TAXATION IN SOUTH AFRICA

FIRST REPORT OF

THE COMMISSION OF ENQUIRY INTO FISCAL AND MONETARY POLICY IN SOUTH AFRICA

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FIRST REPORT OF THE COMMISSION OF INQUIRY INTO FISCAL AND MONETARY POLICY IN SOUTH AFRICA

TO THE STATE PRESIDENT OF THE REPUBLIC OF SOUTH AFRICA

MAY IT PLEASE YOU, MR. STATE PRESIDENT:

We, the undersigned, who have been appointed as Commissioners have the honour of presenting the following report:

INTRODUCTION

On 24th November, 1967, you appointed a Commission consisting of Dr. D. G. Franzsen as Chairman and Messrs. W. B. Coetzer, A. J. du Toit, Profs. R. D. Hobart Houghton, J. A. Lombard, Messrs. H. S. Mabin, L. J. van den Berg, W. J. C. Wessels and Dr. B. S. Wiehahn with the following terms of reference:

(1) to inquire into—

(*a*) the present system of taxation;

(*b*) the existing financial structure in South Africa; and

(*c*) the fiscal and monetary policies of the South African authorities;

(2) submit recommendations regarding modifications in the above connection which will tend to promote economic growth as well as financial stability in the Republic.

In view of the wide scope of its terms of reference your Commission found it desirable first to devote its attention to that part of its terms of reference that deals with the reform of the tax structure.

In an announcement in the *Government Gazette* of 15th December, 1967, interested persons, groups and organisations were invited to submit to the Commission memoranda in connection with all aspects falling within the scope of the terms of reference. The two questionnaires appearing as Appendices A and B to the present report were also sent to interested parties. 153 Memoranda were submitted to the Commission. The Commission heard oral evidence from representatives of nine national organisations, several prominent businessmen, and also from representatives of the Department of Inland Revenue, the Department of Customs and Excise, the Department of Industries, and the Board of Trade and Industries. The Commission would like to express its appreciation of the kind co-operation received from the persons and bodies concerned.

Information with regard to the tax systems of various countries was obtained from the relevant South African Embassies and also by means of an overseas visit by two members of the Commission. The present report consists of five chapters. In Chapter I appears a brief summary of the findings of the Commission in respect of the current tax system and its recommendations with regard to tax reform. Chapter II is devoted to the taxation of the income of individuals and recommendations in respect of the rates, the replacement of rebates by a system of abatements, the position of the working wife and the relationship between the Central Government and the Provinces with regard to the taxation of individuals. Chapter III discusses the desirability of the introduction of a selective sales tax in the Republic and recommendations are made in this respect. Chapter IV contains the Commission's recommendations in connection with a capital gains tax. A minority report on this subject by Mr. H. S. Mabin follows immediately afterwards. In Chapter V certain changes in the present system of company taxation are recommended.

While it was considering the share of the Provinces in the taxation of the incomes of individuals, the Commission was in contact with officials of the Cabinet Committee appointed to compile a White Paper on the future subsidising of the Provinces and related matters.

The Commission was also in close touch with the Department of Bantu Administration and Development in connection with the way in which the Commission's present recommendations, especially those in connection with a broader base of indirect taxation, might affect the overall tax liability of the Bantu and possibly also the revenue of the Bantu authorities. The Commission also took due note of the fact that the above Department contemplates considerable reforms in the existing taxation in respect of the Bantu in order to obtain greater simplicity in the form and administration of the present direct taxation payable by the Bantu.

The Commission intends shortly to report on a few additional taxation matters. The rest of its terms of reference that deal with fiscal and monetary policy will be considered after that.

The Commission would like to express its thanks to the following bodies and persons without whose assistance it would have been impossible to report at this early stage: The Department of Inland Revenue; the Bureau of Statistics and the South African Reserve Bank for the furnishing and/or the processing of data; Profs. D. C. Krogh, M. G. Loubser, J. L. Sadie, and Mr. A. F. van Niekerk, who were seconded on a full-time basis and Prof. D. W. Goedhuys on a part-time basis by their respective universities; Messrs. W. J. H. van der Walt (Department of Inland Revenue), J. L. Hattingh (Department of Customs and Excise) and H. O. Uys (Department of Bantu Administration and Development) who were seconded to the Commission by the Departments concerned; Dr. B. P. Groenewald of the South African Reserve Bank; Profs. C. W. I. Pistorius, H. J. J. Reynders, Messrs. J. Poolman and P. J. van der Merwe, and Dr. T. van Waasdijk who undertook special investigations for the Commission; Mrs. S. Dippenaar and Mrs. M. Coetzee, and Miss D. Barclay, who were responsible for the typing. The Commission also wishes to thank Messrs. A. Nieuwoudt of the Department of Inland Revenue, and J. G. Meiring of the South African Reserve Bank, who acted respectively as secretary and assistant secretary, for their dedicated services.

It is with sorrow that the Commission has to place on record the death of Mr. J. W. Loubser, a member of the Commission's research personnel, who, in the course of his duties, was killed in the Windhoek air disaster.

MEMBERS OF THE COMMISSION:

D. G. FRANZSEN (*Chairman*).
W. B. COETZER.
A. J. DU TOIT.
R. D. HOBART HOUGHTON.
J. A. LOMBARD.
H. S. MABIN.
L. J. VAN DEN BERG.
W. J. C. WESSELS.
B. S. WIEHAHN.

Signed at Pretoria, November 1968.

LIST OF RECOMMENDATIONS

CHAPTER I

The Commission's Assessment of the Present Tax Structure

1. The proposed relief in respect of the present income tax on individuals will result in a loss of tax revenue of approximately R140 million. This amount comprises the following:

In the existing marginal tax schedule a so-called "bulge" occurs at the income levels between R5,000 and R14,000. Its removal would entail a loss of approximately R60 million. Although this concession would particularly benefit those with an income falling within this "bulge", it would also provide some measure of relief to taxpayers with an income above R14,000.

