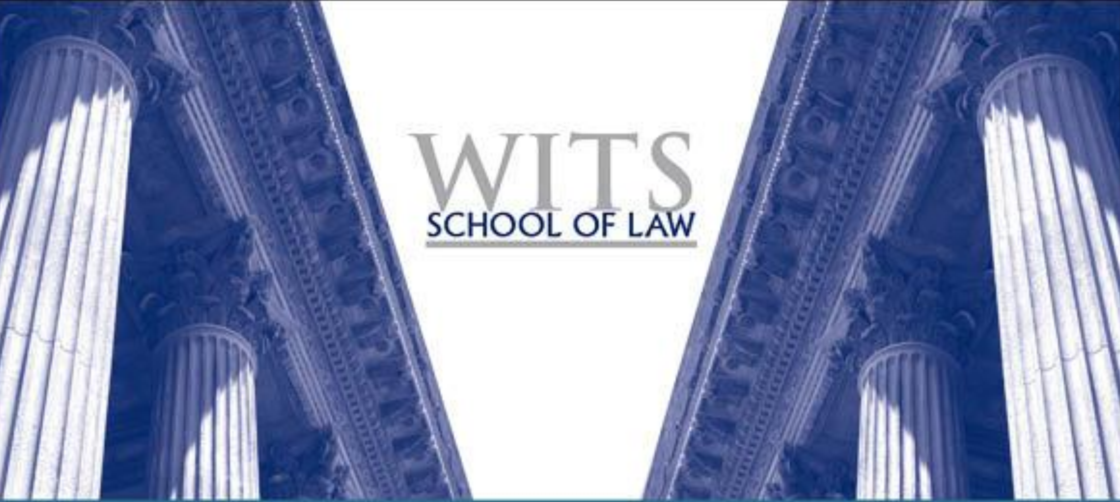

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TAXATION IN A POST APARTHEID SOUTH AFRICA:
ITS LIMITATION AS A FISCAL TOOL:
A PRELIMINARY OVERVIEW

by

D M Davis

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INTRODUCTION

Notwithstanding the enormous intellectual and political inadequacie of the Margo Report, there has been little systematic research t develop an alternative set of proposals. This paper represents the firs tentative product of a larger research project designed to fill this gap It should be treated as an an initial work in progress. It is published i the hope that constructive debate might be stimulated thereby.

Comments, criticism and suggestions will be most welcome.

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Centre for Applied Legal Studies
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TAXATION IN A POST APARTHEID SOUTH AFRICA: ITS LIMITATION AS A FISCAL TOOL: A PRELIMINARY OVERVIEW

Taxation is only one and certainly not the most important means of achieving national economic objectives. Indeed it would appear that the potential of taxes for achieving many of the goals and objectives in developing countries has been grossly exaggerated. The evidence is ambivalent in respect of the redistributional role of tax and there is considerable uncertainty particularly as a result of the unknown extent to which taxes such as those in companies are shifted into consumer public. In general it can be argued that the main form of redistribution through tax is personal income tax. It has been accepted that income which could be defined to include all accretions to capital provides a particularly suitable means for a system of personal income taxation. Viewed from the perspective of equity the tax implications of an additional rand of income should be the same irrespective of the source of such income. In practice, however, neutrality between the taxation of various forms of accretion of economic power does not take prace. Administrative realities impose modifications on an ideal tax system. Thus in some countries the resulting lower profitability of taxing a rand of capital within the tax net has meant that capital taxation has never been taken as seriously as taxation on wages and salaries.

This paper was originally written in an attempt to test the viability of the proposals put forward by the African National Congress in its journal Mayebuye (April 1991). The ANC proposed that government expenditure should be increased to 35% of the Gross Domestic Product (GDP) as compared to the present ratio of 28% of the GDP and that tax revenues be increased from 25% of the GDP to 30% of the GDP. These proposals were designed to achieve additional revenue of R58 billion of which approximately R40 billion would be collected by way of taxation (R8 billion x 5 years). This paper began as an attempt to assess the possibility of improving our tax structure in order to collect the additional R8 billion. As the research continued, it was inevitable that it should attempt to address questions relating to present economic decisions which have been tax driven and hence have influenced the process of investment in South Africa.

