

# **Standing Committee on Finance (SCOF): Report-Back Hearings**

**[DRAFT Date: 5 June 2012]**

## **Rates and Monetary Amounts and Amendment of Revenue Laws Bill, 2012**

### **Draft Response Document from National Treasury, as presented to SCOF (Final version will be published by date of National Assembly Debate)**

#### **1. BACKGROUND**

##### **1.1 Process**

This Bill deals (as the name implies) merely with rate changes and other numerical matters. The more substantive tax proposals will be dealt with in the Taxation Laws Amendment Bills, 2012 or specific legislation (e.g. gambling) to be released later this year. Together with the rest of the taxation laws amendments for 2012, this legislation will give effect to the tax proposals announced by the Minister of Finance in the Budget Review 2012 (see Chapter 4 and Annexure C) tabled in Parliament on 22 February 2012.

The Rates and Monetary Amounts and Amendment of Revenue Laws Bill, 2012 was introduced in Parliament on 13 March 2012. National Treasury conducted the initial briefing before the Standing Committee on Finance on 22 May 2012. Public responses to the Committee were presented at hearings held on 30 May 2012.

##### **1.2 Public comments**

As the more substantive policy matters will be contained in the Taxation Laws Amendment Bill, 2012 due out later this year, National Treasury did not receive significant comment in relation to the Bill. Only three organisations responded (PricewaterhouseCoopers, Size Ntsaluba Gobodo and South African Constitutional Property Rights Foundation).

#### **2. POLICY ISSUES AND RESPONSES**

Provided below are the responses to the policy issues raised by the public comments received.

##### **2.1 Timing of effective dates (Bill reference: General)**

*Comment:* The effective dates for most of the proposals have been set either on 1 March 2012 or 1 April 2012. These dates are retroactive, going into effect before the Bill is promulgated. This retroactive treatment is often adverse for the taxpayer and should accordingly be avoided.

*Response:* The proposal ignores long-established tax practice with regard to rate changes. Over the years, many rate changes have taken effect immediately after Budget announcement (before Bills are promulgated). If this comment were to be accepted, rate changes would be delayed for up to a year. Most taxpayers would find these delays problematic because personal income tax rates changes (typically in the form of reductions) have consistently occurred within a week or two of Budget announcement. In fact, provisions within the income tax have officially recognised this procedure early enactment of rate changes based on Ministerial announcement, followed by Parliamentary ratification.

On the other hand, in terms of changes to the tax base, National Treasury has largely taken the decision to delay effective dates due to the complexity of the changes involved. Hence, most changes in the pending Taxation Laws Amendment Bill will take effect sometime after 1 January 2013. However, even in the case of tax base changes, Government reserves the right to make urgent changes from date of announcement, especially to prevent large-scale avoidance.

*Comment:* The new Dividends Tax goes into effect as of 1 April 2012 so the whole tax is retroactive. The short-time period between the budget announcement and the effective date also places unfair strain upon taxpayers.

*Response:* As an initial matter, Government reserves the right to make urgent rate changes for revenue, equity and other considerations. It should also be noted that only the rate change is new. The Dividends Tax itself was initially promulgated several years ago with the final version settled in 2011. The date of the tax was officially set by Ministerial notice in December 2011 (pursuant to Parliamentary authority).

## 2.2 Rate increases (Dividends Tax and Capital Gains Tax)

*(Dividends Tax Bill reference: Clauses 4 and 6; Sections 10B and 64E; and Capital Gains Tax Bill reference: Clause 9; Paragraph 10 of the 8<sup>th</sup> Schedule)*

*Comment:* Introduction of the new Dividends Tax at a rate of 15 per cent comes as an unwarranted surprise, especially since only a 10 per cent rate was previously indicated by Government. The current argument that the rate had to be increased to cover the anticipated losses associated with the newly enacted Dividends Tax is misleading because the Dividends Tax was anticipated for quite some time. Similarly, no reason exists for increasing the capital gains tax rate.

*Response:* Government reviews its revenue needs on a regular basis and the decision to introduce the revised rate from 10 to 15 per cent takes into account the need to adjust for unanticipated revenue changes. Given

the latest revenue trends, it was determined that the revenue losses from the new tax required compensating adjustments.

*Comment:* One argument advanced for the increased Dividends Tax rate is to eliminate the arbitrage between individuals (40 per cent) and companies (28 per cent). Under this argument, it may be appropriate to levy a higher tax rate for dividends paid by closely-held companies but the higher rate should not apply to widely-held companies.

*Response:* While the arbitrage issue alluded to was a factor in the decision to raise the Dividends Tax rate, the issue of revenue was the overriding consideration. In this regard, the main revenue to be collected from the change is to be collected from widely-held companies, not from closely-held companies.

*Comment:* Consideration should be given to levying a lower rate of Dividends Tax on dividends paid by small business corporations. Much of the benefit of the lower corporate rate of 10 per cent versus 28 per cent is offset by the 15 per cent Dividends Tax charge.