The Commission found that even after the elimination of the "bulge", the marginal rate would still accelerate rapidly for the income groups between R5,000 and R18,000. The latter is the level at which the present marginal rate reaches its maximum. A lowering of the maximum marginal rate from 66 to 60 per cent and the shifting outward of the income level at which it is reached from R18,000 to R28,000, plus a more moderate rate of progression up to the latter point would sacrifice R40 million in revenue.

The recommendation contained in Chapter III in respect of a selective sales tax on luxury and certain durable consumption goods would impose an additional tax burden, although a limited one, on the lower income groups. For this reason the Commission recommends that relief in income tax be granted to persons with incomes below R5,000.

These concessions comprise amongst other things: (1) A raising of the exemption limit before income tax liability is incurred; (2) a reduction in the marginal rates for income groups below the R5,000 level; and (3) an increase in the concessions in respect of children, dependants, etc. It is also recommended that the last-mentioned concessions start tapering off beyond an income level of R6,000 and finally disappear. The cost of the above concessions will amount to R40 million (paragraphs 30 to 34).

2. The above loss of R140 million must be recouped from two sources, viz. (1) R90 million from additional indirect taxation and (2) R50 million from company taxation (paragraph 36).

CHAPTER II

Taxation on the Income of Individuals

1. The new maximum rate should be set at 60 per cent. The income limit at which the maximum rate is reached should at the same time be raised from R18,000 to R28,000 for married and R24,000 for unmarried persons (par. 74).

2. (*a*) A new comprehensive tax schedule, in which the State and Provincial taxation is merged, should be introduced (par. 83);

(*b*) the progressive bracket system of taxation and differentiated rates as regards married and unmarried persons should be retained;

(*c*) the existing normal and provincial rates should be replaced by the rates contained in the tables as set out in par. 83.

3. The system of rebates should be replaced by one of abatements and after a taxable income of R6,000 is reached, the abatements should be reduced by R1 for every R10 of the taxable income above R6,000 (par. 92).

4. A primary abatement should not be granted because the tax rates recommended in par. 83 already make provision for it (par. 95).

5. An abatement of R500 per child should be granted regardless of number (par. 97).

6. The abatement for a dependant should be the same for a married as for an unmarried person and specifically as follows: completely dependent: R200; not completely dependent: R80: provided that the contribution of the taxpayer towards the support of such a dependant amounts to at least R200 and R80 respectively (par. 99).

7. The existing rebate in respect of insurance premiums should be transformed into an abatement equivalent to the actual premiums up to a maximum of R400 (par. 100).

8. In respect of medical expenses, an abatement of R150 per year (regardless of the actual expenditure) should be granted for a married person and R75 for an unmarried person, or R150 when an unmarried person is the only support of a dependant. An additional abatement of R100 for the year in which a child is born should also be granted (par. 104).

9. In the case of married persons, the statutory exemption limit should be set at R750; in the case of a married person above the age of 60, the exemption limit should be set at R1,200; and in the case of unmarried persons the existing exemption limit should be set at R500 for those under 60 years and at R750 for those above 60 years (par. 108).

10. (1) Since the system of aggregation of the incomes of married couples fulfils the test of the ability to pay and the reform of the tax rates proposed by the Commission would remove the sting from the existing progression, the present system of joint assessment should be retained;

(2) the reduction of the taxability of married couples as a result of additional financial obligations when both are working, should be recognised and in determining the family's tax liability, the wife's total annual taxable income should be exempted up to at most R500 per year;

(3) the exemption in (2) above should be applicable only to payments made to married women for services rendered and the existing restrictions as contained in section 5 (6) of the Income Tax Act should be retained;

(4) the exemption in (2) above should be applicable to married couples with a joint taxable income of not more than R8,000 and should diminish thereafter by R1 for every completed R10 by which the joint taxable income of the married couple (before deduction of the exempted amount) exceeds R8,000 (par. 130).

11. (*a*) The rights of Provincial Authorities to levy personal taxation and income taxation on individuals should be withdrawn, and

(*b*) Provincial Authorities should share in the revenue from taxation collected by the Central Government on the income of the individuals as is already the case with company taxation (par. 147).

CHAPTER III

SALES TAXATION

1. The private domestic consumption, with the exception of food, clothing, footwear, cost of housing, certain health expenditure and certain excisable goods, should be the basis of the sales tax (par. 178).

2. The value of the goods at the point of manufacture should be derived from the cost price f.o.r. negotiated in the open market between a manufacturer and a wholesaler who are completely independent of each other, i.e. at arm's length (with the exclusion of quantity and trade discounts, but including any excise duty which might be payable) (par. 211).

3. An equitable contra duty on taxed goods which are imported should be calculated on the basis of customs value of the goods plus a reasonable cost mark-up plus customs duty (par. 214).

4. In the choice of commodities the expenditure pattern of Whites, as well as non-Whites, should be taken into consideration (par. 217).

CHAPTER IV

TAXATION OF CAPITAL GAINS

1. The existing legal position with regard to normal taxation on "capital gains" should be maintained (par. 235).

2. Subject to the exemptions mentioned hereinafter, the tax should be applicable to—

(1) all persons other than companies, who are ordinarily resident in the Republic or were ordinarily resident in the Republic during any part of the tax year in which the capital gain accrued to them;

(2) all companies which are managed and controlled in the Republic; and

(3) all other persons, including companies, who realise capital gains on assets situated in the Republic (par. 285).

3. The base of the tax should be limited to capital gains from the realisation of—

(1) marketable securities and rights or options which, in the case of their being exercised, imply the acquisition of marketable securities, rights, or options, or might lead thereto; and

(2) immovable property and rights or options which, in the case of their being exercised, imply the acquisition of immovable property, rights, or options, or might lead thereto (par. 293).