CHANGES IN THE TAX STRUCTURE

There has been a dramatic shift in the basis of taxation in South Africa particularly over the past decade. For example in the 1979-80 year of assessment some R9 billion was collected by Inland Revenue

Of this R1.67 billion was collected from tax on gold mines, R1.9' billion from individual income tax and R1.873 billion from compa taxation. In addition, Genera Sales Tax accounted for revenue R1.23 billion. Viewed in percentage terms, gold mining accounted f some 12% of taxes collected, individual taxation - 22%, company t - 20% and General Sales Tax accounted for 13% of the amou collected by Inland Revenue.

In the 1989/90 year of assessment Revenue collecte approximately R58 billion of which gold mining accounted f R1.015 billion, other mines for R1.33 billion, personal income tax R19.558 billion, company tax for Rll billion and Sales Tax for R16. billion. The changes are quite obvious and are extremely dramati Thus gold mining accounts for a relatively inconsequential amount c tax, personal tax accounts for almost 35% of tax revenue, compan tax for 20% and Sales Tax for approximately 28% of tax collection.

INTERNATIONAL EXPERIENCE

Since 1986 all Organisation for Economic Cooperation an Developmen (OECD) countries have reformed their tax structure resulting in a lowering and flattening of tax rates as well as broadening of the tax base. In general the total tax ratio in the OECI countries rose from 27% to 39% of the GDP from 1965 to 1987.

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The most significant aspect of this change was a dramatic escalation in personal income tax which increased from 7,30 to 12% in this period. This was caused not only by fiscal drag but also through radically improved collection techniques in the OECD countries. The following tables illustrate these changes:

TABLE 1
OECD: Tax Revenue Trends, 1965-87
(Unweighted Averages)

	1965	1970	1975	1980	1985	1987	1987 minus 1965
A. Tax Revenue as Percentage of GDP							
Taxes on Income	14.6	17.4	20.8	22.9	23.8	24.5	9.9
Personal income tax	7.3	8.9	10.7	11.6	11.6	12.0	4.7
Corporation income tax	2.4	2.6	2.4	2.7	3.0	3.0	0.6
Social security contribut.	4.9	5.9	7.7	8.6	9.2	9.5	4.6
Taxes on Consumption	9.7	10.4	9.8	10.3	11.2	11.8	2.1
Taxes on Property	2.0	2.0	1.9	1.7	1.8	2.1	0.1
Other Taxes	0.3	0.4	0.4	0.5	0.5	0.4	0.1
Total Tax of which:	26.6	30.0	32.8	35.2	37.3	38.8	12.2
United States	25.9	29.2	29.0	29.5	29.2	30.0	4.1
Japan	18.3	19.7	20.9	25.5	28.0	30.2	11.9
European Community	27.2	30.8	33.4	36.4	39.4	40.6	13.4

B. Percentage Composition of Total Tax Revenue

Taxes on Income	53.7	57.0	62.8	64.6	63.7	62.9	9.2
Personal income tax	26.3	28.2	31.4	32.7	31.1	30.7	4.4
Corporation income tax	9.2	9.0	7.7	7.7	8.1	7.9	-1.3
Social Security contrib.	18.2	19.8	23.7	24.2	24.5	24.3	6.1
Taxes on Consumption	37.1	34.8	30.1	29.1	29.8	30.3	-6.8
Taxes on Property	8.0	7.1	6.1	5.2	5.0	5.5	-2.5
Other Taxes	1.1	1.2	1.3	1.2	1.1	1.0	-0.1
Total Tax	100.	100.	100.	100.	100.	100.	100.

Source :OECD, 1989, Tables 3, 10-15, 20-25.
Note :Totals may not add because of rounding.

Broken down into OECD countries the following is a percentage of taxation in terms of Gross Domestic Product:

TABLE II

GENERAL GOVERNMENT TAX REVENUE - 1987

	------ Tax Source-----		
	Income & Profits	Social Security	TOTAL %
	------% of GDP-------		
Country			
Australia	17,4	0,0	31,3
Austria	11,0	13,7	42,3
Belgium	18,1	15,6	46,1
Canada	16,3	4,6	34,5
Denmark	29,4	1,9	52,0
Finland	17,8	3,2	35,9
France	8,1	19,2	44,8
Germany (FR)	12,8	14,0	37,4
Greece	6,4	12,2	37,4
Ireland	15,1	5,6	39,9
Italy	13,1	12,4	36,2

