TAX, REDISTRIBUTION

AND REALITY

BY: ERNEST M. KHAILE

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Within the context of the economic consideration of nationalisation as proposed by the ANC through its documents VIZ. Freedom Charter and Constitutional Guidelines; it becomes important to analyse and comment on the commonly known source of Government revenue: Taxation.

1. POLITICAL INTEREST AND ECONOMIC REFORM:

Effective stabilization and structural adjustment programs require political support. This is especially true of public finance policies, because they generally affect the distribution of income. Four main as aspects of the political process that can be highlighted are as follows:-

(a) Interest Groups:

Economic policies are heavily influenced by the balance of power among competing interest groups, especially business, labour and agriculture. Reforms are unlikely to succeed without the backing of some of these groups. For example, the support of business groups - and the confidence that reforms will be sustained - is vital for a successful re-allocation of resources. Labour unrest over wage restraint, for instance, can undo reforms, as has been demonstrated in Argentina, Egypt and Jamaica to mention a few.

(b) Type of regime:

Authoritarian regimes have not always been better at imposing economic austerity than democracies - Strong democracies have a tradition of consultation with business and labour; this facilitates acceptance of economic programs. In contrast where policy making is conducted by technocrats behind closed doors, reform may succeed in the short-term but may be difficult to sustain. Strong authoritarian governments characterized by continuity in leadership, insultation from societal measures, work established and integrated interest groups, and the power to enforce decisions - tend to be relatively successful in imposing the short-term costs of economic reform.

Weak authoritarian government, which maintain political authority through personalistic patron-client relations, tend to be bad at economic reform. Several of the small, ethnically fragmented, fall into this category (e.g. Bantustants).

(c) Political Cycles:

The time horizon of a government may influence its decisions. This will differ according to whether countries have a stable electoral system. In a stable system the period before elections is characterized by expansionary policies,, the period thereafter by retrenchment Authoritarian tend to follow the opposite path. Typically the military seizes power in the midst of a crisis and attempts to restore order and nationalize the economic system.

(d) The bureaucracy:

The governments' administrative capacity is crucial to its ability to organise and carry out a program of economic reform. The bureaucracy may form an influential interest group that may oppose stablization and structural reform.

Hence, this paper in its analysis maintains that as point of departure on its subject of Taxation recognises that political factors are important in developing a program of economic reform. Opts for policies that will prove more successful if they respond to political reality and thus are sustainable in the LONG-TERM.

A pragmatic approach to public policy, can draw..on)the strengths of both the public interest and private interest -viewed by;(The mixed economy concept reassures

- Considering both the benefits and costs of government involvement.
- Asking which groups in society are likely to receive the benefits and which to bear the costs.
- Recognizing the institutional and political constraints that are likely to be encountered in implementing a particular policy (e.g. Tax policies).

2. REFORMING TAX SYSTEMS:

South Africa is reported to be facing a process of attempting to reduce the fiscal deficits; which by economic theory and practice would mean some combination of lower public spending and higher public revenue. Indeed may be the mouth-full gum exercise of privatisation which is intensively undertaken on the public sector.

We are all aware that ultimately public spending (e.g. health, education) is limited by the ability of the public sector to transfer resources from the private sector through taxes or to issue public debt secured by taxes or charges on future economic activities. Other sources of finance are either temporary or corrosive, as in the case of money creation in excess of real economic growth, are of minor importance, as is income from public property licences and fines and other non tax revenues. (See Figure 2).

Therefore, focus is on taxes and user charges (or public prices) as the primary means of financing public spending.

2.1. Criterion of choice Taxes and Uses charges:

2.1.a. Charges should be used wherever a publicly produced good or service can be sold and should reflect some measure of the cost- preferably the incremental cost - of production: We should work out away from whereby uses charges suggest having their benefits understated and their costs exaggerated.

The main advantages of User charges:

Efficiency -unlike taxes, most user charges do not involve a trade-off between revenue and efficiency. Setting prices correctly generates revenue while ensuring an efficient allocations of resources.

Equity - By charging marginal cost prices to most users while targeting limited subsidies to poor consumers, it is possible to improve efficiency and relieve poverty at the same time.

Revenue - The public revenue aspect of user charges is not readily apparent in Standard fiscal statistics because revenue is not transferred to the central budget directly.

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2.1.b. Tax financing should be reserved for cases where user charges are not appropriate: to pay for public goods whose costs or benefits cannot be assigned to individuals, to compensate for market failures (such as externalities) or to achieve a distributional goal (such as alleviating poverty).

2.2. TAX PATTERNS:

2.2.1. Tax levels:

Globally speaking; on average, taxes laise risen slightly as a proportion of GDP since 1975 in all broad country groups. (See Fig. 4.2). However, this disguises wide variation from country to country. The Tax-GDP ratios for Botswana, Italy and Yemen Arab Republic grew faster than the average of their groups, while the ratios for Sri Lanka, Venezuela and Zimbabwe fluctuated sharply from year to year and those of Brazil, Canada and Turkey were lower in 1985 than 1975.

Observations are that Tax-GDP ratios appear to rise with per capita income, bust as a partial explanation. It is therefore, of interest in this presentation to know the significance of this aspect as regards SA now.

2.2.2. TAX COMPOSITION

Tax revenue is usually considered under two headings: direct taxes on individuals and firms; and indirect (commodity) taxes on goods and services.

Direct taxes include taxes on personal and company income as well as other direct taxes, consisting mainly of social security contributions, payroll taxes, and taxes on property and wealth. Indirect or commodity taxes include demoestic taxes, such as broadly based taxes on turnover, value added, and sales, as well as excises on specific goods; and taxes on international trade, namely import duties, export taxes, and cesses.

In industrial countries income and other direct taxes account for 69% of total tax revenue. The weight placed on personal income (27%) social security taxes (31%)+in industrial countriesis feasible because the necessary administrative apparatus exists. INorway 9% to Australia high of 56%).