4. There must be excluded from the tax on capital gains—

(1) profits and losses which qualify for normal taxation;

(2) the realisation of property on which the taxpayer's only or main residence is situated and which is used by the taxpayer exclusively or mainly for residential purposes of himself or his wife or his dependent children;

(3) (*a*) should the aggregate gross proceeds from the realisation of taxable assets of a taxpayer, excluding a company, during a tax year not exceed the amount of R2,000, all capital gains and capital losses from such realisations, unless the taxpayer can prove to the satisfaction of the Secretary for Inland Revenue that his capital losses, after the setting off of capital gains exceed during the tax year the amount of R1,000;

(*b*) should the aggregate gross proceeds from the realisation of taxable assets of a taxpayer, excluding a company during a tax year exceed the amount of R2,000, such a portion of the taxable capital gain for the tax year as does not exceed R1,000;

(4) the realisation of securities and debentures issued by the State, Local Authorities and other non-profitseeking organisations which are specifically exempted from normal taxation;

(5) the realisation of assets situated outside the Republic; and

(6) the transfer of a business concern by a foreign parent company to a South African subsidiary company, should the provision of section 28*bis* of the Income Tax Act (58 of 1962) be applicable to the company (par. 296).

5. A tax at a comparatively modest rate of 20 per cent should be levied upon taxable capital gains and the levelling off effect should be obtained by decreasing the capital gains to the percentages which are indicated below. If the asset is realised—

more than 3 years but not more than 6 years after its acquisition: 66⅔ per cent of the capital gain;

more than 6 years but not more than 9 years after its acquisition: 33⅓ per cent of the capital gain;

more than 9 years after its acquisition: nil (par. 307).

6. (i) Capital losses should be determined in the same way as capital gains and should be diminished in a similar way to the same percentages as above in order to obtain an assessed capital loss for a particular tax year;

(ii) assessed capital losses may be set off against capital gains, as diminished above to obtain the capital gain for a particular tax year; and

(iii) if the assessed capital losses together with the balance of assessed capital losses of previous years exceed the capital gains as diminished above, such new balance may be carried forward to a subsequent tax year (par. 308).

7. (1) The tax should be applicable only to capital gains from the realisation of assets (recommended in the tax base) acquired during a period with effect from the date on which the announcement in connection with the intended introduction of a tax on capital gains is made in Parliament; and

(2) where certain assets are acquired before the above-mentioned date and other assets of identical class acquired on or after the date, the last-in-first-out method should be followed in the case of the realisation of a portion of such assets (par. 309).

8. Persons, in the sense and meaning as intended in the normal income tax legislation, who specifically enjoy complete exemption from normal taxation should also be exempted from the tax on capital gains (par. 311).

CHAPTER V

Taxation of Intercompany Dividends

The existing provision of the Income Tax Act (58 of 1962) in connection with the taxation of undistributed profits must be amended in such a way that public companies will be subject to the taxation of undistributed profits at a rate of 25 per cent on the excess of distributable income over distributions, provided that—

(*a*) distributable income for this purpose will be only that part of a public company's net profit for a tax year which consists of net branch profits from abroad and net dividends from all sources, after such portions of the net profit for a tax year have been reduced by not more than 25 per cent;

(*b*) assessed losses and/or accumulated deficits are taken into consideration in such a way that there will be no distributable income for this purpose until the assessed losses and/or accumulated deficits of the company have been eliminated by net profits; and

(*c*) for this purpose net branch profits from abroad and net dividends do not include taxation which might have been levied abroad (par. 335).

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CHAPTER I

THE COMMISSION'S ASSESSMENT OF THE PRESENT TAX STRUCTURE

Previous Reports on Taxation

1. Apart from the 1945 *Report*[1] of the former Social and Economic Planning Council, there has not been an official inquiry into the South African tax system as a whole. Several Commissions and Committees have indeed investigated specific fiscal matters, such as the financial relations between the Central Government, Provincial Administrations and Local Authorities, taxation of gold mines, stamp duties, etc. The income tax system was investigated during the early 'fifties first by the *Committee of Inquiry into the Income Tax Act* (1951 and 1952)[2] and afterwards by a parliamentary *Income Tax Commission,* (1953).[3] The most important official reports in connection with the structure of customs duties in South Africa are those of the *Customs Tariff Commission of* 1934-35[4] and the *Commission of Inquiry into Policy relating to the Protection of Industries,* 1958.[5] The terms of reference of the present Commission, however, are concerned specifically with the tax system as a whole.

2. This Commission's investigation into and assessment of the current tax structure are based upon the norms specifically mentioned in its terms of reference, viz. the promotion of economic growth and the stability of the economy. In this connection, however, the Commission took it for granted that any reform of the tax structure would also have to take due account of the limits set by the norms of equity, fiscal productivity and administrative efficiency, and simplicity.

3. A few broad characteristics of the South African tax structure that are important for the consideration of possible tax reforms will now be discussed.

The Total Tax Ratio

4. Two kinds of taxes are imposed by the Republic's various tax authorities, viz. (1) *direct* taxes which are levied directly on the income and/or wealth of individuals and companies, and (2) *indirect* taxes which are levied on certain commodities and transactions. The Central Government and the Provincial Administrations levy both direct and indirect taxes whereas Local Authorities impose virtually only indirect taxes.

5. The most important source of direct taxation is the normal tax levied by the Central Government in terms of the provisions of the Income Tax Act (at present Act 58 of 1962), which has already been in operation since 1914. Provincial direct taxation consists of two levies, viz. (1) a personal tax and (2) a provincial income tax. The former has developed from a poll tax to a mildly progressive tax; the latter is assessed by way of a percentage of normal tax and was previously assessed

[1] U.G. 48/1945.
[2] U.G. 75/1951. Also known as the Steyn Committee.
[3] U.G. 11/1954. Also known as the Diederichs Commission.
[4] U.G. 5/1936. Also known as the Holloway Commission.
[5] U.G. 36/1958. Also known as the Viljoen Commission.

also by way of supertax. These taxes are levied in terms of the various Ordinances on the Taxation of Persons and the Income of Persons.