Japan	14,2	8,6	30,2
Luxembourg	18,6	11,6	43,8
Netherlands	13,2	20,5	48,0
New Zealand	22,9	0,0	38,6
Norway	16,0	11,4	48,3
Portugal	6,1	8,9	31,4
Spain	9,8	11,9	33,0
Sweden	23,4	13,7	56,7
Switzerland	12,9	10,3	32,0
Turkey	8,6	3,8	24,1
United Kingdom	14,0	6,8	37,5
United States	13,3	8,6	30,00
Unweighted avg.	14,7	9,5	38,8
South Africa	12,2	0,4	23,5

*Other taxes are on goods and services, payroll, property and sundries.

Certainly in the OECD countries a number of traditional theories have been rebutted; in particular the utilitarian argument that people derive diminished returns of satisfaction from the traditional unit of goods or service as well as from any increment added to income has been under severe question. Hence the argument that to increase the general happiness level high income should be taxed at progressively high rates of tax and revenue raised should be transferred to low income earners has not found much favour. In almost all OECD countries the maximum marginal rate of tax has fallen dramatically particularly over the past five years. For example, the Netherlands has reduced its tax from 72% to 60% between 1986 and 1990, Belgium from 72% to 55%, Sweden from 50% to 42%, Britain from 60% to 35%, and the United States from 50% to 33%.

Furthermore the question of increased taxes promoting welfare by increasing economic growth is a questionable proposition. It is perhaps significant that in developing countries in which taxes have been significantly raised the increased revenues have not come from direct income tax but rather from a variety of indirect taxation and consumption, that is ironically from taxes which would hitherto have been considered as being regressive and inefficient. For example, in Nicaragua virtually the entire increase in tax revenues from 10% to 40% of the total GDP was funded by indirect taxation. Significantly the benefit principle, namely that taxes be levied in accordance with the benefits received from the expenditure they finance, has returned to favour as opposed to the ability to pay principle which hitherto dominated during the highpoint of the theory of high maximum marginal rates of tax.

But whatever principle is adopted a tax system can only succeed if two important conditions are met, namely, (a) an accountable administration to ensure, for example, that health expenditure goes to health care and not to heart transplants - that is - there is a need to ensure that any administration is accountable to civil society; and, (b) a good tax administration which results in a minimum of corruption and a sound Inland Revenue service which is able to implement tax policy and to collect the maximum amount of tax possible.

VAT

In the balance of this paper I have focused upon the possibility of raising the additional R8 billion per year referred to above. There are a number of steps that could be taken without changing the structure of the South African income tax system which presently operates. The introduction of VAT will only exacerbate the tendency of shifting the tax burden onto the individual taxpayer. The government's claim that the introduction of VAT will result in a loss of revenue, should only be valid in the short term. The experience in countries which have recently introduced VAT, particularly New Zealand, has been increased tax collections. Furthermore, VAT with a superior audit trail, should also contribute to increasing income tax collections.

The question does arise as to the applicability of VAT in South Africa. The Margo Commission recommended the introduction of a comprehensive business tax (CBT), to be levied at a low rate. This tax was to be calculated on salaries, wages, interest, royalties, rent, profit and depreciation less gross investment (whether in rent, fixed assets but not financial assets). In short, the Commission recommended a fiscal value added tax of a consumption type.

CBT proved to be a controversial recommendation.

Failing CBT the Commission recommended VAT. It suggested that VAT is superior to GST for a number of reasons, inter alia,

(a) its immediate impact as it is collected at each stage of a series of transactions;
(b) amounts collected at each point are relatively small;
(c) improved audit trail to prevent evasion. The International Monetary Fund (IMF) suggested that VAT would recover 60% of the tax evaded under GST;
(d) control for poor perceptions of GST.

It noted, however, that GST was superior to VAT in a number areas, including:

(a) ease of collection;
(b) minimum returns as compared to VAT;
(c) effect on power. Because VAT is split among a number of traders there will be a greater tendency for traders to "finance the tax";

(d) lesser demands for accounting and book-keeping and hence GST costs less to administer.

VAT has become a predominant means of indirect taxation but both rates and the tax base alter fairly substantially. For example, South Africa has copied the New Zealand legislation where the initial rate of 7,5% has already increased to 12,5%. Taiwan imposed VAT at 5% on all goods save for land. Korea imposes VAT at a rate of 10% but a number of goods and services are exempted from tax. Japan imposes a consumption tax at 3 % .