Personal taxes are hard to collect in predominantly rural, agricultural economies, where people are widely dispersed. Taxes on company income including taxes levied on the profits of commodity exporting firms, especially mining and agricultural estate operations - present fewer administrative difficulties (Will this hold true in new South Africa with the conglomerates in finance flight to so-called off shore operations).

Revenue shares of general commodity taxes are usually VATs in Latin America; in Africa, Asia, and the Middle East they are usually taxes on turn over. In industrial countries are typically retail sales or comprehensive VATs). Reliance on import taxes also varies by region. Excise applies to a few goods in Africa. (What is the position experience by the large poor S.African population).

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Objectives and constraints in Tax Reform.

Governments attempt to use tax systems to achieve many goals, raising revenue is only one of them. To facilitate compliance and collection, however, a tax xystem must be administratively feasible. For the same reason, but also as an end in itself it must spread its burden EQUITABLY. To avoid misallocating resources, it must not upset patterns of production, trade, consumption, saving and investment. All these aims can rarely be satisfied simultaneously, so TAX REFCRM is A MATTER OF TRADEOFFS.

POLICY PROPOSALS:

On the revenue-raising side of the public account, reforms should achieve.

(i) more revenues be raised for socially and economically desirable programs.

(ii) the structure of incentives for the development of industry, commerce, and agriculture be improved but with a firm and cautious manner.

(iii) the structure of taxes and prices be more equitable and facilitate proverty alleviation and

(iv) internal balance and stability be improved. **On** the expenditure side of the account, they should achieve reforms. Such that

(v) expenditures would be better applied to improving the health and education of the labour force, provision of**infrastructum** ture services and public services in general.

The principal source of tax revenue in Africa has historic lly been taxes on trade. In the 1960s' and 1970s' this source accounted for about 45% to 50% of total revenue, though it declined slightly in the 1980's.

TABLE: TAX REVENUE & STRUCTURE, 1966 - 1982

	1966	1970	1974	1978	1982
Tax revenue (% of GDP)	11.6	14.2	15.6	16.3	16.1
Tax Structure (% of tax revenue)					
Tax on income	25.1	26.9	29.7	29.9	29.5
Taxes/Domestic Comodities	25.0	24.6	24.5	24.2	27.9
Taxes on international trade	49.9	48.5	45.8	45.9	42.6

Source: Shalizi and Squire, based on Government F

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FINANCIAL STATISTICS, IMF/IBRD, various issues. Note that these figure are based on arithmatic averages. These figures neglect the financial transfers from the surpluses of the export marketing boards: if they are counted as an indirect form of tax, taxes on trade probably would amount to over 50% of tax revenue.

In certain parts of the world, trade taxes arises because such taxes are relatively easy to administer. Other taxes, require more extensive and costly systems of administration, and are more prone to losses through evasion, to bribery and corruption. However, there is a shift away from taxes on trade toward a greater reliance on taxes on income and commodities.

The above analysis and reference is purely to highlight what obtains in the future trading partners, patricularly taking into consideration the partitioning of world trade in the year 1992.

Lessons that can be drawn from the heavy dependence of the public revenue in Africa and low income developing countries on taxes on trade reflects administrative and political convenience. It does not imply that such a dependence is in escapable or even desirable, and indeed there is much empirical analysis which shows that it is improverishing and urgently needs to be addressed. Specifically, consider the questio what these countries would gain socially and economically by reducing their reliance on trade taxes? There are 3 advantages:

1. Non-trade taxes tend to be more stable and less prone to amplifying the economic shocks of changes in trading conditions th are trade taxes.

2. Trade taxes are more damaging to the growth of agriculture, industry and commerce, i.e. they have greator economic costs. ~~Reasons for this can be stated briefly:~~.

   (i) ~~Low returns on capital and to labour.~~
   ~~(ii)~~
   ~~(iii)~~

3. Gradually moving away from trade taxes is that other taxes, both on commodities and income, can be designed to be socially more equitable. Elements of progressivity can be introduced in income taxes, luxury goods taxed, and basic needs goods, when and if necessary, subsidized... in each case with more predictable and favourable effects on income distribution and poverty alleviation.

Effect especially on poverty alleviation for example is that the most effective way of raising incomes and reducing malnutrition is to raise outputs, labour demand, labour productivity and thus real wages in agri culture industry and commerce. This can be done through providing a proper system of incentives for investment in these activities.... the importance of tax reforms.

COMMODITY TAXATION: Commodity taxes take many forms but two of them easily outweight the others in terms of revenue generated, namely excise taxes and general sales taxes.

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TABLE: TAXES ON COMMODITIES

(PERCENT OF TOTAL REVENUE)

	1966	1970	1974	1978	1982
Taxes on commodities of which:	24.1	26.6	28.7	28.1	35.2
Broad based taxes	9.4	10.9	13.9	12.6	17.3
Excises	9.8	12.4	12.4	13.9	17.5
Other	4.9	3.3	2.4	1.6	0.4

Source: Shalizi and Squire, based on Government Financial Statistics IMF/IBRD

The table distinguishes between taxes (excise taxes) levied on a few targeted commodities, and taxes that are more broadly based, such as general sales and value added taxes.

Commodity taxes are widely agreed to be a more desirable way of raising revenues than taxes on trade because they do not adversely effect the efficiency of production. With these taxes, all domestically consumed goods, whether imported or produced locally, are taxed at a common rate. Other goods are tax free. Commodity taxes are prefered because they do not "cascade" through the production process and enable producers to choose among factors based on their relative cost advantages; compared to both tariffs on imports, they do not draw capital and managerial resources away from agriculture) and from more employment intensive local industry and commerce; compared to export taxes, they do not reduce the incentives to produce for export.