6. The main source of indirect taxation is customs and excise duties. These taxes were already in force before the establishment of the Union of South Africa and are currently levied in terms of the provisions of the Customs and Excise Act (Act 91 of 1964). In addition, the Central Government also obtains revenue from transfer duties (Act 40 of 1949), the Marketable Securities' Tax (Act 32 of 1948), and stamp duties (Act 77 of 1968), while the main source of indirect taxation for the Provincial Authorities is the licensing of motor vehicles and taxes on entertainment, auction sales, and racing and betting. The main source of revenue of Local Authorities is property taxes.

7. The part played by taxation in the economic life of a particular country can be gauged from the ratio between the total amount of all taxes collected[6] and the national income. In the case of the Republic this ratio, also known as the *total tax ratio*, came to approximately 18 per cent in 1967.

8. The question arises whether this tax ratio can be regarded as reasonable against the background of South Africa's particular economic conditions. From a comparative study of tax ratios and incomes per head in developed and less developed countries it would appear that this ratio cannot be regarded as either too high or too low. Although South Africa's tax ratio has been considerably higher during the post-war period than it was before the war and is slowly increasing all the time, it still compares favourably with the country's *taxable capacity* which, in turn, is determined by the growth of the country's national income and population. This phenomenon is mainly due to the country's rapid economic development as well as the fact that government expenditure, especially on defence and social services, has not increased unduly.

9. The Commission does not at this stage wish to commit itself on the representations made to it by certain national bodies that there has recently been signs of "overtaxation" or "ultra-conservative budget planning". For the purpose of this report priority had to be given to the question of how the tax structure could be reformed. The fact that the Commission wished to devote its attention first to this part of its terms of reference does not mean that it wishes by this to express its approval or disapproval of the present nature and scope of the activities of the government sector. In the formulation of its proposals for tax reform it adopted the point of view that the present level of the combined tax revenue of the Central and Provincial Authorities had at least to be maintained.

The Role of Direct Taxes

10. Although South Africa's total tax ratio is considerably lower than that of highly developed economies, its pattern of direct and indirect taxation bears a strong resemblance to that of the group of countries concerned. The share of direct taxes, including social security contribu-

[6] The share of the various tax authorities in the total tax revenue of R1,590 million in 1967 was: Central Government: R1,241 million; the Provincial Authorities: R227 million; and the Local Authorities: R122 million. The share of the Local Authorities in the total has remained virtually constant during the post-war period.

tions, in the total tax revenue[7] of the Republic amounted to an average of 58 per cent for the years 1963-1965 compared with 50 to 66 per cent in most highly developed countries.

11. If social security contributions are excluded from the total of direct taxation, the share of direct taxation in the adjusted grand total of all taxes declines to between 30 and 50 per cent in the case of highly developed countries whereas the corresponding South African percentage change is negligible. As regards the so-called less developed countries the share of direct taxation in their total tax revenue is generally comparatively low. Therefore, in comparison with both the highly developed and the less developed countries, the present South African direct tax ratio must be regarded as exceptionally high.

12. In the long run the share of direct taxes also shows an increasing tendency. Whereas it was approximately 45 per cent just before World War II, it has gradually increased to an average of nearly 60 per cent during the past few years. The above pattern can be ascribed to the large but relatively static contribution received from companies, the moderate but fast-growing contribution received from individual income tax, the declining share of customs duties and the limited scope of the current excise duties.

The Role of Companies

13. The share of company taxation in South Africa's total direct taxation came to no less than 53 per cent between 1960 and 1967 compared with averages of between 7 and 35 per cent in most highly developed economies for the years 1963-1965.[8] The reasons for this are mainly the exceptional importance of companies in the mining sector, the relatively high percentage of profits in comparison with labour earnings in the national income of the Republic and the fact that the existing tax rates favour the company as a form of business organisation.

14. It can, however, be expected that as South Africa undergoes further industrialisation, the share of company taxation in the total of direct taxation will show a declining tendency. The share of labour earnings in the national income will in due course tend to increase as a tax base vis-à-vis profits which constitute the basis of company taxation. In the absence of a gold price increase and/or the development of new goldfields, it can be expected that the role of gold mining taxation will gradually diminish. The relative contribution of the gold mining industry to total direct taxes has already declined from just over 40 per cent before

[7] The scope of the concept "total tax revenue" can be broadened or narrowed by the inclusion or exclusion of social security contributions. The latter represent the compulsory contributions of employees and private employers to special funds from which benefit payments are made to the beneficiaries concerned in the case of illness, unemployment, etc. These kinds of compulsory levies are also known as para-fiscal payments and can be distinguished from the ordinary taxes in the sense that they are paid into specific funds and not paid direct to the Treasury. In the Republic these para-fiscal levies comprise only the compulsory contributions to the Unemployment Insurance Fund, the Workmen's Compensation Accident Fund, and the General Council for Pneumoconiosis Compensation. In most Western countries social security plays a much greater role than in the Republic, and consequently the total of all their para-fiscal levies includes a wider range of compulsory contributions.

[8] Even if social security contributions are excluded from the total of direct taxation, the difference between South Africa and the developed countries remains large.

World War II to 15 per cent in 1960 and 10 per cent in 1967. As a percentage of total company taxation, it decreased from 35 per cent in 1960 to 25 per cent in 1967.

15. Since the ratio of company profits to labour earnings is larger in the case of mining companies than in the case of other companies, the smaller role of the gold mining industry in the Republic's future industrial growth would also imply that the share of company taxation in total direct taxation measured at constant tax rates will decline in future. This tendency has already manifested itself, as is indicated by the fact that the increase in the revenue from direct taxation of individuals between 1963 and 1967 was larger than that of companies. The amounts concerned are R179 million and R140 million, respectively.

