rule of law and good governance allow families and firms to have confidence – in other words, to save and invest.'

is more likely to eventuate from progressive, comprehensive income taxes and not regressive, consumption taxes.[28] Effective governance of the economy requires the influencing of fundamental issues, particularly the establishment and support of sound institutions,[29] rather than superficial, short-term interventions.[30]

V ARBITRARY DISTINCTIONS BETWEEN GOODS

(a) Traditional distinctions

Consumption taxes (notably sumptuary excise duties) have traditionally been levied on goods deemed luxuries. Recently, VAT systems have been commonly constructed on a trifurcation of the tax base between luxuries (highest rate); ordinary goods and services (standard rate); and necessities (zero rate). However, South Africa has reduced the scope of excise duties so that currently they apply only to alcoholic and tobacco products. Furthermore, South African VAT does not include a luxury rate, a distinction being drawn only between standard rated goods and services, and privileged, zero rated supplies.[31]

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[28] Consumption taxes are not inherently regressive but they are invariably regressive in practice.

[29] See Chapter 9, section IV above for a discussion of W Easterly & R Levine 'Tropics, Germs and Crops: How Endowments Influence Economic Development' NBER Working Paper 7946 (2002) and their research into the socio-economic success of 72 ex-colonies.

[30] P Ormerod *Butterfly Economics: A New and General Theory of Social and Economic Behaviour* (1998) 182

[31] As VAT is levied on the value of goods and services consumed within a particular territory, exports are zero-rated. Various financial services are exempted because of the perceived difficulties in calculating the value added by these services at a particular time. Unlike zero-rating, exemption does not confer a substantive tax advantage, as an enterprise which makes supplies of exempt goods or services is unable to set off input tax (tax charged by its suppliers) against output tax, which would otherwise be charged to consumers.

Nevertheless, the prospect of a luxury rate being introduced cannot be discounted.[32]

(b) Identifying luxuries

The crucial query here lies in identifying which goods and services should be disadvantageously classified as 'luxuries', those as 'standard', and those preferentially categorised as 'necessities'.[33]

Rousseau exhibited no doubts in identifying what should be designated as luxuries, producing a taxonomy of immanently taxable goods and activities, on which heavy taxes should be laid, specifically 'servants in livery, on equipages, rich furniture, fine clothes, on spacious courts and gardens, on public entertainments of all kinds, on useless professions, such as dancers, singers, players', in short, 'all that multiplicity of objects of luxury, amusement and idleness, which strikes the eyes of all, and can the less be hidden, as their whole purpose is to be seen, without which they would be useless'.[34] Essentially, then, his proposal was for a tax on *conspicuous* consumption, consumption that offends the envious or disapproving eye. This may strike the contemporary observer as remarkably arbitrary, and yet, it is discernibly the same sentiment that continues to inform sumptuary taxes, including the distinctions between

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[32] South Africa imported its VAT legislation virtually intact from New Zealand and, like New Zealand, has not, so far, included a luxury rate. Although tax theorists tend to support such a 'pure' VAT system, the political appeal for a luxury rate is strong.

[33] Traditional sumptuary taxes are charged on goods identified as luxuries. Under the common VAT set-up, luxuries are taxed at highest rate; normal goods and services at a standard rate and necessities are zero-rated.

[34] J-J Rousseau 'A Discourse on Political Economy' in *The Social Contract and Discourses* (trans GDH Cole, revised JH Brumfitt & JC Hall, 1973) (1992 reprint) 128, 166

different classes of goods and services under VAT systems. Under the constitutional dispensation, 'the enforcement of the private moral views of a section of the community, which are based to a large extent on nothing more than prejudices, cannot qualify as a legitimate purpose'.[35]

Contemplating the traditional luxury/necessity distinction in consumption taxes, Galbraith argues that, in the affluent society, it is not possible to draw 'a useful distinction' between the two.[36] He reasons that food and clothing will always be universally recognised as necessities, yet 'they can be and frequently are among the most opulent of expenditures'.[37] In other words, distinctions will invariably be irrational and arbitrary.

(d) Conclusion of irrationality of consumption taxes

Generally, consumptions taxes are irrational. They are premised on unsupportable assumptions regarding economic activity and perpetuate unfounded prejudices. Even when they are instituted in pursuit of the legitimate objective of promoting long-term savings, they represent a disproportionate means of achieving that end. However, VAT displays its disconsonance with constitutional expectations most starkly when equity is considered.[38]

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[35] Ackermann J in *National Coalition for Gay and Lesbian Equality* v *Minister of Justice* 1999 (1) SA 6 (CC) [38]

[36] JK Galbraith *The Affluent Society* (1968) 254

[37] Ibid

[38] Since income and consumption are different stages in the wealth narrative (see Chapter 14, section IV above), the criteria of equity applied to income tax may be applied to VAT. Ability to pay (incorporating horizontal and vertical equity considerations) is the fundamental criterion of fairness with regard to income tax. (See BP Herber *Modern Public Finance* (1983) 118.) This principle may be applied to VAT to test its fairness.

VI DISRUPTION OF EQUITY IN INCOME TAX

Assuming that government gives due consideration to the equitable taxation of pre-tax income (through progressive income tax), it is reasonable to expect that the patterns of equity so established should be maintained when after tax income is consumed. This is not so, and the table below illustrates how the operation of VAT skews the equity efforts of income tax.

(a) Effect of regression in VAT on income tax progression

Assumptions:

- All income (after the deduction of income tax at 2003-2004 rates) is consumed.
- All goods and services consumed are chargeable at the standard rate of 14 per cent.

A	B	C	D	E	F	G	H
Pre-tax income (R)	Income tax liability	Post-tax income (R)	Average income tax rate	VAT liability (R)	Total tax liability (R)	Average total tax rate	Variance from income equity norm of 1
40 000	2 340	37 660	4,5%	5 348	7 148	18%	3
80 000	9 700	70 300	12%	9 842	21 812	24%	1
240 000	63 000	177 000	26%	24 780	92 888	37%	0,42
480 000	158 700	321 300	33%	44 982	209 048	42%	0,27

Assuming that government's premeditated strategy for equitable tax contribution is reflected in graduated income tax rates (as demonstrated by the average rates set out in column D), if government's aims in this regard are not to be undermined by the effects of VAT, the VAT rate should be similarly progressive. The values in column H indicate the extent to which a flat VAT rate of 14 per cent

varies from the income tax rate for a particular income level.[39] However, not only does VAT have a considerable regressive effect at lower income levels (it is only acceptable around an income of R80 000 per year), it also increasingly favours those with high incomes. Therefore, the higher a person's income (noting that a taxpayer consumes a smaller portion of her income as her income increases), the lower the effective additional VAT burden becomes.[40] It is self-evident that VAT is regressive: these figures provide an indication of how VAT causes the greater tax system to tend to regression.

It might be argued that VAT, although regressive in itself, is a premeditated element of government's planned pattern of equitable tax contribution. Certainly, all community members should contribute to the fiscus, fairly and according to their varying abilities, but the proposition that a strategy, based on scientific analysis, has been effected which balances the regressive effects of VAT and other proportional taxes against progressive rates of income tax is not plausible. Rather, it is clear that the effects of VAT undermine the laudable efforts made to promote fair contribution amongst income taxpayers.

VII CONCLUDING COMMENTS: CAN VAT BE FAIR?

(a) Multiple rate proposition

There is a widely-held belief, and one typically followed in European versions of VAT, that a multiple rate system for VAT, for instance, a standard rate of five per

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[39] $\frac{\text{Average total tax rate (G)} - \text{Average total tax rate (D)}}{\text{Average total tax rate (G)}}$

[40] If it is assumed that the taxpayers consume only 50 per cent of their disposable incomes on standard rate supplies (lower income earners consume a greater portion of their incomes on zero-rated supplies and higher earners save more of their incomes), the variance of the R40 000 earner is still 1,8 but the variance of the R480 000 earner falls to 0,15.

cent on goods and services, combined with a rate of 17 per cent on luxury items can 'raise significant revenue while being a more progressive system than the present tax'.[41] South African VAT, however, presumably in the interests of administrative efficiency,[42] does not employ differentiated rates for designated luxury goods, and limits zero-rating to as narrow a scope as is politically feasible.

(b) Zero-rated supplies

The sole area where equitable differentiation can be claimed under South African VAT lies in the choice for goods to be zero-rated. When considering this issue, the Katz Commission followed the basic principle that any zero-rated products should be of specific nutritional benefit to the poor but should not incidentally provide an undue benefit to the non-poor.[43] (As noted previously, the Katz Commission made the remarkable recommendation that the regressive effects of a pure VAT system should be made good by social security measures which were not in place.[44])

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[41] D Davis 'Taxation in a post-apartheid South Africa' in R Schrire (ed) *Wealth or Poverty: Critical Choices for South Africa* (1992) 105, 111

[42] Parliamentary Joint Standing Committee on Finance *Final Draft Report of the Joint Standing Committee on Finance on the Third Interim Report of the Katz Commission of Inquiry into Taxation* (1996) 10

[43] It is not obvious why the quest should have been limited to food and should not include other prerequisites for survival. Kerosene, the normal cooking fuel for low-income groups, was zero rated in 2002 (see Schedule 2 to the Value-Added Tax Act 89 of 1991).

[44] PJSCF (note 42 above) 10 observed that, notwithstanding official doubt as to the effectiveness of zero-rating, there was a scepticism in the community on the possibility of targeted relief being an effective substitute for broad zero-rating.