The real difficulty which confronts the government concerns the effect of the input credit on capital goods. It has been calculated that the removal of sales tax on capital goods will save the manufacturing sector R6 billion in the first year of VAT. A major question has remained unanswered regarding the government's determination to grant a full credit for capital goods in year one. In a number of countries including the Netherlands, France, Belgium and Luxembourg, the tax credit was phased in over a period of a year. In Germany a tax of 8% was levied on capital goods with the rate being reduced each year until it was phased out completely. These measures were designed partly to deter the postponement of the purchase of new capital goods until the introduction of VAT and to prevent a sharp drop in revenue when VAT was introduced. Whilst VAT should increase the tax take compared with GST, it is difficult to assess its impact accurately given the government's inaccurate figures and obvious lack of econometric models.

OTHER IMPROVEMENTS TO THE TAX SYSTEM

Since the appointment of qualified accountants serving their army service to the Revenue department, substantial additional tax has been collected. For example, in 1986, shortly after the introduction of qualified accountants, the Minister announced that an additional R1,16 billion had been collected in Income Tax. There can be no doubt that the increased use of professionals can only add to the potential tax net. The government should consider scrapping civil service pay scales in order to attract experienced accountants for senior Revenue positions and a group of talented lawyers to replace the present legal division which is completely inadequate for the task. The administrative system needs to be made more efficient. In many countries there is a move away from the present system of official assessment to self assessment. This means that less manpower is needed for the usual process of income tax returns and a specialised staff can then focus upon the test audits particularly in the corporate sector. If the proper professional staff is employed there can be little question that a major increase in tax collections can take place and this should be accompanied by sophisticated software which arguably sanctions have prevented South Africa from acquiring.

At the same time the tax system needs to be "user friendly" in order to facilitate certainty in economic and financial planning. This can also be facilitated by regular published rulings in so far as revenue practice and interpretation of the Act is concerned. This is a practice which is adopted in many countries and which has been almost absent in South Africa where no more than thirteen practice readings have been published. The appointment of a competent lawyer in each Revenue office can only contribute to maximising the efficiency of assessment and the clarity of decisions.

As was noted above, the tax collection in respect of companies has decreased enormously over the past decade and it has been suggested that the average rate of taxation on companies is closer to 20% than it is to the flat rate of 48%, the official rate of company taxation. In the manufacturing sector a study of the 75 largest groups reveals that the effective tax rate was 42% for 1990 with the range being from 49% to 18,89%. In the banking sector the rate is lower, averaging at 33%.

The Margo report also found that the effective rate of company tax was far less than the nominal rate. The following table is reproduced from the report:

ESTIMATED LOSS OF REVENUE IN THE NON-PRIMARY CORPORATE SECTOR AT VARIOUS TAX RATES

Year	Non-primary corporate tax receipts (R million)	Effective tax rate (per cent)	Loss of revenue at nominal tax rate of 40%	35% (R million)	30%
1983	3 596	20	3 596	2 697	1 798
1984	3 213	20	3213	2410	1 606
1985	3 700	25	2 220	1 480	780

This decrease in the rate of taxation has been caused by the imaginative use of tax deductions by companies, tax investor partnerships and the creative acquisition of capital equipment.

The following examples illustrate a number of aspects of the tax structure which influences corporate structuring.

1. Thin Capitalisation

As the Margo Commission noted:

"In some countries, loans from shareholders - in circumstances where the loan really forms part of permanent capital - are treated as disguised equity, and the interest payments thereon are treated as dividends. Countries which legislate against thin capitalisation of companies usually stipulate a debt-equity ratio. The deduction of interest payable on 'disqualified' shareholder loans is restricted, and the balance of the

> payment is treated as a dividend. This rule often applies where parent companies finance foreign subsidiaries with interest-bearing loans. It is clear from evidence submitted in respect of different Western countries that there is no international consistency in the area of thin capitalisation."