The Contribution of Income Tax on Individuals

16. Comparatively speaking there are only a small number of individuals who pay income tax in the Republic, viz. 8 per cent of the total population as against between 30 and 40 per cent in most of the highly developed countries. In addition, the larger portion of even this 8 per cent is subject to relatively low income tax rates. In the Republic a married person who has two children and an income of R5,000 pays, on average, 7 to 8 per cent of his income in the form of direct taxation as against 10 to 12 per cent in the U.S.A. and Canada, and between 15 and 25 per cent in most other highly developed economies. Since the average income in these countries is substantially higher than in the Republic, the percentage of income-tax payers who earn less than R5,000 is correspondingly lower. In fact, approximately 94 per cent of the comparatively small number of income-tax payers in South Africa are responsible for only one-third of the relevant tax total or, conversely, 6 per cent are responsible for two-thirds. In highly developed economies in which a much larger section of the population pays income tax at considerably higher rates, the proportion is often almost the reverse. For example, the highest 5 per cent of income-tax payers in the U.S.A. and Sweden are responsible for only 36 per cent and 32 per cent, respectively, of the total revenue and for approximately 45 per cent in the United Kingdom.

17. The exceptionally large amount contributed to the total by the very small group of taxpayers in the higher income brackets in South Africa need not necessarily cause concern if it were merely a reflection of an unequal distribution of income. This, however, is in fact not so. In South Africa the large contribution of the top six per cent of taxpayers is mainly the result of the particularly sharp increase in the marginal rate of income tax on incomes of more than R5,000. At an income of R15,000 South Africa becomes one of the countries with the highest average tax rate for the relevant group of taxpayers. Whereas South Africa is one of the countries that have the lowest tax rates on incomes of R5,000 and less in the developed world, it is at the same time one of the countries that have the highest tax rates on incomes of R15,000 and higher.

18. On the basis of evidence and observation, the Commission is of the opinion that during a period of overspending a particularly large part of any increase in income taxation is paid out of savings rather than consumption. The more progressive the rates, the more pronounced this effect becomes. This means that a tax increase with a view to the

financing of larger government expenditures might actually have a strong inflationary effect both on the side of costs in the form of new wage demands, and on the expenditure side, because a larger volume of government expenditure is added to a volume of consumption expenditure without the latter being essentially reduced by the tax. A tax increase would lead, namely, to a shifting of a portion of the savings of the private sector to the public sector without necessarily decreasing the level of spending in the private sector correspondingly. Other disadvantages of high progressive rates are the discouraging effect they have on work effort on the one hand and the encouraging of tax avoidance on the other.

The Role of Indirect Taxes

19. The contribution of indirect taxes to South Africa's total tax bill was, on average, 42 per cent during the years 1963-67, whereas the corresponding figure in most highly developed countries lies between 35 and 50 per cent. Much higher percentages apply in less developed countries where the pattern of income and expenditure can be compared more readily with that of a very large section of the population in South Africa. The great dependence of the latter on indirect taxes can be ascribed mainly to its administrative advantages as well as the fact that domestic and, more especially, foreign trade, as compared with income per head, provides the authorities concerned with a broader tax base.

20. The relative contribution of indirect taxes has moreover declined considerably in South Africa, viz. from 56 per cent in 1938 to 45 per cent during the second half of the 'fifties, and 41 per cent in 1967. Accordingly, the capacity of especially customs and excise duties to ensure a proportionate increase in government revenue concomitant with the increase in the national income is indeed particularly low.

21. The share of customs and excise duties in the aggregate of indirect taxes has been approximately 57 per cent, on average, since 1963. The remaining portion is collected by way of a variety of levies by the Central Government, the Provincial Administrations and the Local Authorities. The share of the Provinces in the country's total revenue from indirect taxation currently amounts to less than 8 per cent, whereas it was as high as 17 per cent shortly before World War II.

22. The declining contribution of customs duties has been, relatively speaking, the most important single cause of the decreasing share of indirect taxes in the country's total tax revenue. Whereas this tax produced three and a half times as much revenue as excise duties just before the war, its present contribution amounts to only one half of that raised in the form of the latter tax. The obvious reason for this is the increasing importance of the role of customs duties as an instrument in the protection of industry. During the period 1946-67 the combined share of manufacturing and construction in the Republic's gross domestic product increased from 18 to 26 per cent, whereas the tax revenue from customs duties in relation to the country's imports declined from 12 to 6 per cent. This decline reflects more especially the change in the country's import pattern, viz. from final consumption goods to goods which are used in local manufacturing and are consequently taxed at lower rates. At present the imports of mineral fuels and related products, textile materials, vehicles, iron and steel, and machinery are together responsible for 60 per cent of the total customs revenue. Not only is the scope of the tax base in

respect of imports becoming more limited, but the level of the customs duties too is gradually being constrained by cost considerations because complementary rather than competing goods are being imported. In any case there are binding international trade agreements that make it increasingly difficult to levy still higher customs duties. Accordingly, customs duties cannot be regarded as a viable tax source for the future whether its base is expanded or such tariffs are further increased.

23. In the light of the above it is therefore understandable why the other traditional form of indirect taxation, viz. excise duties, came to be increasingly employed during the post-war period as a source of revenue, by means of a slight extension of the number of excisable products and especially by the increasing of the duties on excisable products.

24. Shortly after the war the scope of excise duties was confined to the traditional excisable products, viz. liquor, tobacco, matches, rubber tyres and motor fuel. At present there are also included new motor-cars, other oils and kinds of fuel, and gramophone records. These additional products are currently responsible for more than 10 per cent of excise revenue. In the meantime the excise duties on some of the traditional products have been increased so much that there is hardly any further scope for increasing the tax revenue in this way. The approximate *ad valorem* equivalents of the present tariffs on a selected number of products are as follows: wine-spirits: already more than 200 per cent; beer: between 75 and 100 per cent; cigarettes: 150 per cent; and pipe tobacco: 63 per cent. Petroleum and related products also carry high tariffs.