(i) Zero-rating in practice

Although research suggests that only maize meal meets these exacting criteria,[45] there are 19 types of food for human consumption that are currently zero-rated,[46] and most of these are as likely to be of particular benefit to health conscious members of higher income groups, as lower income groups, whose members are more likely to be ill-informed with regard to nutrition.[47] The unavoidable conclusion is that zero-rating of virtually any basic food will benefit the poor to some extent but there will be no way of preventing the non-poor from benefiting, and generally to a greater extent.[48]

(ii) Zero-rating and other options

It is a plausible exercise to identify for zero-rating particular goods and services that are likely to be of specific – but not exclusive - benefit to members of lower income groups. There is no obvious reason for limiting this exercise to a

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[45] H Alderman and C del Ninno 'Poverty Issues for Zero Rating Value-Added Tax (VAT) in South Africa' South Africa: Poverty and Inequality Informal Discussion Paper Series (19336) (1999)

[46] Schedule 2 to the Value-Added Tax Act

[47] T Smith 'Women and Taxation in South Africa' IDASA Women's Budget Initiative (2001) and the PJSCF (note 42 above) recorded the differential effects of regressive taxes, given inequalities between women and men. Both considered that women were more likely to benefit from zero-rating of necessities than men. Yet the focused zero-rating approach implausibly assumes that there are two classes of taxpayers: the poor, who should benefit from zero rating and the non-poor who should not benefit.

[48] The International Monetary Fund considers the United Kingdom's zero rating of all non processed foods to be an unintentional subsidy for the rich, from which the rich benefit disproportionately.
A Beattie 'IMF tells Brown to consider putting VAT on food' *Financial Times* 7 March 2002

consideration of qualifying food items.[49] Given the practical impossibility of fine-tuning zero rating for the unique benefit of the poor, VAT as currently configured, faces two basic policy choices in pursuing fairness. One option is to have no zero-rated goods (with compensation being granted to those most badly affected). The alternative is to select goods and services generally considered to be necessities and zero-rate them, however much the non-poor may benefit from this policy.

(c) Respecting corporeal dignity

The constitutional conception of human dignity includes an imperative of respecting the dignity of the human body and in doing so privileges basic corporeal needs. If we consider that idea of dignified corporeality, particularly in the light of Maslovian theory,[50] which provides an indication of universal human needs and their priorities, it might be concluded that the so-called base needs, relating to physiological and security necessity, are worthy of zero-rating under VAT. Similarly, from a perspective of the Bill of Rights, goods and service related to the socio-economic guarantees would be the obvious candidates for zero-rating.

VAT, or any other consumption tax, is fundamentally hobbled in its aspirations for fairness since it necessarily considers the condition of a thing or activity rather than the circumstances of the person who consumes that thing or activity. Ultimately, if ability to pay is recognised as the fundamental criterion of justice in taxation, VAT can only be equitable if it is syncretised with an equitable income

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[49] The proponents of a pure VAT system are well aware that the further a VAT system moves away from a standard rated system, which includes all feasible goods and services, the more its efficiency is compromised.

[50] See, generally, AH Maslow *Motivation and Personality* 3 ed (1970).
I outline Maslow's proposition of a hierarchy of needs in Chapter 6, section IV, note 51 above.

tax arrangement. Thus, if VAT acts a provisional withholding of an integrated tax liability, its regressive effects can be taken into account within a comprehensive income tax-benefit system.[51]

[51] Galbraith (1968) (note 36 above) 254 considers that a general sales tax on all privately produced goods and services is appropriate, but, crucially, with the specific purpose of funding the production of public goods and services to counterbalance the market's preference for the production of private goods. However, this argument only has cogency if the society under consideration is affluent and, in broad terms, taxpayers are similarly situated. Notwithstanding pockets of wealth, the scale of poverty and the degrees of inequality prevent the epithet of 'affluent' being plausibly applied to South Africa. (See Chapter 2, section III above for an outline of poverty and inequality in South Africa.)

CHAPTER 20 THE ROLE OF SPECIFIC INDIRECT TAXES IN A CONSTITUTIONAL SCHEME OF TAXATION

I INTRODUCTION

(a) Specific indirect taxes

The taxes I have considered so far levy a charge against certain manifestations of wealth at one or other stage in the wealth narrative. These taxes form the basis of modern tax systems, but, additionally, specific indirect taxes, including excise duties, hypothecated taxes, and user charges for state-provided goods and services,[1] constitute an important source of government revenue.[2] Unlike the major taxes, which are asymmetrical (no direct reflection of contribution made in benefits received) these specific indirect taxes often manifest symmetry between a taxpayer and a state-provided benefit, or in other ways. In the extreme instance, user charges set a 'price' for the 'consumption' of a public good or service. Furthermore, there is typically a discernible connection between the raising of revenue and expenditure: for instance, a levy on motor fuel might be used to fund road building and maintenance. In this way, there is nexus between the payment and the benefit, if less pronounced than the direct connection of a

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[1] I do not discuss state-administered insurance schemes for unemployment and occupational injury and disease.

[2] National Treasury 'A People's Guide...Budget 2003') records the following items of government revenue and their proportions of the total: personal income tax (32 per cent); VAT (26 per cent); company tax (21 per cent); fuel levy (five per cent); excise duties (four per cent); customs (four per cent); and 'other' (eight per cent).

According to the Taylor Report, an amount approximately equal to six per cent of tax revenue is raised by various fees and charges for specific services. (See V Taylor (Chair) *Report of the Committee of Inquiry into a Comprehensive System of Social Security for South Africa: Transforming the Present – Protecting the Future* RP 53/2002 (2001) para 14.8.) These figures do not include the proceeds of the National Lottery. (See Chapter 10, para III (c) note 47 above for a discussion of the quasi-tax nature of the National Lottery.)

user charge. However, this is not always the case with specific taxes. A dedicated tax might be levied against a broad tax base but for a specific purpose.[3] There may even be an inverse connection between tax base and area of expenditure.[4] However, there may be no obvious connection.[5]

(b) Classifications

Specific indirect taxes, levies and charges may be broadly distinguished between those whose informing purpose is neutral with regard to behaviour and those which designed to modify behaviour by increasing the cost to a consumer of a good or activity. The first category includes revenue raising devices and user charges for publicly provided goods and services. These may be specific or general in their impact, and so may be further distinguished in this way. The second category principally includes what have been traditionally designated as 'sin' or sumptuary taxes, and, since these may be problematic in the context of a constitutional scheme of taxation, is of greater current interest.

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[3] For instance, the United Kingdom has introduced a one per cent national insurance surcharge hypothecated for expenditure on its national health service. See M Brewer, T Clark & M Myck 'Credit where it's due? An assessment of the new tax credits' (2001) Institute for Fiscal Studies Commentary 86.

[4] The demutualisation levy charged against windfall profits (such profits arose on the demutualisation of the mutual insurers, Old Mutual and Sanlam), for instance, was used to seed an investment fund for the benefit of those who may reasonably be assumed not to have benefited from the demutualisation share distribution.

[5] According to MF Jacobson & KD Brownell 'Small Taxes on Soft Drinks and Snack Foods to Promote Health' *American J of Public Health* 2000; 90: 854, 855 the state of Washington levies a tax on soft drink syrup whose proceeds are hypothecated to violence enforcement and drug prevention.

Naturally, taxes whose primary purpose is the modification of behaviour can also prove to be useful sources of revenue: this may be problematic. If the tax fails to modify behaviour as was intended, there is an expectation that it should be discontinued and another technique of behaviour modification implemented. However, government may become dependant on and reluctant to forego this the revenue stream, and become complicit in the continuation of the disapproved activity.

Before returning to a consideration of behaviour modifying taxes, I briefly consider the general constitutional acceptability of those specific, indirect taxes that are behaviour neutral.

II BEHAVIOUR-NEUTRAL SPECIFIC, INDIRECT TAXES

(a) Benefit principle

There is no necessity that the rate of specific indirect taxes should be proportional but the incorporation of progressive rates would undermine the simplicity appeal of these taxes. More significantly, graduation would run counter to the 'benefit principle' that underpins them.[6]

The benefit principle requires an approximation of market behaviour in the allocative procedures of the public sector so that a taxpayer is taken to exchange voluntarily purchasing power in the form of taxes for the acquisition of public goods and services.[7] Simply, a price is set for the public good or service in a way

[6] The 'benefit principle' should be distinguished from the 'benefiter-pays principle'. The latter ensures intergenerational equity and does not necessarily mimic the market. See J Thompson 'Intergenerational Equity: Issues of Principle in the Allocation of Social Resources Between this Generation and the Next' (2003) Research Paper No 7 2003-03 Information and Research Services, Australian Parliament 5.

[7] BP Herber *Modern Public Finance* (1983) 124

that mimics the market mechanism. That mimesis of the market on the part of government may conflict with constitutional expectations.

(b) Benefit principle and dignity

In an affluent society, whose comprehensive social security network has ensured the basic needs of all community members and thus some degree of material inclusion, the primary concern with regard to benefit principle taxes will lie with the fact that these taxes treat equally those differently situated. However, in a widely impoverished society, like South Africa, the first concern must lie with the capacity of these taxes and levies for perpetuating exclusion. If respect for dignity is to be upheld, concrete inclusion must precede a consideration of equality. This does not imply that user charges are automatically disqualified from funding public goods and services in the constitutional community, simply that they must be constructed in way that is not exclusionary. In practice, inclusion might be achieved by ensuring that a basic need level of a good or service is provided free, with any excess charged at a market related rate.[8] In an affluent society, there can be few objections to government's levying user charges at market rates when consumption of such public goods and services is a matter of choice untainted by exclusion. The exercise of choice must constitute the most persuasive liberty motivation for this form of taxation but, in an impoverished society, choice is often illusory.

(c) Benefit principle and cross-subsidisation

Since specific indirect taxes are invariably levied at flat rates, cross-subsidisation of wealthier taxpayers by those less wealthy is likely. The levies payable to fund

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[8] This principle informs the Free Basic Water policy instituted by the Department of Water and Forestry Affairs.

the Financial Service Board, for instance, are charged on a capitation and flat rate basis per institution, irrespective of the amount of an individual's aggregate investments with financial institutions.[9] Generally, taxes based on the benefit principle are incompatible with the fundamental fairness criterion of ability to pay. This is unavoidable, as the benefit principle requires the importation of the principles of the market to public provision of goods and services. The structure of user charges may distinguish between broad classes of users, for instance, pensioners, as a user class, may be charged preferential rates. However, such differentiation does not generally attempt to take into account an ability to pay within a preferred class of users. Yet, in practice, the intra-class variation in financial circumstance, say, amongst pensioners, is likely to be as great as inter-class variation, say, between pensioners and single-mothers.