TAX,RE-DISTRIBUTION AND REALITY:

Taxation in its own right tends to be a technical subject concerned essentially with questions of classification and consistency, and with assessing the direct revenue implications of particular tax proposals, or the extent to which a particular subsidy or relief really helps those whom it is meant to help.

We are seeking fairness in our tax system. To discuss certain constraints which equalitarian tax legislation cannot ignore, and to make proposals for altering the balance of the SA tax system.

Let us consider a much used objection to equalitarian tax policies, namely that some people are much more productive than others and accordingly either ought to, or inevitably will, receive a much greater post tax-reward for their productive contribution. Somebody may well think that the conomic contribution of especially productive people will be reduced if taxes on earned income are high, while at the same time believing it is anti-social and morally wrong for them to respond that way.

Thus the equalitarian minded moral philosopher will emphasize the paradox involved, the arguement that the exercise of a superior innate talents deserves an exceptional high reward. What merit is there in doing what comes naturally. Why in moral terms, should one person enjoy 10 times as high a standard of living as another who is putting in the same amount of effort merely because he (the former) is more naturally gifted? OR should we not aim with Marx to cross the narrow horizon of bourgeois rights in its entirety and inscribe on our banners - from each according to his ability, to each according to his needs?

What about a great leap forward for South Africa.?

DO THE POOR SINCERELY WANT TO BE WEALTHY

Another question is whether there is any meaningful sense in which wealth can be transferred to the poor. It is one thing to give the poor some shares in a company but quite another to make them hold the shares. In short the poor do not want to be wealthy in the proper sense of that term; waht they do want is higher living standards. Any susbstantial improvement in the living standards of the poor can be achieved by levying higher taxes on the earnings of all people with salaries of more than say Rx per annum i.e. these should be fixed on their excess consumption not on their savings.

We should balance the tax system to discourage extravagant consumption and encourage - or at any rate not discourage - saving and risk taking.

FISCAL FOG:

In South Africa the majority of the population is underprivileged in terms of literacy, among others: A democratic SA would certainly undertake a tax system that is indiscriminate in terms of Income Tax purposes. The problem that we will face is already an eyesore even in some developed countries: Complicated tax literature may be the simple outcome of a complicated tax system. But there is reason to suppose that some scope exists for making tax literature more helpful to tax payers. Literature on taxation however, suggests that already SA has devised a recommendable butthe point is that it will be an expensive exercise and certainly that will benefit tax advisers because of the mere understanding of the tax literature. We should adopt the Swedish method-highly recommended.

DOUBLE - TAX RELIEF:

(a) Definition of a resident in tax considerations varies from country to country. It will therefore presuppose that our tax specialists define the concept for tax purposes. The importancebeing that issues for examples pertaining to double-tax relief for individuals, companies, unilateral relief(when there is no double taxation treaty in existence with the overseas territory or where such treaty does not deal with the particular type of income. To illustrate this further take for example:

"Thus, the original double taxation treaty with the Union of South Africa (g) did not contain provisions governing royalties arising in SA; hence any SAfrican tax payable in respect of Such a royalty was a subject of unilateral relief in the UK except where such royalty fell to be treated for the purposes of UK tax on profits of a trade, when it came within the provisions of Article X III (a) of the treaty and relief was due".

b. Treaties

It is commonly known that several foreign companies and individuals have invested in SA. It therefore, also becomes crucial to be conversant of treaties which the Government of South Africa entered as regards taxes. For example the UK: Statutory Rules and Orders and Statutory Investments 1962 No. 2352, Date of Order in Council: October 24, 1962. Date effective in UK: April 6, 1962.

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THE TAX IMPLICATIONS: TNCS

Our fragmented country we are told is embarking on export orientated industrialization, does this imply that during the period of oil embargo, sanctions, disinvestment, lack of foreign capital South Africa opted for the import substution industrialization. If so who was bearing the costs: We therefore missed out in terms of taking advant ge of lower word prices where they occured. The country therefore, began to loose out even on Tariffs denying our people another source of revenue. Export, concessions to prop Apartheid of Secondly the TNCs' in the country probably had the popular trend TNCs' as seen around the world with assurances of:

(a) Adequate tariff protection
(b) Exemption from payment of taxes which are not levied on certain raw materials.
(c) Continued permission to remit dividends, royalty (Free of tax) and interest and repay foreign loans, and in the event of the venture terming, permission to repatriate capital and reserves.
(d) Permission be granted to employ foreign technicians with the continued.

Provision of the TAX HOLIDAY.

Thirdly, again many concessions including tax in the border industries of the so called homelands. With South Africa turning a new leaf these issues need to be looked at, the BARGAINING STRENGTHS AND WEAKNESSES. Tax specialists know that, it is generally accepted principle in international agreements that the country in which the income arises has the prior right of levying tax, but each nation reserves to itself the right to impose tax on the income enjoyed by those persons regarded as physically or technically resident within its territory. In consequence the problem of producing an international blue print had become more officially, but the model convention recommended by the Organisation for Economic Co-operation and Development and the Fiscal Commission of the Social and Economic Council of the United Nations were used for example by the UK in negotiations.

For the ANC it must be of great importance to really know what operates now. Whether these agreements benefited or still would be beneficial need to be reformed a mammoth though an attainable task in the long run.

This paper does not intended participating in the technicalities of computations such as "deductions not allowed", meaning of "whole time service director" mineral rights duty and royalties welfare levy", chargeable accounting period" etc; all the same tax practioners or consultants in the spirit of reconciliation, trust and good faith in the reconstruction of a new democratic South Africa will have to think of how best to share their experience and solutions to difficulties in the complexity of taxation, & computation measures.