25. As a result of the process of industrialisation, already mentioned in par. 22, more final or finished goods are being produced in the Republic while, at the same time, fewer finished goods are imported. To the extent that this tendency prevails, the Commission is of the opinion that indirect taxation has to rest decreasingly on imports and will have to shift progressively to domestic consumption. A structural adjustment of this nature, however, has important implications with regard to the burden of taxation on individual groups in the community. This issue is discussed in detail in Chapter III.

A Summary of the Commission's Point of View

26. On the basis of its study of the present tax structure the Commission came to the conclusion that the maintenance of the current system would increasingly impede the economic development of South Africa. As the analysis above has indicated, the emphasis of the present tax system is shifting rapidly from indirect to direct taxes and from direct taxes on companies to direct taxation on individuals. The Commission expects that if this development were to continue, a growing number of problems would arise, and it is for this reason that it advocates the structural changes set out in the present report. In principle the possibilities of reform are to be sought in three directions, viz. (1) a reduction in the rate of progression of direct taxes; (2) a shift of emphasis in the direction of indirect taxation through a broadening of the base of this form of taxation; and (3) a broadening of the fiscal concept of income to include capital gains, *inter alia*.

27. In the following three chapters details will be given of the ways in which the tax structure can be reformed along the lines indicated above. Before this detailed discussion is entered upon, however, a

quantitative framework of the changes recommended by the Commission can be presented in general terms.

QUANTIFICATION OF THE PROPOSED CHANGES ON THE TAX STRUCTURE

28. The Commission had to make two sets of calculations in order to assess the quantitative effect of its proposals on the accounts of the Exchequer. Firstly, an estimate had to be made of what the loss of revenue to the fiscal authority would be if the proposed tax relief were to be introduced and, secondly of the amount that alternative sources would have to yield to make up for this loss. As has been mentioned in par. 9, the Commission's premise was that the maintenance of the current level of tax revenue had to be regarded as given for the purposes of the present report.

29. The estimated amounts which follow concern 1967-68 and are based on the latest available information, viz. that for the tax year 1965-66.

THE COST OF THE RECOMMENDED TAX RELIEF

30. The commission's proposed relief in respect of the present income tax on individuals will result in a total loss of tax revenue of approximately R140 million. This amount comprises the following:

Eliminating the "Bulge"

31. In the existing marginal tax schedule a so-called "bulge" occurs at the income levels between R5,000 and R14,000. Its removal would entail a loss of approximately R60 million. Although this concession would particularly benefit those with an income falling within this "bulge", it would also provide some measure of relief for taxpayers with an income above R14,000.

Lowering the Present Maximum Rate and Extending the Level at which it is reached

32. The Commission found that even after the elimination of the "bulge", the marginal rate would still accelerate rapidly for the income groups between R5,000 and R18,000. The latter is the level at which the present marginal rate reaches its maximum. A lowering of the maximum marginal rate from 66 to 60 per cent and the shifting outward of the income level at which it is reached from R18,000 to R28,000, plus a more moderate rate of progression up to the latter point would sacrifice R40 million in revenue.

Reducing the Total Tax Burden on Income Groups below R5,000

33. The recommendation in Chapter III in respect of a selective sales tax on luxury and certain durable consumption goods would to a limited extent impose an additional tax burden on the lower income groups. For this reason the Commission recommends that relief in income tax be granted to persons with incomes below R5,000.

34. These concessions comprise amongst other things: (1) a raising of the exemption limit before income tax liability is incurred; (2) a reduction in the marginal rates for income groups below the R5,000 level;

and (3) an increase in the concessions in respect of children, dependants, etc. It is also recommended that the last-mentioned concessions start tapering off beyond an income level of R6,000 and finally disappear. The cost of the above concessions will amount to R40 million.

35. The Commission is fully aware that the scope of the above tax concessions is such that when they are introduced by the Government a substantial *structural* change in the tax system will be involved.

THE EXPECTED REVENUE FROM ALTERNATIVE SOURCES

36. The Commission wishes to recommend that the above loss of R140 million must be recouped from two sources, viz. (1) R90 million from additional indirect taxation and (2) R50 million from company taxation. It also recommends the introduction of a capital gains tax but for reasons mentioned in Chapter IV, it is difficult at this stage to establish what the yield of such a tax would be within the first year after its introduction. Consequently, for present purposes, the possible revenue from this new source is disregarded.

The Revenue from Additional Indirect Taxation

37. The Commission considered the possibilities of recouping the entire loss of R140 million by means of a selective sales tax. It decided, however, that such a major shift from direct to indirect taxation in a particular year would be both too drastic and inequitable in its effect, because too wide a range of goods would have had to be included in the base of such a sales tax. The recommendation is therefore that in the year of transition only a portion of the loss of R140 million, viz. R90 million, be obtained from this source.

38. Should direct taxation be reduced to the extent of R140 million and the amount fully recouped from indirect taxation in the same year, it would mean a return to the distribution of the total tax bill between direct and indirect taxation which obtained in 1962. In that year the share of each in the relevant total was approximately 50 per cent. Since 1962 this fifty-fifty pattern of distribution has changed drastically with the result that the contribution of direct taxation is at present 58.5 per cent and that of indirect taxation 41.5 per cent. This represents an annual increase in the share of direct taxation of 1.6 percentage points. The corresponding figures for the periods 1938-1962 and 1946-1962 were only 0.3 and 0.13 respectively.

39. The high rate of growth in the share of direct taxation during 1962-67 necessarily affected the saving capacity and work effort of income-tax payers. Increased indirect taxes, in contrast, would have had a restraining influence on consumption expenditure.

40. In 1951-52 the Minister of Finance stressed the same point when he referred to the tax structure in his Budget Speech and said: "... various countries have introduced some sort of system of purchase or sales taxes and it is my personal conviction that it would be better for a young country requiring a great deal of capital for development to impose direct taxes on consumption rather than to increase income tax to a level where it would discourage saving and impede the building up of private capital."[9]

[9] House of Assembly Debates 1951, column 3414.