(d) Functions of government and market

Although the norms and practices of the private sector may indubitably guide the public sector on organisational issues, such as efficient management, the fundamental capitalist motive of producing profit for a select group of beneficiaries cannot guide democratic government toward appropriate goals. Indeed, the state is often viewed an 'anti-market'. Yet, a characterisation of the state/market as binary oppositions is insufficient. The state is not necessarily inimical or incompatible with the market but often has different goals and strategies. Neither the market nor the state is, it seems, capable of effecting a complete or even an acceptable allocation of goods and services in society, and

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[9] Although the assets managed by a financial institution are its own, the investor merely purchasing a promise, it seems that the Financial Services Board levy is predicated on the fiction that investments are held in trust with beneficial ownership vesting in the investor; that is, in the way of a bewind trust. (Unlike a common law trust, whereby trust assets vest in the trustee for the benefit of the beneficiary, under a bewind trust, trust assets vest in the beneficiary, with the trustee acting as administrator.) If this fiction were taken further, progressive rates of levy could be charged.

it is increasingly difficult to draw bright lines between the functions of the two.[10] It is preferable, then, to conceive of the overall function of distribution as dyadic, so that, for those scarce resources that are actually distributed, the market and the state complement the gaps left by the other. Nevertheless, there is no plausible reason why the state should mimic the market mechanism when performing a public function. If government has assumed a particular function because that function cannot (or community consensus deems that it should not) be performed by the private sector, then, there is no plausible explanation beyond ideology why there should be an expectation of market principles informing the operation of that public function. Conversely, there can be no expectation that the market ought to differentiate prices in the way that government distinguishes burdens and benefits. Indeed, there is an expectation of a single price for a particular good or service.[11] Likewise, if the State opts to compete in a particular area with the private sector, there is an expectation of some correspondence between state user charges and the pricing mechanism of the market, subject to recognition of basic human needs.

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[10] RA & PB Musgrave *Public Finance in Theory and Practice* (1973) 5 observe that, since the market mechanism alone cannot perform all economic functions, public policy is needed to guide, correct and supplement it in certain regards, so that 'the proper size of the public sector is, to a significant degree, a technical rather than ideological issue'. The reasons for this include: the need for a government-provided legal structure to ensure the protection and enforceability of contracts and exchanges; government regulation is needed promote market knowledge and to keep markets open; some goods and services simply cannot be provided through the market; there is an expectation that government will step in when there are market failures; public policy is often needed to bolster employment and stabilise prices; and government intervention may be needed to ensure distributions reflect social values.

[11] This distinction springs from the expectation that distributive justice should operate vertically and commutative justice horizontally. Yet the distinctions between groups seen in the public sector, are not unknown in the private sector: for instance, cinemas may grant concessions to pensioners.

(e) Transparency

Turning to certain criteria of good governance, Geoff Mulgan, a founder of the United Kingdom's influential Demos think tank, argues that hypothecated taxes promote transparency, a proposition that is certainly plausible within the ambit of a particular dedicated tax.[12] Yet, a multiplicity of taxes necessarily obfuscates an assessment of overall tax burden, and there are good reasons for being wary of tax metastasis, since a compounding of trivial charges must arrive at a point of aggregate materiality that may impact on general distributive justice.[13] Furthermore, it seems that if government is able to demonstrate the fiscal discipline necessary to respect the hypothecation of taxes within the fiscus, then, it should be able to adhere to similar probity and restraint within a single tax as within a plethora of taxes and levies. (Governments seem to have little appetite for respecting notional ring-fences erected around dedicated tax revenues, and so to be effective, hypothecated taxes need to be legally discrete.)

Transparent governance seems better achieved through the smallest practical number of general taxes and not a multiplicity of hypothecated taxes. However, even if a single tax would be ideal from a transparency perspective, it is practically impossible for government to rely on a single tax to fund all of its functions, and specific taxes may be appropriate where participation in and benefit from an activity is specific. Levies on investments with financial institutions, for instance, permit the funding of an oversight body, the Financial Services Board, which is of specific benefit to financial institutions and their clients. Restricting the tax to community members who hold investments with financial institutions is a rational means of funding such an oversight body

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[12] G Mulgan *Connexity: How to Live in a Connected World* (1997) 214

[13] See, for instance, Patrick Harries's list of Giyani taxes discussed in Chapter 13, para II (a) above.

(f) Equal treatment

The hypothecation of taxes holds potential for conferring a disproportionate privilege or prejudice on one type of activity in relation to others, and, in extreme cases, skewing the strategies and effects of mainstream taxes.[14] Furthermore, it seems that the more that public finance diverges from the principle of there being a pool of general revenue from which government makes allocations to beneficiaries at its discretion, the greater will be the temptation to construct taxes for the benefit of the most vocal groups in society. Needless to say, it is the least empowered members of the community who are least able to lobby for their own taxes, and, of course, the Constitution envisages the voices of the weak in society being heard, not only those of the powerful.

(g) Democracy

In the most pessimistic view, the call for dedication of taxes may be viewed as an element of an anti-democratic strategy, inasmuch as such constraints necessarily hobble the policy manoeuvrability of democratic government.[15] In the case of South Africa, if the general revenue-allocation process were to be constrained by dedicated taxes and allocations, there would be an effective limitation on government action that the framers of the Constitution did not see fit to include.

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[14] National Insurance contributions in the United Kingdom may affect equitable initiatives in income tax. See T Clark, M Myck & Z Smith 'Fiscal Reform Affecting Households, 1997–2001' Institute for Fiscal Studies Briefing Note (2001)

[15] RM Bird *Financing Canadian Government: A Quantitative Overview* (1979) 92 recommends the introduction of user charges wherever possible and earmarking particular taxes for particular purposes as way of stopping government growth.

(h) Prudent governance

Finally, as a matter of prudent governance, when expenditure is linked to specific revenue flows, it will necessarily rise and fall in line with the economic cycle. A fall in revenue should not be a concern in relation to a tax whose predominant purpose is to modify behaviour: indeed, falling revenues should indicate its success. However, a reduction in yield could be problematic for other hypothecated taxes.[16] For instance, in the event of an economic depression, revenues of a special tax on remuneration to fund unemployment benefits would fall precisely when they were needed most.

The Taylor Committee recommended that specific taxes should not be considered as an alternative to the general budget but should rather be used only in specific instances where the quasi-public nature of the good or service requires a direct relationship to be established between the contributor and the good or service to be provided.[17] I agree with this proposition. Specific taxes that are informed by the benefit principle are not inherently incompatible with a constitutional scheme of taxation but they are limited in their appropriateness.

III BEHAVIOUR MODIFYING TAXES

(a) State's right to modify citizens' behaviour

While the starting point for a discussion of taxes designed to modify behaviour might lie with a query into whether government may or should seek to modify citizens' behaviour, there seems to be little doubt that constitutional government

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[16] MM Katz (Chair) *Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa* (1994) Third Report para 3.3.7 mainly objected to hypothecated taxes on the grounds of revenues varying with economic circumstances.

[17] Taylor Report (note 2 above) para 14.10.2.3

may, indeed, intervene to counter activities it considers to be social ills.[18] The Constitutional Court held in *Jordan* that: 'The Legislature has the responsibility to combat social ills and, where appropriate, to use criminal sanctions. In doing so, it must act consistently with the Constitution.'[19]

If government may criminalise an activity it considers socially destructive, there can be no objection, in principle, to a tax on the activity as an element of a programme of behaviour modification. Nevertheless, as an ethical ideal, if government considers an activity sufficiently socially repugnant so as to constitute a form of criminal activity, however mild, the activity should be treated as any other crime and outlawed. Society should not seek to profit from the commission of an activity that is considered socially destructive. However, in practice, such matters are rarely straightforward. An example of this complexity is provided by the case of plastic shopping bags whose disposal, either in landfill or as litter, presents significant environmental problems.

(b) The example of plastic bags

From various plausible solutions to this common problem, South Africa opted to outlaw the issuing of plastic bags,[20] and Ireland to introduce a Plastic Bag Levy.[21]

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[18] I limit my discussion here to the constitutional principle of rationality. (See chapter 2, para II (e) above for an outline of the constitutional embrace of rationalism.) I do not consider aspects of power that government seeking effectiveness should take into account when modifying the behaviour of its citizens. (See Chapter 9, section VIII above for comments on effective governance and coercion.)

[19] Ngcobo J in *S* v *Jordan* 2002 (6) SA 642 (CC) [25] delivering a majority decision from which Sachs and O'Regan JJ dissented in part.

[20] Regulation No R543 under the Environmental Conservation Act 73 of 1989

And so, rather than seeking to educate consumers about the environmental consequences of excessive use and careless disposal of plastic bags; taking others steps to modify behaviour; or working with retailers to develop alternatives, South Africa took the draconian measure of banning. In doing so, it effectively criminalised a practice, which until recently, would generally be seen as a valuable service provided by retailers to their customers. In contrast, in the first four months of its currency, the Irish Plastic Bag Levy, which charged a nine pence tax against the issue of plastic bags, is claimed to have reduced the use of plastic bags by 90 per cent and raised some €3,5 million, which is dedicated to environmental concerns. Furthermore, the Irish government was able to claim that because of the introduction of the levy, 'there was evidence that the mindset was changing' with regard to the issue and disposal of the offending bags.[22]

(c) Ethical coherence

Ostensibly, a policy of prohibiting a socially damaging activity is ethically more coherent than that of taxing the activity. Yet which, it may be asked, is the more appropriate strategy under the constitutional dispensation, when government is expected to engage in a politically mature discourse with its citizens. Certainly, experience, for instance, of the official prohibition of alcohol in the United States

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[21] A point of sale tax was preferred over the point of supply tax that was actually enacted. Although a point of sale tax was considered more likely to communicate the relevant message to consumers, administrative considerations prevailed. (From documents published on the website of the Irish Ministry for the Environment and Local Government.)

[22] Press release from Martin Cullen, Irish Minister for the Environment and Local Government, 25 August 2002

The plastic bag tax is regressive in the way of any other flat tax. (Notwithstanding the possible claim that the wealthy are likely to consume more and therefore pay more bag tax.) However, it is probably only regressive to a trivial extent. It seems that the less wealthy shopper has an equal opportunity to go without bags as the wealthy shopper. (See also comments on the suspension of the expectation of equality and behaviour modifying taxes in para (d) below.)