NATIONAL AUDIT CORPORATION: Added to the question of computation, it is a strong opinion of this presentation, that though SA is endowed with

several chartered Accountants of tremendous experience heading corporations some as public accountants (unfortunately again the majority of the people in this category are poorly represented) as tax consultants and so forth - we need to have a vast broad-based National Audito Corporation to safeguard among other things - proper taxes are collected. ----

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Whereby the government interest is certainly taken care of. Hence, there is a need for an undertaking to train more Blacks in Tax Assessment etc. The details of this undertaking is subject to an open, frank and honest discussion broadly with all interest groups.

(i) Import Tariff Reforms

Focus should be on how, in the mediume-term and beyond, tariffs can be used as protective measures to encourage a relatively efficient industrial development in the country. As tariffs (i) bring in revenue to governments as for example under an import control system scarcity margins on imports are captured by traders or direct importers

(ii) Provide a protective margin whilst not insultating domestic producers entirely from price movements on the world market.

Tax revenue considerations.

In practice there will always be some tariff exemption for goods that all into special categories, but from a revenue and incentive point of view there should be minimized. It is clear that donorssupport programmes may insist that particular goods are tax exempt and this particularly valid for items imported as emergency relief or as gifts. There should be a single uniform rate - for administrative purposes and also the advantage that its effect on the incentive to produce is neutral as between activites. In this connection it is useful to work with the concept of the Effective Rate of Protection (ERP) which measures the extent to which value-added in an activity is increased by protection in cf. with what it would be with a free trade or zero tariff policy.

A major objective of a tariff reforms should be to ensure that the range of ERP s generated by the new tariff structure is in line with government objectives in terms of encouraging priority activities particularly dynamic industries.

Equity considerations andTariff Policy.

On equity grounds there will be some categories of imports which the government is likely to wish to tax significantly more highly than the average, because they are consumed by high-income groups. E.g. for these there could be a relatively high additional rate, which would be on top of thebasic flat rate. ie. basic rate plus a premium rate for luxaries.

Tariffs and longrun protection.

The system proposed here involve indentifying activities which should receive special encouragement from the tariff system:

- dynamic or "infant" industries with a potential for long run efficiency provident new investment or rehabilitation is undertaken;
- inefficient industries with little dynamic potential but which government wishes to support because of their employment effects.

The important general point is that any industry wishing special tariff protection must make a case to the government, and that the protection granted should be reviewed periodically to assess, the progress of change and restructing in protected activities.

INVESTMENT INCENTIVES:

The ANC would have to undertake a careful tax system that would rêlate tò profits tax dividends exemptions for new invesment, existing producers not able to undertake new investment: A tax system that will not be a disincetive. A policy which will rationalise the system of exemptions, that will have a beneficial effect in terms public revenue. Rationalization of tax exemption.

The case for annual revaluation of company assets, so that depreciation allowance can approximate more closely the economic use of assets is clear. For existing companies current depreciation figures based on historical asset valuation are likely to have little economic meaning.

In the event tax holidays are a practice currently in the country limitation of years in necessary, this is not only important on revenue grounds to finance profit tax (if low) but also to avoid encouraging investment by foreign forms, who can recover their capital over the initial tax holiday period, and which is not "footloose". It would be defined as a percentage of the original capital investment over a maximum period.

The view here is that a permanent Tariff Commission be established within the Ministry of Finance or Trade to deal with requests for this type of special protection. This commission could request information from enterprises and their sponsoring Ministries for example relating, to

- costs of production
- size of expected market
- productivity proformance over time and gains from rehabilitation
- technical capability
- prices of competing imports
- employment effects

Those to be protected for employment reasons, plans will have to include a basic run down of production, and diversification into further areas.

Export promotion and tariff policy

A tariff system is envisaged that does not penalize the export sector. Exporters sell at world prices, so that unless some form of export subsidy scheme is in operation, they cannot receive positive ERP. However, if imported inputs used by exporters are taxed they will have to exporters are taxed they will have to a negative ERP. Since whilst their output is sold at world prices their inputs will be incre sed above world levies by the rate of tariff.

But, the ANC should be concerned about transfer pricing especially within multinationals.

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ILLUSTRATION OF NOMINAL PROTECTION AND THE EFFECTIVE RATE

	NOMINAL IMPORT TARIFFS	EFFECTIVE RATE OF PROTECTION %
Case I Standard Protection	20% uniform tariff on output i. and 50% input j	$ERP=\frac{0.20-0.50(.20)}{(1-0.5)}$ $= 20\%$
Case II		
Special protection for favoured industries	40% tariff on output i and 20% tariff on input j	$ERP=\frac{.40-0.5\ (0.20)}{1-0.5}$ $= 60\%$

(This higher ERP will create an incentive for resources to move into these specially favoured activities).

Case III

Special protection with Tariff free inputs	50% tariff on output i zero tariff on input j	ERP = 100%

TECHNICAL APPENDIX - EFFECT OF CHANGES IN TAX INCENTIVES

Technical Appendix - Effect of Changes in Tax Incentives

The possible impact of the changes in incentives discussed in the text can be illustrated with a simple numerical example. Table 1- sets out data on a new investment project with a cost of US$1.5 million (at the official exchange rate), and a pre-tax profit of US$0.65 million in a normal year of operations. The project has a 15 year life, with production starting in the year after the investment expenditure has been made. For simplicity assets are depreciated over 15 years and all profits after depreciation are distributed as dividends. Revenue and all costs are constant over the life of the project.

Table 2 shows taxes and net project income over time under different tax-incentive packages, whilst table 3 summarises the different cases and the total taxes collected. Case 1 illustrates a situation with no special tax concessions. Profits and Dividend Taxes are at their current basic rates of 50% and 45% respectively, and there is no special depreciation allowance. The project has an IRR of 17% post-tax and US$7.06 million are collected in tax revenue. Case 2 introduces a 5 year tax holiday during which no Profits Tax is paid, and where Dividends Tax is 50% of the basic rate - that is 22.5%. During the first five years (1-5) there is a double depreciation allowance. Here the project IRR rises to 36% and total taxes collected fall to US$5.33 million.