In his 1965-66 Budget Speech the Minister further said in this connection: "In South Africa we do not have at our disposal the full range of fiscal instruments available in some other countries to regulate the course of the economy. We do not have for example a general sales tax quite common to-day in many countries and which constitutes a useful weapon in certain circumstances for containing excessive consumption. We might have to consider supplementing our instruments at some future stage."[10]

41. The Commission admits that during a period of rapid economic growth an almost automatic or built-in increase in the share of a progressive income tax in the total tax bill would manifest itself. But it is of the opinion that the relevant growth rate during the past five years had clearly been excessive. In view of this and on the basis of its study of the part played by direct and indirect taxation in the past, the Commission came to the conclusion that an average increase of 0.5 percentage points cannot under present circumstances be regarded as unreasonable. If this average annual increase were to have applied from 1962 to 1967, the share of indirect taxation in the latter year would have amounted to 53 per cent. If the latter percentage could be accepted as reasonable, an additional amount of R90 million of indirect taxation and, conversely, the same amount less of direct taxation would have had to be levied in 1967.

42. The Commission thus wishes to recommend *that R90 million be collected by way of additional indirect taxation in the form of a selective sales tax.* Its detailed recommendations in Chapter III are accordingly based on this amount. This leaves an amount of R50 million that will have to be found in the company sector.

The Revenue from Additional Company Taxation

43. The Commission regards company taxation as the appropriate source for recouping the remaining R50 million. The Commission is of the opinion that such a step is justified by reason of the fact that (1) the South African taxation of non-mining companies is at present substantially lower than that of most developed countries; (2) there is a large difference between the current company rate and the marginal income tax rate applicable to the higher income groups, which in turn promotes tax avoidance; and (3) the burden of this additional tax would fall largely on the higher income groups. It would thus tend to have a similar effect as the capital gains tax in that it would also leave the small man virtually unaffected.

Conclusion

44. The Commission does not wish to convey the impression that the implementation of its recommendations would create an ideal tax system. The new pattern would indeed be a considerable improvement on the existing one as regards the promotion of economic growth, and at the same time it would not impair fiscal productivity. The Commission feels, however, that even after the proposed changes have been implemented a continuous study of the South African pattern of taxation would remain desirable to keep abreast of changing circumstances. The Commission would like to suggest that the possibility of the establishment of a study group within the Treasury be considered for this purpose.

[10] House of Assembly Debates 1965, column 3314.

45. Although the Commission, in considering its proposals, constantly gave its attention to the question of how the new system would influence the distribution of the tax burden among the various strata of the population, it wishes to point out that the lower income groups receive relatively more direct benefits from Government expenditure than the rest of the population. In this connection it can be mentioned that for the year 1964/65 the total direct and indirect tax contribution of the Bantu is estimated at R38 million as against a much larger amount of direct Government expenditure for their benefit. The Commission does not wish to imply, however, that it can necessarily be expected of each population group to be completely self-sufficient in the fiscal sphere.

46. In its 1945 Report the Social and Economic Planning Council also posed the question of how the expansion of social services after the war could best be financed. The conclusion it came to was that: "the present taxes, especially after the abolition of the special wartime taxes, will furnish insufficient revenue for the country's requirements . . . the bulk of the increased expenditure envisaged by the Council will be devoted to social services, which will benefit principally the lower paid groups; it therefore seems reasonable that these groups should bear part of the cost."[11]

47. At the time, the average income per caput was 45 per cent lower than at present, while indirect taxation was mainly relied on as source of revenue. Accordingly, the Council recommended that the exemption limit of the income tax be lowered and the relevant rates be gradually increased.

48. Since then South Africa has experienced rapid economic growth together with a gradual decline in the value of money, which has almost automatically given rise to higher effective or average income tax rates. In the meantime, because insufficient reductions were effected in the marginal rates, the economic disadvantages of the latter as well as social resistance to it increased. At the same time, the share of indirect taxation declined to the relatively subordinate position previously occupied by direct taxation, whereas social services for the benefit of a growing section of the population continued to expand. It is against the background of these structural changes during the past quarter of a century that the Commission recommends a re-demarcation of the spheres of direct and indirect taxes.

[11] *Op. cit.*, par. 136, pp. 49-50.

CHAPTER II

TAXATION ON THE INCOME OF INDIVIDUALS

The Tax Base

49. The base of an income tax on persons (other than companies) is the "income" accruing to an individual during a given period. This "income" is supposed to give a reasonable indication of the change in an individual's economic power and thus of his ability to pay, provided that the fiscal definition of the income concept is comprehensive enough to include at least all of the most important forms of economic power.[1] Because the lower income groups employ most of their income for consumption purposes, the income tax in their case will be tantamount to a tax on consumption. For the highest income groups, who save a large part of their incomes, the incidence of this tax will be increasingly on the growth of the wealth of the persons concerned. In most developed countries the number of persons in the middle income group is fairly large so that a large part of the income tax total can be collected from this group at rates which do not affect either consumption or saving unduly. Figures have already been quoted in par. 16 to indicate that the South African distribution of income and rate of progressive taxation are such that a very small percentage of taxpayers have to bear the brunt of the tax burden.

50. The Republic is currently at a stage of development where the Government has to take care that the taxation of individuals does not harm economic growth by imposing too great a strain on certain groups in their effort to save and to increase the fruits of their labour. The current pattern of low average or effective tax rates in respect of the lower income groups followed by a particularly sharp rise in the marginal rates relating to the higher income groups is a legacy of the two-tier system of tax assessment that formerly applied. This demerit of the present system will now be discussed further.

Specific Features of the Current Income Tax

The Earlier Normal and Super Tax

51. Until and including the 1959 tax year, a normal tax was levied on total taxable income (excluding dividends) and a super tax on the so-called "super taxable" income, i.e. the sum of normal taxable income and dividends. This super taxable income had to exceed a certain level before liability arose. However, as soon as this level was exceeded, the *full* income became taxable at a rate of progression starting from the first £1.