(1920 to 1933) or the contemporary criminalising of recreational soft drugs, indicates that outlawing an activity, although ethically coherent, may give rise to greater social problems than it might solve. In the case of plastic bags there seems to be no plausible objections to government's aim of eliminating particular forms of environmental degradation: concerns may, however, lie with the means adopted in curbing the mischief. A levy on bags might have been the more appropriate policy response.

Activities taxed by governments are not always so indubitably worthy of universal opprobrium as the purposeless degradation of the environment, and frequently appear to represent a particular moral stance. This can be problematic in the constitutional state, as '[t]he enforcement of the private moral views of a section of the community, which are based to large extent on nothing more than prejudice, cannot qualify as a legitimate purpose'.[23] The imperative here is not that government should refrain from taking a particular moral stance but that the stance taken should be consistent with constitutional principles and should, therefore, be rational and free from prejudice. The 'constitutional framework not only permits, but requires, the Legislature to enact laws which foster morality, but the morality must be one which is founded on our constitutional values'.[24]

(d) Behaviour modifying taxes and regressive rates

Behaviour modifying taxes tend to be regressive, and so, at first face, unfair to lower income groups; an argument which the tobacco industry, for instance, has championed.[25] Even where taxes have positive results through increasing the

[23] Ackermann J in *National Coalition for Gay and Lesbian Equality* v *Minister of Justice* 1999 (1) SA 6 (CC) [38]

[24] Sachs and O'Regan JJ in *Jordan* (note 19 above) [105]

[25] See Anon. 'Smoke alarm' *The Economist* 2 March 2002.

price of a socially undesirable good,[26] they may have harmful substitution effects. A stark example in this regard is that of the parent who, to offset the effect of an increase in excise, spends more of her limited resources on cigarettes than on food for her children.[27] Nevertheless, if government enters, in good faith, into a programme of behaviour modification, then, an expectation of progression in tax rates must fall away.

The fundamental concern for behaviour modifying taxes is rationality not equality. Constitutional government should be able to justify its policies, to show a rational connection between a legitimate purpose and the means of achieving this, whether or not it is of the opinion that a judicial challenge is possible or likely.

IV TAXING ALCOHOL AND TOBACCO

South Africa currently levies behaviour modifying taxes on alcohol and tobacco. I describe these taxes as 'behaviour modifying' in good faith as, if they were mere

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[26] According to World Bank estimates, a 10 per cent increase in tobacco products could lead to a four per cent drop in demand in rich countries and twice that in poor countries. See note 25 above.

[27] C van Walbeek 'The Economics of Tobacco Control in South Africa' paper presented to the 11th *World Conference OR Health*, 6-11 August 2001, Chicago, concludes that demand for cigarettes in South Africa has become more elastic as prices increase due to hikes in excise. Nevertheless, the resilience of consumer demand for cigarettes (and perhaps even more for Lotto) should not to be underestimated. In-depth market research on consumer spending habits shows that, in the upper household income bracket (monthly income in excess of R8 000) 82 per cent of respondents reported no cutbacks to fund their Lotto habits. However, of the lowest income group (monthly income between R1 and R799), 18 per cent of respondents reported reducing consumption of everyday food and 12 per cent of respondents reducing expenditure on clothes to fund their Lotto tickets. Yet, amongst all respondents, only one per cent claimed to have cut back on cigarette consumption to fund lottery ticket purchases. See Anon. 'One in two urban adults play lotto' *Business Day* 27 September 2002.

remnants of an historical opprobrium on the part of a certain section of the community, then, their continued operation would be constitutionally suspect.[28] Taxes on alcohol and tobacco must benefit from the principle of shifting purpose, since any contemporary health concerns that may justify them arrived long after taxing on sumptuary and moral opprobrium grounds. Moreover, there will always be the suspicion that, since these goods tend to face inelastic demand, such taxes provide a steady flow of revenue without undue economic disruption.

(a) Alcohol

There is no evidence that moderate consumption of alcohol has negative health repercussions, indeed, there is a widely held belief that moderate consumption of alcohol may be beneficial to health. Generally, alcohol is not considered to be inherently 'bad' or to have universally anti-social effects. Furthermore, the wine and brewing industries are important components of the South African economy, contributing significantly to employment and national wealth. However, alcohol abuse is a considerable social problem, manifest, inter alia in: domestic violence, driving offences, occupational accidents and personal illness. If all consumers of alcoholic products demonstrated moderation and prudence in their drinking habits, there would be no behaviour to modify. There would be no obvious grounds for specially taxing alcoholic beverages any more than, say, bottled water.

If the behaviour sought to be modified by specially taxing alcoholic products is their anti-social abuse, and the objective of the elimination of this abuse is to ameliorate its undesirable social consequences, it is self-evidently a legitimate purpose of government. However, it must be considered whether the excise duty

[28] The Minister of Finance, TA Manuel, 'Budget Speech' 26 February 2003, having outlined increases of roughly 10 per cent for most alcohol and tobacco products, described such measures as 'the right thing to do', implying an ethical motivation.

is likely to achieve this legitimate purpose. This seems most unlikely. Alcohol abuse has deep social causes, particularly unemployment, which cannot be remedied by a price increase in the abused substance. (There is an assumption, perhaps unfounded, that the alcohol that causes most harm falls within the scope of excise.) Otherwise, it is not obvious how a moderate excise duty can curb alcoholism, which is a disease with some genetic contribution.

It seems, therefore, that excise duty on alcohol cannot be justified in terms of rationality, rather it represents the continuation of an arbitrary means of raising revenue. This may be compared with the excise on tobacco.

(b) Tobacco

Outside of the tobacco lobby, there is universal acceptance that smoking is deleterious to health and the complete elimination of smoking would improve the quality of individual lives and benefit the community at large through significant savings in health expenditure. (Unlike alcohol consumption, tobacco is inherently 'bad' and any consumption of it constitutes abuse.) Indeed, it seems, that government should only refrain from taking radical steps to eliminate smoking if its ethical information incorporates the idea that a person should be left alone to perform a self-harmful activity without extraneous interference, whatever the costs for society and those in her proximity. A constitutional conception of freedom does not extend to such an extreme version of negative liberty. The elimination of tobacco products is, then, a legitimate government purpose and, once more, it must be queried whether the excise duty is an appropriate means of combating this social mischief.

Government has established a coherent anti-smoking programme,[29] of which an increase in excise is an integral and effective element of that strategy.[30] It may be concluded, therefore, that excise duty on tobacco is a rational and proportionate response to a legitimate government concern. Indeed, unlike its approach to alcohol, government's approach to tobacco, in essence, a strategy of scientific application of punitive taxes in conjunction with focused prohibitions and information campaigns, is a model of mature engagement with a serious social malaise.

(c) Other modifiable behaviours

(i) Equal treatment

If a tax on tobacco is laudable, it may be asked whether other products or activities are similarly socially undesirable and would respond appropriately to a strategy that includes taxation. This is a pertinent enquiry in a constitutional state which abhors arbitrary laws to consider why certain activities, which are commonly practised by numerous otherwise law abiding members of the community, should be considered punishable wrongdoings, yet other comparable activities are not criminalised.

Currently, gambling is legal but prostitution is not, although they share certain common grounds for prohibition (not necessarily relating to the potential harm to the participant but from the attendant social problems); alcohol consumption is legal but consumption of cannabis and other broadly used opiates is not. I do not

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[29] The Tobacco Products Control Amendment Act 12 of 1999 prohibits, among other things: tobacco advertising, sponsorships and promotions; smoking in enclosed public and work places; and regulates issues such as: the labelling of tobacco packages with health warnings; and the maximum amounts of nicotine, tar and other hazardous chemicals in tobacco.

[30] See Y Salojee 'Bridging the Policy Gap in South Africa' paper presented to the Global Forum for Health Research, Geneva, 9-12 October 2001.

suggest that activity *x* should be prohibited because activity *y* is prohibited, or that activity *x* should be permitted because activity *y* is not prohibited. Nevertheless, comprehensive equality implies that government's approach to similar activities should be consistent, even if outcomes are different.

(ii) Taxes to promote health

One popular proposal in the economically advanced countries is for a tax on so-called junk food,[31] but it is questionable the extent to which such a tax would be appropriate in South Africa. Certainly, excluding accidents and other violent events, major causes of death in South Africa (and presumably causes of extensive health costs before death) include heart and cerebrovascular diseases,[32] and diabetes, which can frequently be attributed to unhealthy lifestyles voluntarily lived. Factors here include smoking, refraining from exercise, and excessive consumption of alcohol and fatty foods. These causes of death are particularly prevalent amongst the over 50s but are dwarfed in their significance with regard to the general population by HIV, intestinal infections, influenza and pneumonia. Therefore, it seems that behaviour-modifying taxes have little to offer in respect of these predominant causes of morbidity and death in the constitutional community. This being so, there can be little urgency at

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[31] To promote healthy American lives, Jacobson & Brownell (note 5 above) 857 propose a one per cent national tax on soft drinks, candy, gum and snacks, with revenues being dedicated to health programmes. It is interesting to note that they consider that the low level of tax would obviate objections from consumers, which implies that the tax would not be aimed at decreasing demand of these products directly. However, of course, programmes for communicating awareness of the relevant health issues, funded by the tax, may be expected to decrease demand.

[32] Statistics South Africa *Causes of death in South Africa 1997-2001: advance release of recorded causes of death* (P0309.2) (2002)

present for extending the scope of behaviour modifying taxes beyond tobacco products.

V CONCLUDING COMMENTS: RESTITUTION AS A TAX PRINCIPLE

(a) Retributive taxation

CN Mitchell, in proposing a 'retributive' conception of taxation, argued that 'punitive taxes are a cost-effective and ethically superior alternative to the criminal law system over a broad range of minor, chronic, and common wrongdoings' such that 'a fault based or legal approach to taxation should have priority over purely revenue raising instruments.'[33] He proposes that government should capitalise on activities judged socially undesirable by, on the one hand, adopting a permissive approach to these activities (including the consumption of alcohol, psychoactive drugs and pornography, and the participation in gambling and prostitution),[34] but, on the other hand, penalising them through taxation. Such cynical profiting from transgression and a sentiment of retribution have nothing to contribute to a constitutional scheme of taxation, other than to highlight converse constitutional values, particularly restitution.[35] It is also a preference for restitution that will permit ubuntu to play an informing technical role in taxation.