Case 2 can be taken to be a fairly representative situation under the existing incentives. Case 3 illustrates the most favourable incentives possible for a new investment under the existing legislation since the tax holiday period and the lower n.3

rate of Dividends Tax extend to 10 years. In addition there is again a double depreciation allowance for 5 years. Here the project IRR rises to 40%, whilst taxes collected are around half of those in case 1 without special incentives. Cases 4 and 5, on the other hand, show the effect of the changes proposed in this study. The basic rate of Profits Tax is 40% instead of 50%, and the tax holiday and the period of lower Dividends Tax are reduced to 2 years. There are no special depreciation allowances. The only difference between cases 4 and 5 is that in the latter an import tariff of 20% is imposed on the capital equipment used by the project which is assumed to be all imported. In these cases the project IRR, whilst still above its initial 17% in case 1, is now 28% and 24% respectively.

In terms of the total taxes collected in cases 4 and 5, it is important to note that these are not dramatically higher than case 2 - our representative case under the existing incentives. In comparison with case 2 there is a percentage increase of less than 4% for case 4 and of around 6% for case 5. However the time profile of the taxes is different in these two latter cases as compared with case 2. This is due to the lower exemptions which bring in tax revenue in the early years of the project's life, combined with the lower basic rate of Profits Tax which generates less tax revenue in the longer-term. Tax revenue has an opportunity cost to the government, so that revenue arising in the future is not as valuable as revenue in the present. The technique of discounting is used to allow for this, and for illustrative purposes the flow of tax revenue from the different cases is discounted at 8% to give the discounted present value of tax revenue. It is significant that now the tax revenue generated in cases 4 and 5, is 21% and 27% respectively above that in case 2. A relatively small adjustment in total taxes collected has thus created a much more favourable impact on the time profile of government revenue. It is this more favourable pattern of tax revenue over time, which the changes recommended here are designed to create.

Table 1 Hypothetical Project

Investment Cost	US$ mill.
Capital[a]	0.75
Buildings	0.75
	1.50
Sales Revenue[b]	1.5
Operating Costs	
Raw Materials	0.50
Labour	0.25
Depreciation[c]	0.10
Profits pre-tax	0.65

Notes: a) All imported

b) In normal year of operations

c) Over 15 years.

Table 2 Project Tax and Income Flows

Year	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Case 1																
Profits Tax	-	0.325	0.325	0.325	0.325	0.325	0.325	0.325	0.325	0.325	0.325	0.325	0.325	0.325	0.325	0.325
Dividends Tax	-	0.146	0.146	0.146	0.146	0.146	0.146	0.146	0.146	0.146	0.146	0.146	0.146	0.146	0.146	0.146
Total Taxes	-	0.471	0.471	0.471	0.471	0.471	0.471	0.471	0.471	0.471	0.471	0.471	0.471	0.471	0.471	0.471
Dividends	-	0.179	0.179	0.179	0.179	0.179	0.179	0.179	0.179	0.179	0.179	0.179	0.179	0.179	0.179	0.179
Depreciation	-	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Net Project Income	-	0.279	0.279	0.279	0.279	0.279	0.279	0.279	0.279	0.279	0.279	0.279	0.279	0.279	0.279	0.279
Project IRR post tax = 17%																
Year	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Case 2																
Profits Tax	-	-	-	-	-	-	0.325	0.325	0.325	0.325	0.325	0.325	0.325	0.325	0.325	0.325
Dividends Tax	-	0.124	0.124	0.124	0.124	0.124	0.146	0.146	0.146	0.146	0.146	0.146	0.146	0.146	0.146	0.146
Total Taxes	-	0.124	0.124	0.124	0.124	0.124	0.471	0.471	0.471	0.471	0.471	0.471	0.471	0.471	0.471	0.471
Dividends	-	0.426	0.426	0.426	0.426	0.426	0.179	0.179	0.179	0.179	0.179	0.179	0.179	0.179	0.179	0.179
Depreciation	-	0.20	0.20	0.20	0.20	0.20	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Net Project Income	-	0.626	0.626	0.626	0.626	0.626	0.279	0.279	0.279	0.279	0.279	0.279	0.279	0.279	0.279	0.279
Project IRR post-tax = 36%																

Year	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Case 3																
Profits Tax	-											0.325	0.325	0.325	0.325	0.325
Dividends Tax	-	0.124	0.124	0.124	0.124	0.124	0.146	0.146	0.146	0.146	0.146	0.146	0.146	0.146	0.146	0.146
Total Taxes	-	0.124	0.124	0.124	0.124	0.124	0.146	0.146	0.146	0.146	0.146	0.471	0.471	0.471	0.471	0.471
Dividends	-	0.426	0.426	0.426	0.426	0.426	0.504	0.504	0.504	0.504	0.504	0.179	0.179	0.179	0.179	0.179
Depreciation	-	0.20	0.20	0.20	0.20	0.20	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Net Project Income	-	0.626	0.626	0.626	0.626	0.626	0.604	0.604	0.604	0.604	0.604	0.279	0.279	0.279	0.279	0.279
Project IRR post tax = 40%																

Year	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Case 4																
Profits Tax	-			0.26	0.26	0.26	0.26	0.26	0.26	0.26	0.26	0.26	0.26	0.26	0.26	0.26
Dividends Tax	-	0.146	0.146	0.176	0.176	0.176	0.176	0.176	0.176	0.176	0.176	0.176	0.176	0.176	0.176	0.176
Total Taxes	-	0.146	0.146	0.436	0.436	0.436	0.436	0.436	0.436	0.436	0.436	0.436	0.436	0.436	0.436	0.436
Dividends	-	0.504	0.504	0.214	0.214	0.214	0.214	0.214	0.214	0.214	0.214	0.214	0.214	0.214	0.214	0.214
Depreciation	-	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Net Project Income	-	0.604	0.604	0.314	0.314	0.314	0.314	0.314	0.314	0.314	0.314	0.314	0.314	0.314	0.314	0.314
Project IRR post-tax = 28%																