The fact remains that the present tax structure encourages the structuring of companies with grossly imbalanced debt equity ratios. The Margo Commission's reasons for refusing to introduce rules regarding this capitalisation simply needs to be stated to realise how unsatisfactory its approach was to this problem:

> "The Commission believes that the introduction of the concept of this capitalisation in South Africa would not have the desired effect, as it would either be so vague as to be meaningless or be so rigid as seriously to interfere with the allocation of resources in business enterprises. It would also, possibly, be disadvantageous to introduce a thin capitalisation rule in respect of shareholder loans as this might induce entrepreneurs to raise bank finance instead of shareholder loans."

2. Transfer Pricing

By means of transfer pricing, taxpayers arrange their affairs to exploit the differentials between tax systems and to gain advantages in relation to the currency differentials brought about by South African exchange control regulations. Common forms of transfer pricing are the export of goods at prices below existing market prices and the import of goods at prices higher than those prevailing in the market.

An important consequence of transfer pricing is to shift the realisation of profit (or part of it) to a different tax jurisdiction. At present South African tax law contains no anti-transfer pricing laws - an omission which is of considerable advantage not only to international investors but local conglomerates who are able to use transfer pricing to shift profits to assessed loss companies within the group. Consideration should be given to the introduction of a section similar to Division 13 of the Australian Act or section 484 of the American Code which empowers the Revenue to apportion or allocate income and deductions as it deems fit where two or more businesses are owned or controlled by the same interests.

3. Tax Shelters

Tax shelters are defined as arrangements whereby the claiming of tax deductions is accelerated, while the related income is deferred, or converted into capital gains.

Again, as the Margo Commission noted:

> "Tax shelters arise from inconsistent or wrong treatment of the time value of money, and also from the situation in which certain tax entities are subject to a lower rate of tax than others. Where the value of future money is incorrectly discounted, a taxpayer could possibly claim excessive tax relief today on costs which will only be payable in the

future. If the discount rate is too low or non-existent, there is patently an excessive tax claim. The other situation could involve borrowing funds from a tax-free institution, so that the interest on the borrowed money is tax deductible, whereas the interest earned by the tax-free institution is not taxable, it could also involve arranging for income (direct or by virtue of recoupment) to accrue to an exempt body."

THE INTRODUCTION OF A MINIMUM TAX ON COMPANIES

The Margo Commission considered a minimum tax as a consequence of the prevalence of the tax shelter (paragraph 5.64 et seq). It noted that the system of the minimum tax on companies would have the attraction of ensuring that major corporations which visibly generate income and perhaps pay substantial dividends do not undermine the general acceptability of the tax system by not paying income tax or by paying only small amounts of tax. It also suggested that a minimum tax could be designed by ensuring that the tax rate be expressed as a portion of tax of an income before the subtraction of the concessional deductions or it could be calculated as the sum of the deductions themselves. This tax was not introduced into South Africa and the Margo Commission was equivocal in respect of its introduction citing three disadvantages, namely the administrative work will increase because beside the normal tax calculations,others are required to calculate the minimum tax, complex rules are needed to decide whether an expense incurred ranks as a deduction for minimum tax purposes and thirdly the rationale for eliminating tax expenditures is weakened.

It is possible to circumvent these difficulties by ensuring a minimum tax of say 25% and then allowing a company to substantiate a claim for a lower rate of tax by proving that certain expenses which were actually incurred in the production of income, wholly and exclusively for the purposes of trade, have the effect of reducing the taxable income of the company below the minimum tax threshold. A minimum tax on companies would certainly flush out considerable revenue which at present is being shielded by means of tax base schemes and other creative planning. To cite an example, it is understood that some 38 000 taxpayers were involved in the investment of films partly or wholly produced in South Africa depending on where the "investment" took place. Many of these film investments provided the taxpayers with a 6:1 ratio of tax deduction to investment and it has been estimated that the potential tax loss in this regard could be more than Rl billion. Experience has shown, by the popularity of investment in film, plantation, aircraft and computer schemes as well as leverage leasing that the tax system can be manipulated to direct private sector funds into particular areas of investment. Whilst this results in a reduction of tax collected, a future government might wish to use tax incentives in order to direct private funds into socially desirable enterprises. Obviously the use of incentives erodes the corporate tax base but there is room for creative use thereof, particularly when compared to the present government's policy, perhaps best exemplified by the government's sponsorship allowance in terms of section 18B.