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[33] CN Mitchell 'Taxation, redistribution and justice' *University of Toronto LJ* 88 (1988) 151

[34] Ibid 164

[35] D Davis 'Taxation in a post-apartheid South Africa' in R Schrire (ed) *Wealth or Poverty: Critical Choices for South Africa* (1992) 105, 118, in considering Mitchell's thesis, suggested that a combination of retribution and reconstruction was a 'compelling reason for a land tax'. The pursuit of social harmony and justice is reason enough for establishing a just land allocation policy, including a land tax: revenge is not needed.

(b) African solutions

Although not a direct constitutional injunction,[36] the colonial abuse of indigenous cultural institutions, including the social philosophies underpinning customary law, should be reassessed. Nevertheless, the limited experience of substantive African jurisprudence before and during the colonial period must be recognised. Communities tend to seek cultural solutions to the social and economic problems face, not to extra-contextual abstractions: law is but 'part of social and cultural engineering'.[37] Nevertheless, certain values, which have informed African cultural solutions, may find application in an open, modern polity, just as the principles of Roman law have been applied to developments, which could not have been contemplated by Roman jurisconsults. Indeed, certain ideas of African social philosophy are not merely compelling in their original context; they are also universally attractive, with potential application beyond their organic source.[38] The value of restitution over retribution expressed in ubuntu, in particular, holds promise for the attainment of social harmony.

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[36] Courts are required to consider customary law where it is applicable and, of course, provided it does not negate the basic rights. See section 211(3) of the Constitution of the Republic of South Africa Act 108 of 1996 (Constitution).

[37] B Malinowski 'A New Instrument for the Interpretation of Law – Especially Primitive' (1942) Yale *LJ* 51 1237, 1247

[38] Noel Bruyns of the World Council of Churches described ubuntu as 'Africa's gift to world theology'. See N Bruyns 'Africa's gift of Ubuntu' *e-Jubilee* No 7 11 December 1998.

(c) Ubuntu and restoration

Ubuntu, like Heidegger's being-in-the-world, in recognising the basic fact of human existence, may imply ethical inevitability,[39] but cannot prescribe specific rules of behaviour. Claims for such prescription may be disbelieved.[40] Nevertheless, certain jural practices have developed which are consistent with and attributable to sentiments of ubuntu. Oscar Peschel, a nineteenth century anthropologist, for instance, observed that, among the South African indigenes 'justice has so far advanced that the fines are paid to the chief instead of to the injured parties, as if the wrong had been inflicted on the society or the person who represents it. They justify the fact that kinsmen are left without compensation by the beautiful saying, that one cannot eat one's own blood.'[41] Desmond Tutu characterised ubuntu as informing African jurisprudence, particularly through a preference for reparation over retribution.[42] Then, at a scientific level of law, the

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[39] M Heidegger *Being and Time* (1927) (trans J MacQuarrie & E Robinson) (1962) 153 considered that the basic fact of human existence, identified as 'Being-in is Being-*with* Others', gave rise to ethical consequences, with ethical rules constituting the 'assignment contained in the dispensation of Being.' (R Bernasconi 'Deconstruction and the Possibility of Ethics' in J Sallis *Deconstruction and Philosophy: The Texts of Jacques Derrida* (1987) 123. Similarly, Emmanuel Lévinas interpreted the god-given command 'Thou shalt not commit murder' not as a law to obey or disobey but 'as the essence of the ethical relation, a necessity which we cannot evade.' See Bernasconi (reference above) 127.

[40] Njongonkulu Ndungane approvingly cites CLS Nyembezi's distillation of the essence of ubuntu as being eight rules of seemly conduct, arguing that ubuntu requires the compliance with the following instructions: live and care for others; act kindly towards others; be hospitable; be just and fair; be compassionate; assist those in distress; be truthful and honest; and have good morals. See N Ndungane 'A new faith for new South Africa' *Mail & Guardian* 19 February 1998.

[41] O Peschel *The Races of Man and Their Geographical Distribution* 2 ed (1876) 239

[42] (Interview) *Mail & Guardian* 12 April 1996

Constitutional Court linked ubuntu to a reformative theory of punishment,[43] concluding that consistency with ubuntu required South African society to be one which sought to prevent crime rather than one which might execute criminals 'simply to get even with them'.[44]

(d) Restorative taxation

Given that ubuntu rejects retribution and favours restoration, Mitchell's concept of retributive taxation must be incompatible with a constitutional scheme of taxation that incorporates the spirit of ubuntu. It is, in this context, ethically bereft not 'superior'.[45] Constitutional taxes should not be perceived as punishments, but nor are they, broadly speaking, mere devices for raising revenue in a socio-economic vacuum. If the message of ubuntu is heeded, urgency will lie not in compensating an individual victim of an action or event but in reaching for social harmony. And, as *Makwanyane* indicated, this does not imply a simple, reactive restoration of the status quo ante in the event of the commission of a wrong, but also taking measures to forestall the commission of wrongs in the first place. While such an idea may have more obvious relevance for a broader conception of the law of delict and criminal law, a preference for restitution over retribution lends itself to the field of taxation, particularly where taxes on particular harmful activities may fund compensation for social disharmony and its correction. Ubuntu seems likely,

[43] Madala J in *S* v *Makwanyane* 1995 (2) SA 642 (CC) [242]

[44] Chaskalson P in *Makwanyane* (note 43 above) [131]

[45] While my current concern lies with the specific context of the constitutional community, the idea of restorative justice is not unique to African law. It informed the ancient Germanic *Sachsenspiegel* and Anglo-Saxon *wergild*, and has survived in Māori, Australian Aboriginal and Samoan traditions. (See, generally, J Consedine *Restorative Justice: Healing the Effects of Crime* Revised ed (1999).) One might suggest that restorative justice is an element of an empirical natural justice. New Zealand has experimented with incorporating restorative justice into criminal law and the United Kingdom is considering similar moves.

therefore, to have particular relevance in situations where there is no specific victim or where the costs of anti-social activity are spread over many victims, for instance, when the environment is polluted or otherwise degraded.[46]

[46] Since this issue is most pertinent to directing the behaviour of corporations, it lies beyond the scope of this study.

CHAPTER 21 CONCLUDING COMMENTS

I TAX REFORM IN THE CONSTITUTIONAL ERA

(a) Focus of Katz Commission

National Treasury[1] observed that the Katz Commission's[2] work was largely informed by 'the global paradigm shift of eliminating tax incentives or preferences throughout the tax codes, thereby enabling tax base broadening that could finance a marked reduction of tax rates'.[3] While these are valid concerns (if incompletely imagined and actualised), goals of dignity, equality, liberation or any other constitutional imperative are conspicuously absent.[4]

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[1] National Treasury Tax Policy Chief Directorate 'Capital Gains Tax Briefing to the Portfolio and Select Committees on Finance 24 January 2001'

[2] MM Katz (Chairperson) *Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa* (1994)

[3] Fifth Katz Report (note 2 above) para 2.2 recorded the following as relevant factors in a consideration of the basis for income tax: the emergence of an open economy; the protection of financial capital and human skills; the relaxation of exchange controls; increased capital flows; possibility of regional headquarters bases being established; and South Africa's rapidly expanding double taxation agreement network.

[4] Section 1 of the Constitution of the Republic of South Africa Act 108 of 1996 (Constitution) provides that:

'The Republic of South Africa is one, sovereign, democratic state founded on the following values

(a) Human dignity, the achievement of equality and the advancement of human rights and freedoms...'

(b) Major developments

Two major developments of the tax system have been implemented after the institution of democracy in South Africa. These are the move from a territorial basis of income tax to a residency basis,[5] and the introduction of capital gains tax (CGT). Arguably, the former development is indirectly attributable to the advent of democracy, inasmuch as, with the end of international trade sanctions and South Africa's re-admittance into the world economy, a source basis of taxation would almost certainly have resulted in an unacceptable portion of South African residents' incomes falling outside the South African tax net. Nevertheless, the desirability of both a residency basis of taxation and a capital gains tax had been considered by earlier commissions of inquiry into the tax system.[6] Both developments are, then, in substance, issues of fiscal modernisation and not attributable specifically to the application of constitutional principles.[7]

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[5] Fifth Katz Report (note 2 above) para 9.1 recommended that passive income should be taxed on a worldwide basis but active income should continue to be taxed on a source basis. This conservative recommendation was taken up with effect 1 July 1997 but the residency (world-wide) principle was rightly extended to all forms of income with effect from 1 January 2001.

[6] The Steyn Commission (1951) recommended a continuation of the source basis; the Franzsen Commission (1971) recommended a worldwide basis; however, the Margo Commission (1987) favoured maintenance of the source basis. See Fifth Katz Report (note 2 above) 2.1.1. The Franzsen Commission supported a limited CGT on disposals of immovable property and marketable securities, whereas the Margo Commission was opposed to the introduction of CGT. Remarkably, the Katz Commission was inconclusive, citing concerns regarding administrative complexity and Revenue's capacity.

[7] In certain areas, for instance, its administrative law guarantees, the Constitution itself represents a modernisation of South African law, a catching up with other jurisdictions. See H Corder 'Administrative Justice in the Final Constitution' (1997) 13 *SAJHR* 28 (Annexure D to the South African Law Commission Discussion Paper 81, Project 115 *Administrative Law* (January 1999)) for an outline of the neglect of this area of law in South Africa before 1993.