Year	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Case 5																
Profits Tax	-	-	-	0.26	0.26	0.26	0.26	0.26	0.26	0.26	0.26	0.26	0.26	0.26	0.26	0.26
Dividends Tax	-	0.146	0.146	0.176	0.176	0.176	0.176	0.176	0.176	0.176	0.176	0.176	0.176	0.176	0.176	0.176
Import Taxes	0.15															
Total Taxes	0.15	0.146	0.146	0.436	0.436	0.436	0.436	0.436	0.436	0.436	0.436	0.436	0.436	0.436	0.436	0.436
Dividends	-	0.504	0.504	0.214	0.214	0.214	0.214	0.214	0.214	0.214	0.214	0.214	0.214	0.214	0.214	0.214
Depreciation	-	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Net Project Income	-	0.604	0.604	0.314	0.314	0.314	0.314	0.314	0.314	0.314	0.314	0.314	0.314	0.314	0.314	0.314
Project IRR post-tax = 24%																

Table 3 Tax Incentive Package and Total Taxes Collected

	Case 1	Case 2	Case 3	Case 4	Case 5
Profits Tax	50%	50%	50%	40%	40%
Dividends Tax	45%	45%	45%	45%	45%
Tax Holidays	None	5 years for Profits Tax and Dividends Tax at 22.5% for 5 years	10 years for Profits Tax and Dividends Tax at 22.5% for 10 years	2 years for Profits Tax and Dividends Tax at 22.5% for 2 years	2 years for Profits Tax and Dividends Tax at 22.5% for 2 years
Import Tariffs on Capital Equipment	None	None	None	None	20%
Depreciation Allowance	Normal over 15 years	Double Depreciation allowance for 5 years (1-5) then normal rate	Double Depreciation allowance for 5 years (1-5) then normal rate	Normal over 15 years	Normal over 15 years
Total Taxes collected (US$ mill)	7.06	5.33	3.71	5.52	5.67
Discounted value of Taxes collected (at 8%) (US$ mill.)	4.03	2.65	1.76	3.21	3.36
Project IRR (%)	17	36	40	28	24

The incentive package in cases 4 and 5 clearly reduces the project IRR below that in case 2. However this is only a problem if the IRR after tax is insufficient to justify the investment so that firms will not choose to invest under these rates of tax and projected profits. Provided the project IRR is above the minimum necessary to stimulate investment, the fact that it is less than could be obtained under an alternative incentive package should not be an issue.

The labour subsidy tax credit referred to in the text can be illustrated with the same project example. It is assumed that on average workers are paid twice the minimum wage, so that labour costs at the minimum wage are US$0.125 million. The value per worker for calculating the credit is taken to be 300% of the minimum wage. Therefore the total tax credit that is deductable from Profits Tax liability is US$0.375 million.

In a normal year of operations taxable profits are US$0.65 million, so that at a 40% rate of tax, Profits Tax is US$0.26 million. With a tax credit of US$0.375 million taxable profit falls to US$0.275 million and Profits Tax collected falls to US$ 0.11 million. However in this particularly case, where labour costs are low relative to profits, this form of tax credit is not a major incentive. With a Profits Tax holiday of 2 years, for example, the firm will save a tax bill of US$0.26 million for two years. However with this tax credit the saving will be US$0.15 million per year. However if the project were to employ twice the number of workers at the same wage rate its credit under this scheme would double, with a net saving of US$0.30 million per year. If the tax credit is transferable between years this would be a more favourable incentive to the firm than a straight two year tax holiday. The degree to which firms would gain from this type of incentive thus depends on the extent to which labour is an important element of costs of production, and the level at which the incentive is set, determined by the ratio of the value per worker used to calculate the tax credit and the minimum wage.

AGRICULTURAL TAXATION AND THE TERMS OF TRADE:

"If land or agricultural output cannot be effectively taxed however, then agricultural taxation will inevitably be inefficient, and ever if it is well designed it with reflect a comprise between equity and efficiency. This charac eristic is evident in the view that justifies turning the terms of trade against agriculture for the following four (related) reasons:-

1. Aggregate agricultural supply is relatively inelastic which fact argues for relatively heavy taxes.

2. Investment in industry provides a higher rate of growth than investment in agriculture and hence it is desirable to transfer the surplus from agriculture to industry.

3. Because the Chief beneficiaries of higher agricultural prices are the larger farmers a case may be on grounds of rural equity for lower agricultural prices.

4. Lower food prices would benefit low-income urban and rural consumers.

The first two points are efficiency arguments (static and dynamic), whereas the last two are equity arguments all suggesting the desirability of possibly quite heavy agricultural taxation. Proponents of lower agricultural taxes argue that:-

(i) individual crop production elasticitizes can be quite high, and even aggregate production elasticities may be quite high in the medium to long run once complimentary investments in irrigation, seed improvement agricultural extention, and rural infrastructure especially transport have been made.

(ii) That these complimentary investments have a high social Late of return arguably higher than that of many industrial projects so the case for transferring surpluses out of agriculture is weakened.

(iii) The distributional impact of lower agricultural prices is not necessarily beneficial because of the possible impact on rural wages.

(iv) If rural wages fall, urban real wages may also fall, in which case the fall in urban money wages would be even greater than the fall in food prices.

Finally rural stand rds of living are on average systematically lower than urban standards of living in almost in any countries, and licence on equity grounds the case of agricultural taxation (and the consequential simultaneous taxation of marginal urban workers) is weak.

Tax reform analysis is well suited to the analysis of small changes in existing taxes or government regulated prices. Hence some of the major conflicts between equity and efficiency from the hunted range of tax instruments available for agricultural taxation - suggests that it is important to examine these supposed limitations carefully.