A personal preference would be for government to make careful use of incentives in areas of training and housing. In addition, a more generous deduction should be granted to encourage donations to educational institutions. Beyond this restricted list, incentives should be used extremely sparingly. Government should then announce a reduction of corporate tax to a maximum of 43% with a minimum tax of 30%, coupled with an increased inspectorate to ensure that the effective rate of corporate tax is as close as possible to the official rate. Such a policy would doubtless increase tax collections while systematically encouraging business by keeping company tax at the same rate as the maximum marginal rate for individuals.

INTEREST

Another means of easy tax revenue relates to the taxation of interest on Escom, in this regard. It should also be recognised that as South Africa trades with an increasing number of countries

Transnet and other para-statal stock. At present interest on such stock is tax free if the investment was made by a person who was neither resident nor carrying on business in the Republic (section 10(1)(h) of the Income Tax Act).

The government initiated a change by abolishing the sectio 10(1)(h) exemption but leaving the date of abolition open to b determined by Government Gazette. This has not yet happened. Ther can be little doubt that if non-residents, particularly those who us blocked monies to acquire Escom stock had to pay full income tax, considerable sum of additional tax could be raised and an annua figure of R300 million would not appear to be unduly optimistic Another area which requires attention is the reintroduction of withholding tax on interest. Whilst non-residents' tax on interest wa no money spinner, its abolition diminished Revenue's ability to tracl down interest from a South African source paid to non-residents an meant that the taxation of non-resident interest accruals depend solely upon the vague concept of source.

At present non-resident share holders' tax which is impose upon non-residents receiving dividend income raises R425 millior from South African companies. The Margo Commission itsel recognised that there were major loopholes in respect of the imposition of this tax and by simple legislative amendmen thesecould be stopped and substantial additional tax could be raised be entered into between South Africa and other governments. It will be important to ensure that adequate tax avoidance legislation is introduced to prevent treaty shopping.

The abolition of tax on dividends cost the fiscus R408 million in 1990. Such a step was a clear manifestation of the narrow supply side economic theory propagated by the Margo Commission and which benefitted the large shareholder at the expense of the balance of society.

It is simply unacceptable to relinquish what in 1991 money terms, is close to R½ billion in the context of the pressing socio-economic demands facing the government. The exemption of dividends from normal tax had an additional impact upon tax collections. It provided scope for dividend stripping and for the use of subsidiaries to channel profits by way of tax free dividends which were immune from undistributed profits tax.

THE INTRODUCTION OF NEW TAXES

1. Capital Gains Tax

South Africa has never had a tax on capital gains. A majority of the Margo Commission recommended that no such tax should be introduced. The reasons were that a capital gains tax creates a bias towards holding onto appreciated assets which can seriously retard and distort markets and that the only way to defeat this bias is to tax unrealised gains which is not a feasible proposition. Furthermore, a capital gains tax yields a low return as a result inter alia of the deferral of tax liability on replaced assets and the exemption of assets such as personal homes. The majority of the Commission also stated that in countries with experience of capital gains tax the perception is that the tax is not paid by the rich who can afford to sit on their gains but it is the less wealthy who are forced to realise gains to obtain cash who "get caught" (para 12.34). Moreover "when the rich do realise assets, they often have portfolios large enough to contain losses to offset any gains that might otherwise be brought for tax". Further, the majority of the Commission added, that in order to preserve a measure of equity there is a need to index the gains for inflation which can be a very complicated system.

Administrative problems do impact upon the introduction of a capital gains tax when existing assets must be appraised at their current value. Australia, for example, solved this problem by taxing only gains and assets acquired after the introduction of the capital gains tax.

Furthermore, elaborate loss offset provisions are needed to prevent people from realising their negative gains and setting them off against ordinary income, postponing the realisation of positive gains or having them taxed abroad under a more favourable regime. Although a capital gains tax should be introduced it is neither legally nor administratively easy to ensure the success of such a tax. Equity, however, dictates that the system be indexed to prevent taxation of purely inflationary gains.

However, it appears that the majority of the Commission missed the point of a capital gains tax which is not so much to raise substantial additional funds which had not been the case (see A Alstone 1981(9) **New Zealand Law Review** 257), but as the Irish Tax Commission has stated:

> "We believe that a major reason for charging capital gains tax is to prevent avoidance of income tax by switching income gains into a form in which they are regarded as capital gains. This is not only necessary for reasons of equity, as not all taxpayers are able to effect this kind of switch; it is also necessary for reasons of efficiency to prevent indefinite distortion. Furthermore, in so far as the presence of a capital gains tax deters such switches, it will serve to protect the

> yield of income tax. Thus, even on the narrow criterion of revenue yield, its contribution will be more than is apparent from looking at the yield of capital gains tax in isolation." (First Report, 1982 at 201)

It is submitted that by the raising of revenue from a capital gains tax and by the impact which the tax has on income tax collection, the additional revenue gained would not be insignificant.