(c) Influence of Constitution

Despite the tectonic shift in South African society brought about by the institution of constitutional democracy, the impetus for recent tax reform has not been animated by a desire to 'constitutionalise' the tax system but to harmonise with contemporary, international norms. Paradigmatic consciousness has been rightly manifest but there has been little indication of awareness of the specific circumstances of the constitutional community. However, it would be incorrect to suggest that the Constitution has been ignored by the framers of tax legislation. Efforts to incorporate principles of administrative justice into the dialogue between the South African Revenue Service (SARS) and individual taxpayers have certainly been made,[8] and measures, albeit flawed, have been taken to extend the special privileges previously applicable only to legally married couples.[9]

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[8] See, for example: rights to appeal an exercise of discretion by the Commissioner of SARS in terms of section 3(4) of the Income Tax Act 58 of 1962. Yet, these efforts to constitutionalise the collection process may also be seen as part of a modernisation, not solely attributable to the Constitution. Nevertheless, SARS has undergone a remarkable transformation from an agency distinguished by bureaucratic opacity to an increasingly effective administration modelled on sound management practices.

[9] Before the enactment of the Revenue Laws Amendment Act 59 of 2000, the undefined term 'spouse' was interpreted by Revenue, for the purposes of the Estate Duty Act 45 of 1955, as referring to persons married in terms of the Marriages Act 25 of 1961. Following, it seems, the decision in *National Coalition for Gay and Lesbian Equality* 2000 (2) SA 1 (CC), which outlawed discrimination against partners of homosexual unions, the Estate Duty Act and Income Tax Act were amended to permit tax-free transfers of capital between broadly defined 'spouses'. (See sections 1 and 4(q) of the Estate Duty Act, and sections 1 and 56(1)(b) of the Income Tax Act.) While it seems that the privileging of partners of legal marriages was unconstitutional, the legislature's reaction appears precipitous and narrowly focused. A constitutionally appropriate approach would have considered the fundamental rationale for this remarkable concession in the light of the general law and likely beneficiaries. In brief, the concession provides a disproportionate benefit to those who have enjoyed historical opportunities to accumulate wealth.

However, these amendments appear piecemeal and reactive. Rather than indicating that constitutional information has pervaded all levels of the tax system, as it should, this approach is consistent with a perception of the Constitution as a checklist against which behaviour and practices may be compared. Generally, there has been an imaginative failure on the part of fiscalists in engaging with the idea of a constitutional scheme of taxation. The substance and context of the Constitution have not led tax debate, rather the prime concern manifest has been the transplanting of an arguably anachoristic Organization of Economic Cooperation and Development (OECD) tax model. Fortunately, however, the Taylor Committee,[10] straying perhaps from its mandate, presented an optative vision, with resolve and attention being paid to the message of the Constitution. Incorporating the Taylor Committee's proposals for a state guaranteed minimum income, a constitutional scheme of taxation can be constructed which is paradigmatically alert and true to the telos of the Constitution.

II A SKETCH OF A CONSTITUTIONAL SCHEME OF TAXATION

Tax liability under a constitutional scheme of taxation would be derived from an assessment of a taxpayer's ability to contribute to the constitutional community during the period of assessment.[11] (Any individual who benefits from the existence of the Constitution and the community's constitutionally informed legal and social institutions would be a taxpayer, subject to a triviality provision to

[10] V Taylor (Chair) *Report of the Committee of Inquiry into a Comprehensive System of Social Security for South Africa: Transforming the Present – Protecting the Future* RP 53/2002

[11] See Chapter 16 above for a derivation of an equitable tax base.

exclude temporary visitors.[12]) A community inclusive tax, informed by the values of the Constitution, would, therefore, be one levied at progressive rates on the net value of all new amounts to which a taxpayer becomes entitled during the assessment period.[13]

The pertinent investigation for this system would lie in assessing by how much the taxpayer's realised economic well-being (income) increased or fell short of a basic minimum level during the tax year. (Since the tax would seek coherence with the broader legal system and people's expectations, gains would, in principle, only become taxable on realisation, that is, legal entitlement.[14]) A deduction from income would be allowed in respect of amounts actually incurred in the production of income during the period of assessment. If the taxpayer's income is lower than or close to a state guaranteed income level, she would receive a negative income tax payment.[15]

This unified scheme of taxation ('unified tax') would replace, but also incorporate, elements of the existing income tax, capital gains tax, donations tax, estate duty, and value-added tax. Any existing welfare or insurance benefits would be treated as income. The unified tax would be distinguishable from the current system principally because no realised income would be free from tax in the hands of an

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[12] Political expedience is likely to require asymmetry between qualification for contribution and benefit. Thus, criteria for tax residency may include people who will not qualify for the guaranteed minimum income. The latter class is likely to be restricted to legal permanent residents or citizens.
See Chapter 17 above for a discussion of fiscal residency.

[13] See Chapter 18 above for a justification of progressive rates and a comprehensive tax base.

[14] See Chapter 16, para VI (a) above for a discussion of legal coherence and the tax base.

[15] See Chapter 12, section III above for a discussion of the ways in which in a state guaranteed minimum income may honour the constitutional pledge to respect human dignity.

individual. Furthermore, no other tax privileges, such as rate averaging or investment exemptions, would be conferred. Consequently, dividends,[16] retirement benefits and long-term insurance policy receipts[17] would become fully taxable, and the distinction between capital and income would be removed.[18] Additionally, since the value of all capital transfers would be fully taxed in the hands of the person who becomes beneficially entitled to the property transferred,[19] donations tax and estate duty would become obsolescent and would be abolished.

III EXITS FROM THE COMMONWEALTH

The unified tax would be supplemented by withholdings against all amounts that permanently leave the commonwealth.[20] The first category of transactions that would be affected includes payments to non-residents, such as dividends, interest, royalties and other fees. The second category includes wealth generated

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[16] See Chapter 8, section V above for a discussion of the current method of taxing dividends.

[17] See Chapter 8, section VI above for a discussion of the current methods of taxing retirement funds and long-term insurance policies.

[18] The unified tax would apply only to individuals so that the deduction of capital items would not cause the major fiscal disruptions which might arise if corporations were, on the one hand, granted the right to make immediate capital deductions, and, on the other hand, denied the right to continue depreciating capital items previously purchased.

[19] Methods to overcome avoidance schemes and generation skipping devices, notably the use of trusts and preference shares in family companies, would be necessary. Chapter 10 of the Fourth Katz Report (note 2 above) indicates the kinds of anti-avoidance measures which would be necessary, changed as appropriate, to take into account the incidence of tax on the beneficiary rather than transferor.

[20] See Chapter 17, section V above for a discussion of withholding and exit taxes.

within the constitutional community that is expatriated. Such withholdings would compensate the commonwealth for the future taxes foregone.

IV CONSUMPTION SURCHARGE: ACTUATING THE SAVINGS PREFERENCE

While I am sceptical of the economic advantages to be gained by privileging savings over consumption,[21] a paradigmatic policy preference for savings may be accommodated by way of a graduated, annual consumption surcharge. This surcharge could be levied on income after income tax less approved socially desirable expenditure. Identification of what expenditure should be deemed 'socially desirable' would, naturally, be a matter of government policy but might include items such as long-term investments, privately funded social security measures,[22] education and health costs, and donations to approved non profit organisations. The consumption surcharge, although withheld at a flat rate, would be finally assessed at progressive rates.[23] Effectively, then, the current VAT system would be maintained (retaining zero rating for exports only) but as a provisional withholding tax.

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[21] See Chapter 19, section IV above for a discussion of the general policy preference for savings over consumption.

[22] Taylor Report (note 10 above) para 4.5 notes the critical importance of private social security provision in South Africa and there appears to be general agreement that such arrangements have a valid claim for tax concessions. While I have proposed a legally coherent approach to the taxation of long-term savings, it is likely that the current worldwide crisis in retirement funding would cause a breach of the principle with regard to contributions to retirement funds.

[23] Since I = C + S (see Chapter 14, section IV above for the derivation of this formula), the final assessment of liability for the consumption surcharge would be calculated on I - S, as records for approved savings would more easily be kept.

V ILLUSTRATIVE EXAMPLES OF THE UNIFIED TAX

(a) The comprehensive income tax-benefit mechanism

The first set of examples demonstrates the operation of progressive rates and the guaranteed minimum income. I consider three possibilities, specifically:

(i) The taxpayer has no income;

(ii) The taxpayer's income exceeds the guaranteed minimum income by a small margin;

(iii) The taxpayer's income exceeds the guaranteed minimum income by a significant margin.

Assumptions

(i) The guaranteed minimum income is R1 250 per annum with a reduction rate of 25 per cent for every rand in excess of R1 250.[24]

(ii) Relevant marginal tax rates are:

(aa) Zero per cent for the slice of taxable income between R5 000 and R10 000 per annum;[25]

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[24] Proponents of the Basic Income Grant (BIG) generally advocate a grant of R100 per month (see, for instance, the Taylor Report (note 10 above) and the website of the Democratic Alliance), which may be assumed to be the minimum subsistence level. I have set the proposed state guaranteed minimum income at a higher level to take into account the consumption surcharge. A reduction rate is used to smooth the transition from receipt of benefit to payment of tax. No one should be worse off by earning more. Ideally, finer gradations for smoothing should be used than the 25 per cent proposed but a practical system is likely to use greater reductions rates. See, for instance, M Brewer, T Clark & M Myck 'Credit where it's due? An assessment of the new tax credits' (2001) Institute for Fiscal Studies Commentary 86) on the United Kingdom's Working Family Tax Credit scheme.

(bb) Two and a half per cent for the slice of taxable income between R10 001 and R15 000 per annum;

(cc) Five per cent for the slice of taxable income between R15 001 and R20 000 per annum.

Tax calculation process

(i) Calculate (comprehensive) income (I_1).

(ii) Calculate the potential benefit (B) to be transferred to the taxpayer. This is the difference between the guaranteed minimum income (G) and income (I_1), multiplied by the reduction rate (r) ie:

$B = (G - I_1) \times r$.

(iii) If the potential benefit (B) is positive, that amount is added to income to arrive at the taxpayer's after tax income (I_3) ie:

$I_3 = I_1 + B$.

(iv) If the potential benefit (B) is negative, deduct the amount of guaranteed minimum income (G) from income (I_1) to find taxable income (I_2) ie:

$I_2 = I_1 - G$.

(v) Apply progressive rates to taxable income (I_2) to find tax due (T).

(vi) Deduct tax due (T) from income (I_1) to find after tax income (I_3) ie:

$I_3 = I_1 - T$.