*Response:* To date, small business tax relief has focused on the taxation of operating income. Dividends are about value extraction, which is not typically a significant issue for most small businesses because most business withdraw funds via salaries or interest payments (the latter stemming from shareholder loans). Turning back to the issue at hand, the proper mix of company taxes is an item worthy of consideration, but a better understanding of the tax factors critical for operating small businesses needs to be considered before further action can be taken.

*Comment:* Capital assets are held over a long period of time and their increase in value is mainly due to inflation, especially in a country like South Africa. Therefore, the lower capital gains rate is needed to compensate for inflation. The proposed increase in the inclusion rate potentially undermines this rationale.

*Response:* In 2001, it was understood that the capital gains tax rate for the South African system is very low by international standards. While inflation is a factor in the South African economy, the inflation rate is reasonable when compared with other developing countries. That said, the overall new capital gains rate for individuals at a ceiling of 13.3 per cent is not high when all factors are considered (nor is the company capital gains rate of 18.6 high when compared with many countries that do not have a lower capital gains rate for companies).

*Comment:* The increased inclusion rate is inequitable between persons who may have disposed of a capital asset before 1 March 2012 as opposed to person who disposed of such assets after that date. The increased 15 per cent rate should apply only for gains arising after 1 March 2012, regardless of the time of disposal.

*Response:* Tax law is often a trade-off between fairness and simplicity. What is being requested is the effective reintroduction of complex

effective date rules with every capital gains rate change (e.g. time-apportionment and valuation date rules). Given the small level of the rate change, these complexities cannot be justified. It should also be noted that one reason for the small rate change was precisely the need to avoid the use of complex effective date rules.

### 2.3 Ongoing top marginal individual tax rates

*(Bill reference: Appendix I)*

*Comment:* It is proposed that a more creative tax model be created for taxpayers falling into the highest marginal 40 per cent tax rate. These taxpayers are “rain makers” for the South African economy in respect of employment creation and poverty alleviation. This class should be given relief so as to stimulate greater job growth, especially in terms of salary-related income.

*Response:* The link between low tax rates for top marginal ratepayers and employment creation is overstated. Lower taxes for wealthier individuals do not necessarily correlate for greater job creation (e.g. funds can be reinvested in machinery or abroad). While lower taxes can act as a stimulus, the question is whether the revenue gain from the economic stimulus over-shadows the revenues lost from the tax cut itself. Moreover, issues of equity should not be forgotten. Lower-income groups may call into question tax cuts for the rich when none are forthcoming at lower-income levels.

### 2.4 Relief for entrepreneurs selling small businesses

*(Bill reference: Clause 11; Paragraph 57 of the Eighth Schedule)*

*Comment:* Under current law, small business owners receive relief upon the sale of that business with the small business being defined as an entity with a gross revenue not exceeding R5 million. Therefore, the increase in the gross revenue maximum threshold from R5 million to R10 million is welcome. However, the overall threshold remains too low and should be re-considered in the near future.

*Response:* The purpose of the change was to bring the relief level fully in line with other comparable thresholds. That said, the small business definition has become a perennial issue. To say that a business with a maximum gross asset value of R10 million is too small is questionable. More importantly, the relief needs to be in line with other retirement relief measures, which will soon become subject to a ceiling (so that this form of retirement relief is not benefited or burdened). Therefore, further increases in the relief need to be considered as part of package going forward.

### 2.5. Proposed land tax

*(Bill reference: outside the scope of the Bill)*

*Comment:* The current income tax and value-added tax systems should be abandoned because these taxes discourage work as well as investment and trade, thereby undermining the economy as a whole. A single land rent system

should be imposed instead because this system would reduce the value of land, thereby freeing land for productive use.

*Response:* This request is ideologically motivated and proposed by a narrow interest group. It seeks to fundamentally review the entire tax system, compromising the key objectives of taxation, such as equitable distribution. Little objective evidence exists that the proposed approach will provide a viable alternative to the current tax system. This cause has been pushed by a select few since the Katz commission, which also implicitly rejected this radical approach. No country in the world has jettisoned the income tax and value-added tax systems in favour of a land tax. Lastly, the notion of land as the source of all wealth is outmoded. In the current “information age”, the nexus between land and wealth is questionable.

*Comment:* Although National Treasury was initially willing to engage on the land tax, National Treasury abandoned discussions on this matter, National Treasury should instead revert back to the process.

*Response:* The National Treasury fundamentally rejects the proposed approach and therefore sees no need to further engage. Research in this area will require more than a theoretical debate or *prima facie* claims. The 8<sup>th</sup> Katz Commission Report reviewed land taxes as an instrument that fall within the domain of local government. The Commission did not view the land tax as a comprehensive substitute for national income tax and/or value-added tax.