2. Land Taxes

Land lies at the heart of the conflict produced by apartheid. The removals of some 3,5 million people from land which they had occupied peacefully for generations is a legacy which no post-apartheid government can refuse to accept and must, therefore, attempt to reconcile the plethora of competing land claims. There is an obvious need for a Land Commission to survey land occupation and/or ownership in South Africa and to document the various competing land claims. Subsequently a land court can provide an appropriate forum to resolve these disputes.

A number of countries impose land taxes whether at a low rate annually billion, this could well be achieved without dramatically increasing tax rates, by placing the emphasis upon a more efficient administrative system and an equitable tax system both of which presently do not exist in this country. or on disposal at a far higher rate. En passant, the Chellia Commission into Zimbabwe's tax system recommended an annual land tax with rates of either 0,5% of the rated value of output or 1% per hectare of land under cultivation, whichever is less. It is also recommended that there be a charge per unit livestock in lieu of a land tax on pastures. These recommendations were made after careful argument which was ignominiously absent from the Margo Commission and subsequent deliberations.

In Korea a tax was imposed on land to the extent of 50% on the increase of the value of real estate regardless of whether the property was transferred or sold there. This taxed land owners irrespective of whether gains were realised or unrealised. Taxation of this kind can influence patterns of land ownership, as well as raising substantial revenue, but in order to achieve these twin objectives there is a need to impose a tax at a high rate. A harsh tax such as the Korean type could well prove inequitable, difficult to impose rationally given the major difference in soil quality in any one farm, and it would cripple efficient as well as inefficient farmers. An annual land tax would appear to be a preferable solution. The rate will be limited by the relatively low returns enjoyed by the agricultural sector.

In Taiwan a land value tax is levied on both rural and urban land on the basis of the official assessed value of land, the rate being

1% in respect of urban land for industrial use, and up to 5% for other forms of urban property. There is also a land value increment tax levied on the increase in the assessed value of land, the rates being between 40% and 60% at the time of transfer.

Recently an interesting form of property tax was introduced in Spain where a tax of 5% is levied upon non-residents who either hold or own real estate under any title in Spain. The tax is calculated on a principal value which is levied on 31 December of each year and is payable within the following month. Significantly, the tax does not apply to entities which develop an economic activity in Spain on a continuous or habitual basis.

Given the South African history of land policy, a land tax becomes a particularly appropriate mechanism to assist in responding to the past. In principle a land tax is unobjectionable. But in South Africa the case becomes even more compelling. Such a tax could be used as the fiscal base for a land court.

As John Stuart Mill noted, not to tax capital accretion is iniquitous for the land owners "grow richer, as if in their sleep, without working, risking or economising. What claim have they on the general principle of social justice, to this accession of riches?" (Principles of Political Economy (1909) at 819)

The notion of a retributive tax is not uncommon in tax literature. As Mitchell (1988 **University of Toronto Law Journal** 151) puts it 'a retributive tax informs people about what behaviour is wrongful and uneconomic, and the tax rates establish a scale of wrongfulness ... the retributive tax raises the revenue in the process of punishing for wrongful acts and collecting damages to pay compensation to injured parties.'

There are problems with a property tax including the lack of proper valuation procedures, and measurement of a property tax on the gross value of the property without taking account of associated debt. The neutrality of the tax in relation to yield and the problem of the burden of tax forcing some property owner to allow buildings to decay must also be taken into account. A land tax on its own will not resolve the pressing land questions confronting the country. But as part of an overall package of reform, the introduction of a land tax should not be discounted. It is estimated conservatively that there is some R60 billion worth of agricultural land in South Africa. Even allowing for an exemption from tax for the poorer farmer, an annual tax of 2% could yield Rl billion. Provided that this revenue is used to develop the agricultural sector, it could prove important particularly as a fiscal base for rural local authorities.