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[25] In terms of these assumptions, the crossover point from receiving a benefit to paying tax is an income of R5 000 per annum. A zero tax band is used to provide a buffer between benefit receipt and taxpaying.

(i) Example of income of R0 per annum

(i) The taxpayer has no income, therefore, $I_1 = 0$.
(ii) Her potential benefit (B) is the difference between the guaranteed minimum income (G) and her income multiplied by the reduction rate (r) ie:
$B = (G - I_1) \times r$
$B = (1\ 250 - 0) \times 0{,}25 = 1\ 250$
(iii) Since the taxpayer is entitled to a benefit transfer of 1 250, her after tax income (I_3) ie the sum of income and benefits ($I_3 = I_1 + B$) is R1 250.

(ii) Example of income of R3 000 per annum

(i) The taxpayer has income (I_1) of R3 000.
(ii) Her potential benefit (B) is the difference between the guaranteed minimum income (G) and her income multiplied by the reduction rate (r) ie:
(iii) $B = (G - I_1) \times r$
$B = (1\ 250 - 3\ 000) \times 0{,}25 = 500$
(iv) Since the taxpayer is entitled to a benefit transfer of 500, her after tax income (I_3) ie the sum of income and benefits ($I_3 = I_1 + B$) is R3 500.

(iii) Example of income of R20 000 per annum

(aa) The taxpayer has income (I_1) of R20 000.
(bb) Her potential benefit (B) is the difference between the guaranteed minimum income (G) and her income multiplied by the reduction rate (r) ie:
$B = (G - I_1) \times r$
$B = (1\ 250 - 20\ 000) \times 0{,}25 = -2\ 750$
As B is negative, no benefit is payable and tax must be calculated.
(cc) Deduct the amount of guaranteed minimum income from income to find taxable income (I_2) ie:

$I_2 = I_1 - G$

18 750 = 20 000 – 1 250

(dd) Apply progressive rates to taxable income (I_2) to find tax due (T). Applying assumed rates:

(A) The slice of income 10 000 to 15 000 is taxable at a rate of two and half per cent ie:

(15 000 – 10 000) x 0,025 = 125; +

(B) The slice of income 15 001 to 18 750 is taxable at a rate of five per cent ie:

(18 750 – 15 000) x 0,05 = 187,5

giving a total tax liability (T) of R312,50

(ee) Deduct tax (T) from income (I_1) to find after tax income (I_3) ie:

$I_3 = I_1 - T$

19 687,50 = 20 000 – 312,5

(ff) Therefore, the taxpayer's after tax income is R19 687,50.

(b) The consumption surcharge

The purpose of the consumption surcharge (levied as a supplement to the basic comprehensive income tax described above) would be to direct particular forms of consumption without causing hardship to those whose circumstances do not permit compliance. The surcharge would be levied on the amount of after tax income *less* approved spending (which might include expenditure on long-term savings, basic housing and education) with value-added tax (VAT) operating as a withholding mechanism at a rate of, say, 10 per cent. The final consumption surcharge liability would be set at progressive rates, as set out in the table below:

Example of a structure of progressive VAT withholding rates	
Expenditure	**Amount of consumption surcharge due**
<25 000	0
25 000 - 50 000	0 + 2,5% of amount in excess of 25 000
50 000- 75 000	R625 + 5% of amount in excess of R50 000
75 000 - 100 000	R1 875 + 7,5% of amount in excess of R75 00
100 000- 125 000	R3 750 + 10% of amount in excess of R100 000
125 000- 150 000	R6 250 + 12,5% of amount in excess of R125 000
150 000 - 175 000	R9 375 + 15% of amount in excess of R150 000
175 000 - 200 000	R15 625 + 17,5% of amount in excess of R175 000
200 00 - 225 000	20 000 + 20% of amount in excess of R200 000
225 000 - 250 000	25 625 + 22,5% of amount in excess of R225 000
250 000- 275 000	32 500 + 25% of amount in excess of R250 000
275 000- 300 000	38 750 + 27,5% of amount in excess of R275 000
300 000 – 325 000	45 625 + 30% of amount in excess of R300 000
325 000 +	53 125 + 32,5% of amount in excess of R325 000

(i) Example of disposable income (after income tax) of R1 250 per annum

If the taxpayer spends all of her income, she will pay a provisional surcharge, by way of the VAT withholding, of R125. The guaranteed minimum income has been set higher than the minimum subsistence level so that a person who makes no approved expenditure will not face undue detriment from paying the surcharge. (Given the likely wide ambit of approved expenditure, it is improbable that all her expenditure would be subject to a final surcharge.)

(ii) Example of disposable income (after income tax) of R325 000 per annum

If a taxpayer, whose income after income tax is R325 000, spends all of that disposable income, she will incur a provisional consumption surcharge of R32 500 but will have a final consumption surcharge liability of R53 125. While this appears to be a considerable mismatch, if she makes approved expenditure of

approximately 25 per cent of her disposable income (which is a reasonable assumption) she will have no further liability.

VI TRANSITIONAL CONSIDERATIONS

Proposals for radical tax reform inevitably face various obstacles. These include dismantling the existing system in favour of the new system; accommodating extant international obligations; and adducing political relevance.[26] However, these hurdles can be overcome and do not provide grounds for refraining from radical change. They imply no more than the speed of transformation may need to be tempered, not that the goal of transformation must be compromised. Reasonable transition periods can be instituted to satisfy current expectations and bilateral treaties may be renegotiated should this prove necessary.

(a) Dismantling the old, establishing the new

Although, a unified tax would abolish the current donations tax and estate duty, its fundamental characteristic is a broadened conception of income, one closer to a generally accepted ideal. By removing naked preferences, as the equality guarantee of the Constitution demands, a greater range of manifestations of economic well-being will be brought into the tax net. This is a broadening of scope rather than a tectonic shift in principle. Certainly, new methods of collecting tax can be anticipated, including the use of smart cards,[27] interactive computer systems, and the greater use of accurate withholding taxes. However, these are techniques increasingly made possible by advances in technology, not

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[26] KC Messere *Tax Policy in OECD Countries: Choices and Conflicts* (1993) para 1.E

[27] S Moore 'The Economic and Civil Liberties Case for a National Sales Tax' before the Hoover Institution conference 'Frontiers of Tax Reform' National Press Club Washington, DC, 11 May 1995 envisages advances in computer technology, particularly smart cards, revolutionising the potential for 'real time' taxation.

changes in principle. The expanded scope of the tax base would represent a further progression along a path on which the Income Tax Act is well advanced.[28]

(b) International obligations

A compelling objection to proposals for novel tax measures lies with their inability to mesh with the established systems of other jurisdictions, a pressing concern in a globalised economy.[29] Nevertheless, a unified tax, although it may replace the existing income tax, remains a tax on income, if based on a more comprehensive definition. Bipartite, international agreements on the taxation of income and capital (DTAs) invariably provide for continuation should a similar tax replace income tax. Consequently, there would be no need to renegotiate extant DTAs.[30] Furthermore, the double taxation arrangements to which South Africa is a treaty party, subject to archaic exceptions, which are in the process of being modernised,[31] already contemplate non-resident withholding taxes on dividends, interest and royalties - even though currently a withholding tax is applied only to royalties paid to a non-resident.[32] Some non-resident individuals may have a greater liability under the unified tax than at present, since specific DTA relief or unilateral relief granted by their state of fiscal residency may not extend to certain

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[28] Fringe benefits tax and capital gains tax (see Seventh and Eighth Schedules to the Income Tax Act, respectively) are relatively recent extensions of the income tax base.

[29] This concern is of particular relevance to the taxing of multinational enterprises (MNEs) but raises issues that are beyond the scope of this study.

[30] See Article 2(4) of the Organization of Economic Cooperation and Development Model Tax Convention on Income and Capital (as at 28 January 2003). DTAs can, of course, be renegotiated and frequently are.

[31] See, for instance, the 2001 DTA between South Africa and the United Kingdom.

[32] Section 35 of the Income Tax Act

items included within the ambit of a unified tax. Even so, in terms of the OECD Model Tax Convention,[33] which serves as the normal template for South Africa's DTAs, many items of income that accrue to a non-resident are only taxable in her country of fiscal residency. Consequently, a broadening of the scope of 'income' under a unified tax will have minimal effect on non-residents; no greater than that of the introduction of capital gains tax.

(c) Political relevance

Tax proposals must have political relevance for the specific political community in which they must operate.[34] Thus, the sentiments of disregard for that society's dispossessed, and for an increasingly unfettered privileging of the wealthy, which are ascendant in contemporary United States tax debate can have no political relevance to South Africa. The Constitution demands otherwise and, simply, the majoritarian neglect for the marginalised that is observed in Western democracies is demographically reversed in South Africa.

The breadth of support for a guaranteed minimum income cannot be easily ignored,[35] yet such a safety net is only one undisputable consequence of a proper consideration of economic well-being. A constitutional scheme of taxation that includes everyone; eliminates unjustified privileges; is scrupulously

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[33] See Article 21(1) of the OECD Model Tax Convention (note 16 above).

[34] WG Gale 'The Flat Tax: Simple, Efficient, Fair: Or Is It?' *Brookings R* Summer 1998 43, for instance, demonstrates that the introduction of a flat tax is a political impossibility in the United States because of its requirement of an immediate elimination of an implausible number of preferential concessions. Similar considerations would not apply to, say, Singapore that already operates a pared income tax.

[35] Proponents include: church groups, unions, non governmental organisations, the Democratic Party and the grassroots African National Congress.

transparent and effectively administered must hold political urgency for everyone who has recognised and respects the telos of the Constitution.