LAND TAXES:

Agricultural land, which is in inelastic supply, is an obvious candidate for taxation. It is often distributed in a highly unequal way, with the largest land owners owning a disproportionate fraction of the total. Land taxes appear very desirable from an equity point of view, noting that political power often coincides with land ownership and reinforces the process of inequality, where as absence taxes, land reform, or revolution allows the process to continue. However, land taxes have declined in some countries. This paper argues for a simple propertional tax on presumptive income (ie normal rent), perhaps with an exemption for small land holdings (though this may be undesirable if it encourages evasion through the registration of land ownership, with a variety of relatives). Progressive land taxes, that depend on the owners' income and wealth introduce, considerable complexity, frequently provoke effective political opposition, and can be evaded by sub-division. Hence simple taxes, which would require only 4 facts:-

Area of property
Location of land
Classification
Name and person to whom to send
Tax bill

Such information can be obtained through e.g. (landset) satalite imaging. Such information is useful in that the fiscal cadastre (official record of location, size, ownership, value) be less detailed and accurate than the traditional legal cadastre used to establish ownership rights Ownership identification will be greatly facilitated if the land can be seized should no owner come forward.

Once the fiscal cadstre is complete than a dear statement of the tax low specifying

- who pays the tax
- method of assessment of tax liability
- penalties for failure or delay in payment which, to be effective, must allow the tax authorities to enforee a lien against the property as a final resort.
- Tax officials to collect the tax.

Main determinants of presumpt-. re'income rent will be:

1. the fertility of the land
ii. Availability of reliable water
iii. Accessibility to the main market

Standard profit maximizing arguments show that land taxes are easy to analyze no matter which model is chosen.

VAT IN AGRICULTURE

Agriculture poses special problems for VAT (in most countries farmers are not easy to handle as taxpayers. Few countries, however, farmers are assumed to be like any other trader and are dealt with wholly inside the usual VAT legislation e.g. Denmark, New-Zealand, Sweden and the United Kingdom. VAT Legislation usually tries to make sure that farmers do not make any VAT return and do not have to deal with tax administration.

A great deal of discussion by for example the EC (Common flat rate for agriculture) treatment, other countries treatment, does take place (Below).

In the South African scenario most farmers are privileged by political power. In the effort of equity, redistribution the agricultural sector has to be seriously addressed.

As farming becomes more complex and capital intensive, so the value of capital inputs and bought in services rises. Modern farmers may purchase the services of specialists to plough, sow, spray, harvest, and transport their crops. These are basically business services and should be required to register as such, as a business.

If their sales are small, they will be exempt under the small business exemptions, if above the exemption limit, but below the limit that allows special treatment, then either (1) the flat inputs can be Zero rated.

Each system has its drawbacks. But both relieve farmers of compliance costs.

Farms with large turnovers or with the characteristies, of commercial undertakings should have to register as full VAT traders.

SUMMARY OF AGRICULTURE UNDER VAT FOR SELECTED COUNTRIES
1982 - 1986

	REG.	VAT RATE	OPTIMAL OUTPUT	INPUT	PURCHASER CREDIT COMPENSATION
Europe					
Austria	x	10.0	-	x	-
Belgium	x	2.0 (wood) 6.0 (food)	-	-	2.0 6.0
Denmark	x	Standard	-	x	-
France	x	7.0 (food) 10.0 (wine)	x	x	3.5 (eggs, poultry, pigs
			Turnover F300000 (U$53,809)	Claimed from Govt. even if opt. out	2.9(wine, fruits & vegetables) 2.4 (other food)
Italy	x	2.0 (cereals) 8.0 (poultry, wine) 15.0 (milk, cattle) 8.0(other)	As small business	-	2.0
Netherlands	-	4.0	-	-	4.5
Sweden	x	Standard	As small traders	x	
United K.	x	Standard but more food is zero rated		x	-

	REG.	VAT RATE	OPTIMAL OUTPUT	INPUT VAT	PURCHASER CREDIT COMPENSATION
New Zeleand	x	Standard	-	x	-
Phillipes	x	Exempt	-	Fertilizer and seeds Exempts	-
Brazil	-	-	-	Principal inputs exempt from tax	-
Argentina	-	Exempt (unprocessed) 18.0 (processed)	-	Principal inputs exempt from tax	-

Out country has a custom union agreement with Lesotho, Botswana and Swaziland. As for this presentation., is concerned it would make little sense to remove border controls for VAT if they remain for excises. For purposes of tax harmonization, as far as VAT is concerned any customs union proposal should ensure that

1. traders are inconvenienced as little as possible
2. the clearing system places as little additional burden as possible on the national fiscal administrations,
3. the clearing system is self financing.

i.e. It is easier for a domestic SA exporter to consider all his production as one, regardless of destination. Where it goes after dispatch as far as VAT is concerned, is no concern at all.

TAXING EXPATRIATE INCOMES :

The conomic activities of foreigners in developing countries are sensitive,both politically and economically. Taxation of the income of foreigners can influence both the flow of foreign [illegible] benefits a country receives from the presence of foreign factors of production. Unless a country prohibits any economies activity by foreigners (and virtually no country in the world does this,) its system of taxation must come to grips with the major issues affecting foreign incomes.

In all cases, the issues involve both the question of how much income is to accrue to government from a given level of domestic economic activity and how foreign exchange earnings of the country will beused.

Since consideration of objectives other than tax liability will influence the decision of foreigners to repatriate earnings, tax proposals must be examined in the light of other issues, such as the exchange rate, exchange control procedures, and incentives for reinvestment in the same or in other economic activities.

To decide on the income tax laws and regulations to be adopted relative to foreign incomes, some general issues must be explored.

(a) Different typesof foreign owned income might be treated differently: National objectives, with respect to the various types of foreign factors of production, may be different, and other policies of government may effect factors in different ways.

(b) A country must decide on what basic principles will apply to the treatment of foreigners in light of its overall national development objectives.