Further, an accurate system of land evaluation and more complete information will aid in the enforcement of a capital gains tax.

3. Capital Transfer Tax

To an extent, land reform should also include estate duty. Thanks in the main to influential white farmers at present South Africa has one of the most generous forms of capital transfer tax (or estate duty). The tax is imposed upon an estate of more than Rl million (the first Rl million is estate duty free) and then only at a flat rate of 15%. To cite John Stuart Mill "I can see that inheritance and legacies, exceeding a certain amount, are highly proper subjects for taxation" (Principles of Political Economy (1985) at 811-812).

Estate duty has never been taken seriously in South Africa. Thus there has never been a similar section to section 103(1) of the Income Tax Act whereby estate duty avoidance schemes could be attacked by Revenue.

Interest free loans have never been brought within the ambit of estate liability. It was always open for estate planners to recommend to their clients that they peg the value of the estate at a fixed amount by selling growth assets to an inter vivo trust and leaving the purchase price as an outstanding loan with no interest being charged thereon. The figure of R140 million which was collected from estate duty in the 1985/6 fiscal year is a very low figure when compared to what could have been collected had a stringent tax avoidance section been in operation and had there been a less lenient attitude towards interest free loans and the use of inter vivo trusts for estate planning purposes. However, it is interesting to note that the R140 million collected in 1985/6 given a 15% rate of inflation over the past five years, would translate into a yield of R380 million in 1990 as compared to the actual yield of R82 million. A comparative analysis of the trends in tax structures in the OECD countries and South Africa indicates that taxes on the use, ownership, or transfer of property (excluding Sales Tax and Capital Gains Tax) produce a meaningful source of government revenue. The OECD average for 1987 was 2, 1% of the GDP. These figures translate to a percentage contribution to total tax revenues and 5 ,5 % as an OECD average. Certain specific comparisons are also illuminating. In the United States of America three forms of capital transfer tax are distinguished, namely an estate tax, a gift tax and a generation skipping tax. Taxes are imposed on US residents and citizens in respect of their world wide property and is calculated on the aggregation of tax on transfers made during the lifetime and at the death of the deceased. The rates are determined in accordance with unified estate and gift tax schedules increasing to a maximum of 55% on estates in excess over $3 million.

In West Germany inheritance tax is imposed on the gratuitous transfer of property whether at death or inter vivo and the rates vary from 3% to 70% over DM100 million. In the United Kingdom inheritance tax is charged at a single rate of 40% whereas inter vivo transfers are charged half that rate, namely 20 % . Notwithstanding recent generous concessions to estate owners, inheritance tax produced £1 256 billion for the Exchequer in 1990.

The comparison between South African estate duty and the various forms of inheritance tax examined illustrates not only the token nature of our present system but that inheritance tax is hardly a revolutionary measure being employed as it is by almost all the great industrial nations. Although inheritance taxes are not major sources of revenue they should raise between 1% and 2 % of total tax revenues as is the case of the United States. Within the South African context we could therefore expect estate duty to raise at least Rl billion and indeed if combined with other forms of taxes on property the contribution to total tax revenues of wealth taxes could be as high as 10% without being totally out of line with the OECD countries such as the United Kingdom. In addition, estate tax, if and economic control particularly where relatively high tax rates force executors to sell assets for cash in order to pay the necessary duty.

CONCLUSION

A successful tax system depends to a large degree on a constitutional, political structure which involves the administration and in particular the extent to which the bureaucracy is accountable to the public. Further, although South African tax rates are vastly below OECD averages, it should be noted that the weaker OECD nations have a lower than average ratio of tax collected to GDP. Thus Portugal at 31,4%, Spain at 33% and Turkey at 24,1% are all well below the OECD average on 1987's figure of 38%. Furthermore, countries which had too high a tax/GDP ratio for their level of economic development such as Ireland (39,9%), Greece (37,4%) and New Zealand (38,6%) have all reduced these ratios in recent years. In addition, tax/GDP ratios are effected by social security tax which involves some form of direct worker contribution and in that sense are a form of compulsory national insurance. In short, if international experience is any guideline, there is a limit to the rate at which we can increase our tax ratios successfully.The point of this paper is that if all that is required is an additional R8 billion, this could well be achieved without dramatically increasing tax rates, by placing the emphasis upon a more efficient administrative system and an equitable tax system both of which presently do not exist in this country.