VII POTENTIAL OF A UNIFIED TAX

(a) Liberation of the dispossessed

A unified tax, particularly through its guaranteed minimum income element, would include all members of the constitutional community in an integrated consideration of economic well-being and, in doing so, promote human dignity in a material way. This promise gives back to individuals in a capitalist society the freedoms denied, practically and imaginatively, by an absence of money.[36] The reduction of poverty implies practical freedom; the possibility of investigating life opportunities both as an autonomous and automotive individual and in concert with others in the community. The socio-economic effects of such financial liberation can be compared to the regenerative impact of rain on the desert's dormant flora: human development and sustainable livelihoods are promoted; socio-economic multiplier effects are released; and the new ability of the poor to access government services renders these programmes valid and effective.[37] The poor, having a newfound financial confidence, become capable of taking risks and are liberated from the docility that extreme poverty engenders.[38] The Taylor Committee predicts the following consequences for a guarantee of as little as R100 per month for all South Africans:

> The incidence of extreme poverty is almost eliminated. The closing of the poverty gap improves to 74 per cent. On a headcount basis, approximately 6,3 million are

[36] JK Galbraith *The Good Society: The Humane Agenda* (1996) 4

[37] Taylor Report (note 10 above) para 5.6.2

[38] Ibid para 5.4.2

moved out of poverty. The number of destitute individuals (measured using half the poverty line) falls by 10,2 million people. Most of the remaining poor individuals are clustered fairly close to the poverty line, so that broad-based growth would demonstrate substantial success in moving additional numbers of people out of poverty.[39]

(b) Fair contribution

A unified tax would ensure fair contribution by all. On the one hand, the current unjustified omissions from the tax base would be included, and, on the other hand, the invisible contribution, disproportionately borne by the poor, through consumption taxes would be taken into account.[40]

(c) Contribution to ubuntu society

This broader contribution base would certainly benefit low and middle-income earners but it is optimistic to claim that a reconfigured tax system would be of direct financial benefit to the wealthy. A broader tax base certainly implies the prospect of lower rates but, denied the current benefits of tax-free capital transfers, an incoherent capital gains tax, and investment income privileges, the wealthy would certainly pay more tax over their life times under a unified tax.

However, my proposals for a constitutional scheme of taxation are not made with a purpose of soaking the rich but with an eye to a future of a just and tranquil society whose citizens are able to live full lives. Everyone would gain from such a society and perhaps the wealthy have most to lose from the alternative prospect of division and social strife. 'Prosperity and well-being, like peace, are indivisible

[39] Ibid para 5.5

[40] The general unfairness of VAT was considered in Chapter 19 above.

and must be shared if they are to be maintained.'[41] Ultimately, 'it is only if there is a willingness to protect the worst and the weakest amongst us, that all of us can be secure that our own rights will be protected.'[42] Economic injustice is ultimately unsustainable, and so, by contributing to economic justice in society, wealthy members of the community protect their own interests.

In a welfare state, it is not only those who actually receive benefits who enjoy the advantages of a social safety net but also those who enjoy the peace of mind that they will be caught if a change in their circumstances make this necessary. Again, such security is more likely to be a benefit enjoyed by low-income earners whose economic well-being is precarious. Nevertheless, experience of advanced welfare systems suggests that 'since benefits are often selective while taxes are usually general, the incentives of individuals belonging to special interest groups to exert political pressure for new favors are often stronger than the incentives of the general taxpayer to resist such favors.'[43] A unified tax, by integrating contributions and benefits within a single system should act to generalise and meld interests. Furthermore, the wealthy, demographically outnumbered at the ballot box, must benefit from a joining unity of interests. Finally, a unified tax would operate in the context of prudent and honest governance, under which taxes are not squandered but are properly and transparently accounted for.

Undoubtedly the administrative challenges of a unified tax would be great but the combined administrative capacities, particularly an ever-improving technological

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[41] World Bank *World Development Report 2003: Dynamic Development in a Sustainable World* (2002) 191

[42] Chaskalson P in *S* v *Makwanyane* 1995 (3) SA 391 (CC) [88]

[43] A Lindbeck 'Changing Tides for the Welfare State' Center for Economic Studies & Institute for Economic Research Working Paper No. 645 (3) (2002) 4

capability, of the public sector, with the private sector performing an important agency function, would be capable of delivery.[44]

To conclude, I wish to adopt a sublime vision of social optimism expressed by the late Chief Justice, Ismail Mohamed.

If realised, a constitutional scheme of taxation would encapsulate 'the ethos of an instinctive capacity for and enjoyment of love towards our fellow men and women; the joy and the fulfilment involved in recognizing their innate humanity; the reciprocity this generates in interaction within the collective community; the richness of the creative emotions which it engenders and the moral energies which it releases both in the givers and the society which they serve and are served by'.[45]

The national scheme of taxation would then be a fractal of the constitutional ideal of an ubuntu society.

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[44] Suplicy, who has promoted guaranteed minimum income legislation in Brazil, observes that, when he first became a convert to the idea of a universal grant, he assumed that it would entail a payment only to the very poor. Advances in computer technology have persuaded him that it is possible and desirable to include all citizens within the ambit of a universal grant. The same technological advances facilitate a unified tax. See EM Suplicy 'Legitimizing basic income in developing countries: Brazil or the answer is blowin' in the wind' Paper presented to a forum of the Basic Income Grant Coalition at the NGO Global People's Forum, Johannesburg, 28 August 2002.
Moore (note 27 above) suggests the use of smart cards, and real concerns regarding fraud notwithstanding, this indicates the kinds of technological advances that permit more comprehensive and integrated forms of taxation and benefit.

[45] As Deputy President of the Constitutional Court in *Makwanyane* (note 42 above) [263]

APPENDIX

NATIVES TAXATION AND DEVELOPMENT ACT 41 OF 1925

I have referred to the natives tax throughout this study as a counterexample to a constitutional scheme of taxation. To illuminate the relevance of this Act, I outline its major provisions below:

(a) Formalities

The Natives Taxation and Development Act 41 of 1925 ('the Act') was assented to on the 27 July 1925, signed by the Governor-General in Dutch, and came into force on 1 January 1926.[1]

(b) Taxing provisions

Under the Act, general and local taxes were to be levied each calendar year commencing 1 January 1926 and credited to the Consolidated Revenue Fund, with local taxes being allocated to the various native areas from which they arose.[2]

(c) Allocation of revenues

Any local taxes attributable to sources outside of the designated native areas were allocated to a special account styled 'the development account' and administered by the Minister of Native Affairs.[3] Additionally, one-fifth of the

[1] Section 21 of the Act

[2] Section 11 of the Act

[3] Section 12 of the Act

general tax revenue was allocated to this account.[4] The general object of the account was to develop educational and welfare facilities for 'natives'. Additionally, a mechanism was introduced whereby a 'native tribe' or community could arrange for a levy to be raised for its benefit in accordance with the Act, provided this was agreed to by a majority of the taxpayers in that community and the Minister of Native Affairs.[5]

(d) Tax liability

The general tax of £1[6] was payable by 'every adult male native who is domiciled in the Union or who has resided therein for a continuous period of twelve months immediately preceding the date on which the tax becomes due.' [7]

In addition to the general tax, the local tax of ten shillings was payable 'in respect of every hut or dwelling in a native location within the Union by the native occupier thereof.'[8]

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[4] This proportion was increased to three-fifths by Act 50 of 1939 and to two-thirds by Act 27 of 1940.

[5] Section 15 of the Act

[6] The tax had been increased to R3 (officially £1,50) at the time of the Act's repeal in 1969.

[7] Section 2(1) of the Act

[8] Section 2(2) of the Act
References may also be encountered to the 'poll' or 'hut tax'.

(e) Taxpayer

The crucial term, 'native', was defined as -

> any member of an aboriginal race or tribe of Africa and includes any person who in the opinion of the receiver is residing in a native location under the same conditions as a native. Where there is any reasonable doubt as to whether any person is a native as thus defined the burden of proving that he is not a native shall be upon such person;[9]

In terms of an interpretative circular issued by the Department of Native Affairs on 3 July 1926 -

> With reference to the definition of "Native" in sec 19 of the Act, I beg to inform you that, while it is recognised that in terms of the definition any full-blooded Hottentot, Bushman, Koranna or Native of similar race, or an individual with an admixture of blood of these races or of one or other of these and Bantu, should be regarded as a "Native," nevertheless, in view of the fact that very few of the individuals now commonly classed as belonging to these non-Bantu races are without a strain of European blood which would exclude them from the definition and from liability of tax, it is considered that the administration of the Act should in this respect be based on a liberal interpretation, and that in consequence the persons generally described as Hottentots, Bushmen, Korannas, etc., should not be regarded as natives and should not be called upon to pay taxes. The few pure-bred individuals who might escape liability as a result of this policy will make little or no difference to the total amount of tax collectible.[10]

Effectively, then, the natives tax was only payable by men of Bantu origin, and not all indigenous men.

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[9] Section 19 of the Act

[10] See *Rex v Makwena* 5 SATC 333 1932 EDL, 335.

(f) Judicial powers

A magistrate was empowered to attach a native's property should he fail to pay the tax within three months of the due date. If property could not be attached, the native could be imprisoned for a period, not exceeding three months, with or without hard labour, for each year's default.[11]

(g) Removal of privileges

The Act rescinded any exemption a native may have enjoyed from the payment of native-specific taxes, conferred by any previous law.[12]

(h) Exemptions

Certain persons qualified for exemption from the taxes, notably disabled indigents, these being defined as -

> any native who satisfies the receiver that he is indigent and is prevented from working by reason of age, chronic disease or other sufficient cause or that he is in necessitous circumstances and is prevented by causes not within his own control from earning sufficient to enable him to pay the tax.[13]

Furthermore, should a native pay income tax of £1 or more in the tax year ending the previous June, he would be exempted from the general tax for that year, but not the local tax.

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[11] Section 9 of the Act

[12] Section 18 of the Act

[13] Section 4 of the Act

(i) Administration and enforcement

The receiver who had been satisfied as to a native's exemption was required to issue a certificate to that effect, the certificate being valid for a year.

Certain persons could, at any time after three months from the due date of the tax, demand from 'any native whom he believes' to be liable for the taxes for his certificate (of payment, exemption or extension).[14] The officials empowered in this way were any -

- Receiver of revenue;
- person authorized in writing by a receiver;
- European policeman;
- native chief recognized by the Government; or
- Government headman.

Any male native who failed to produce the certificate, as demanded, could 'be arrested, without warrant, by any person authorized to make such demand', although this right to demand certificates was only applicable in areas prescribed by the Minister.

[14] Section 7 of the Act

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