BASIC PRINCIPLES IN TAXATION FOREIGN INCOME

Equality Due to the difficulties of arriving at "equal" treatment for the income of foreigners and the income of local taxpayers, the adoption of specific sets of rules designed only to apply to incomes of foreigners seem warranted.

Many questions do also arise in the meaning of a foreign individual or firm. Such as, would it mean special treatment of foreign corporations" : Different treatment of the domestic shareholders in a joint venture with foreigners from those in purely domestic ventures?

What the Traffic will bear

A country might seek maximum tax reserves from foreign enterprises or individuals who work within their borders. The short term maximazition and long run, with possibility of reinvestment by existing firms or a continued flow of capital from abroad. Focus on income tax reserve may lead to actions on the companies or individuals that may not be in our interest that for lead to a worse balance of payments situation if the profits had been taxed more lightly and been made more easily available for negotiation This issue and many other related ones need the new SA to consider.

Optimizing Benefits from Foreign Factors

The appropriate tax strategy in dealing with foreigners its main question is: What does the country wish to gain from the presence of foreign factors of production?

This question is important for several reasons:

Political and social costs. There should be a clear cut notion of the economic reason for allowing foreigners to carry on economic activity.

Foreign factors of production can bring a variety of economic benefit e.g. management skills and organis tions (Japan in the UK), new processes of production (Japan - UK) etc.

Foreign factors of factors of formation will generally enter a country in response to a "package" of policy responses by the local government to the concerns of foreigners.

A country must be able to respond in details to the items in the package presented by foreign firms or individuals.

At this stage of presentation there could appear that silence on income taxes prevails. We all agree that progressive tax system is more well come. That by all means high incomes should experience higher taxes because it is justifiable and even morally so.

However, this paper wishes to attend to the anomalies accompanying income taxes.

INCOME TAX EVASION AND INCOME DISTRIBUTION

It is a fact that there is a considerable amount of income which is understated in individual income tax returns (Most of the blacks in SA to the authors knowledge submit no returns its all withold taxes - PAYE even without rebates....... how much deliberate impoverishment has been taking place to prop the hideous apartheid against a privileged society with some elements fully engaged in tax evasion).

This phenomenon has two serious consequences.

First it leads to a loss in tax revenue for the government which could otherwise be used for constructive purposes. Secondly it may reduce the progressivity of the tax income distribution.

Several writers propose for example models of tax evasion that allows for a progressive tax system where tax payer is assumed to maximise his after-tax expected income instead of his cardinal utility function. This amounts to the assumption that the tax payer is risk neutral.

Without engaging in the effects of evasion taxes penalty the new democratic SA will have to devise a tax system that has taken into account theory and practice on how to combat tax evasion - even if it means employing outsiders..... for too long this could have been happening in SA.

Mr. Chairman this paper has by and large attempted to raise all the aspects in the impact of taxation in favour of equity poverty alleviation, allocation redistribution and reality. Those who were expecting a "National Budget like Speech". I hope they are not dissappointed rather should appreciate that in the ANC we would be concerned with a myriad of economic problems - among others how to raise revenue to meet public spending.

WEALTH AND PROPERTY TAXES

As with any other particular tax wealth or property taxes are used in contribution with other kinds of taxes to achieve a variety of purposes. The principal arguments in favour of wealth or property taxation are related to the appropriateness of wealth as an index of:-

i. ability to pay taxes

ii. the benefits that accrue to owners of wealth or property from government expenditures and

iii. the superior incentive effects connected with wealth as against income as a tax base.

The major argument in favour of wealth or net worth taxes is that wealth is an appropriate indicator of ability to pay indeed it may be more appropriate than income. Wealth is usually found to be more unequally distributed than is income in countries for which data exist. Therefore, an income tax that is progressive with respect to ability to pay as measured by income levels may be much less so, or many even be regressive when tax liability is related to wealth instead of income. The wealth tax of course should be thought of as a supplement to, not a substitute for, income taxation wealth is another different index of ability to pay. Implicitly the assumption in wealth - that this cannot be shifted. This non-shifting assumption should be retained I repeat the wealth tax of course should be thought of as a supplement to, not as a substitute for income taxation wealth is another different index of ability to pay.

Wealth or property taxes create a need on the part of the tax payers to generate cash or pay the taxes that we levied on his wealth or property. This discourages the uneconomic use of assets (such as hoarding gold jewelry or luxury housing) and may result in more capital assets employed in economic activity that would benefit the society as a whole by employing more labour for example.

The most general tax on stocks of assets would be assessed on the net worth of individuals - ie total assets minus total liabilities. To illustrate the variations on wealth and property taxes Table 4 and 5 show the balance sheets for two families. If wealth or net working is to be the basis of taxation the entire balance sheet must be used.

BALANCE SHEET FOR URBAN
FAMILY 31 DECEMBER, 1970

ASSETS

Shares in xyz co.	30,000	Mortgage on house	15,000
Government bonds	14,000	Bank loan	10,000
Bank Accounts	1,000		
House site	20,000	Total Liabilities	25,000
House	20,000		
Other purpose property	10,000	Net worth	70,000
TOTAL ASSETS	95,000	TOTAL LIABILITIES AND NET WORTH	95,000

BALANCE SHEET FOR FARMING FAMILY
31 DECEMBER, 1970

shares xyz co	1,000	mortgage farm	50,000
Govt. bond	2,000	" house	17,000
Bank A/c.	2,000	Bank loan from opers	8,000
Farmland	50,000		
Fpom bldg.	20,000		
Form	5,000	TOTAL LIAB.	75,000
" Im	10,000		
House site	10,000	NET WORTH	45,000
House	15,000		
Other personal property	5,000		
TOTAL ASSETS	120,000	TOTAL LIAB. & NETWORTH	120,000

Hence from this observation the urban family should pay more wealth tax.