52. Before 1948 both normal and super tax rates increased gradually with each additional £1 in taxable or super taxable income until a maximum of 3s. and 7s. 6d. respectively was reached with regard to normal and super tax. These maximum rates were, however, applied to the full

[1] The nature and the scope of the fiscal income concept are explained in Chapter IV.

normal or super taxable income. From 1948 to 1953 the tax rates also increased gradually up to an income of £16,000, beyond which any additional income was taxed at given fixed rates. With effect from the 1954 tax year, the income level at which the progressive rate terminated and a fixed rate on the surplus started was reduced to £9,300.

Provincial Taxation

53. Apart from the above-mentioned taxation, each province levied its own taxes on persons and the income of persons. The personal tax was levied in the form of a fixed amount per taxpayer, and after 1946 it was transformed into a tax graduated according to income. The provincial income tax, which was a percentage of the normal and super tax, not only varied from province to province, but in some cases different percentages were levied on normal and super tax respectively. As a result of this system of multiple imposts, the degree of tax progression was difficult to determine.

Tax Progression under the "Bracket" System

54. With the introduction of the so-called "bracket" system in 1960, a uni-schedular income tax known as *normal* tax took the place of the former normal and super tax. The progression in the rates of the new tax was based on the needs of the Treasury at the time and on the consideration that no income category should be more heavily taxed than it had been previously.[2] At the same time the point at which the marginal progression reached its maximum was set at R18,000 and within the range of R1 and the new upper limit provision had to be made for a reasonable distribution of marginal rates.

55. Under the "bracket" system the tax on consecutive income segments increases gradually, and the sum of the tax on the successive segments is the effective tax on the taxpayer's full income. The tax rate applicable to a segment of income is therefore not the rate at which the full income is taxed but applies only to that particular segment.

56. With the introduction of the new system the sharp progression above R5,000, which was a feature of the earlier system, was retained. Although the acceleration in the marginal rate was thus smoothed out to some extent, a more equitable distribution of the relevant rates was not effected because of the limited range within which the adjustments were made.

Is a Change required in the Existing Progression?

57. If one looks specifically at the 1969 marginal rates for married persons, it appears that the rate for an income of R5,000 is only 13 per cent, after which it rises steeply to 26.4 per cent at R6,000, and 38.3 per cent at R7,000. At R10,000 it already reaches 50.2 per cent.

58. The Commission would like to accept that it was not the intention of the Treasury to introduce such an extremely sharp progression specifically in the case of these income groups but that the transition from low average rates at low incomes to high average rates at high incomes

[2] Because normal and super tax liability did not start at the same point, the progression could not be spread proportionately from the first R1 to R18,000 without detrimentally affecting persons with incomes under R4,600.

had to be achieved in some way or another. The Commission is of the opinion, however, that the current sudden change-over to high rates cannot be regarded as being equitable.

59. In evidence given by employers' and employees' associations the discouraging effect that this tax acceleration has on work effort was very strongly emphasised. It is also the Commission's opinion that, with a view to the efficiency of the work done by those who currently contribute two-thirds of the tax revenue, the progression in the marginal rates from R5,000 to R9,000 is too steep.

60. The effect that the progression in rates obviously has is that mere inflationary increases in incomes which do not of necessity change taxpayers' ability to pay nevertheless subject taxpayers to a higher tax liability.

61. The high marginal rates have a detrimental effect on the work effort of those groups in the labour force who can vary their income by working either more or less. These include almost all the professional groups who earn, with few exceptions, more than R5,000 these days; a section of the skilled workers who have the opportunity to work overtime; and an ever-increasing number of families in which the wife considers entering the labour market.

62. The high marginal rates also discourage the labour mobility of persons in the highly paid managerial groups, unless employers eliminate the effects of the high tax progression. This action on the part of employers is increasingly becoming a general practice and takes the form of higher gross salaries (part of which is recouped against company taxation) or the granting of all kinds of fringe benefits.

63. Furthermore, the establishing of many private companies is being attributed to mere tax avoidance practices.[3] At present, when a person's marginal rate exceeds the company rate (40 per cent including the loan levy) it may be worth his while to receive his income by way of the company form for subsequent redistribution. Moreover, there is a tendency among well-to-do persons to let income accrue to them in the form of capital gains. These practices are discussed in Chapter IV.

The Underlying Principles of the Proposed Tax Schedule

64. Thus far the nature and the defects of the current income taxation with regard to individuals have been outlined. Now the more specific considerations which the Commission took into account in arriving at its recommendations with regard to (1) the starting point of the income tax rate, (2) the maximum marginal rate, and (3) the rate of progression, will be dealt with.

[3] Information supplied by the Office of the Registrar of Companies shows that there are currently some 140,000 registered companies in the Republic, of which about one-third have been registered during the past five years and, indeed, at an increasing tempo of more or less 15,000 new registrations per year as against approximately 5,000 ten years ago. Of all the new registrations, 99 per cent are private companies of which three-quarters have an authorised share capital of at most R200. Approximately 50 per cent of these new private registrations are finance and investment companies.

The Starting Point of the Tax Schedule

65. In the income tax system of each country certain concessions are made in order to ensure that no person shall pay tax on his income if his income should be below a certain minimum amount. These concessions can take the form of an amount or limit exempted and/or primary rebate.[4] In South Africa there are statutory exemption limits with regard to provincial personal taxation and normal income taxation. Furthermore, for the purpose of calculating normal income tax, primary rebates, which vary according to marital status, are granted.

66. It is the opinion of the Commission that in the interest of effective economic policy and administrative simplicity, the provincial and normal taxes with regard to the incomes of individuals should be merged into a single rate. Its recommendations in this connection appear in par. 83. Such a merging also requires that the various exemption limits be transformed into a uniform exemption limit. The Commission's recommendations in this latter connection appear in par. 108.

67. As regards the existing primary rebates, it is the Commission's opinion that their purpose can be served by a reduction of the initial rate. The Commission's recommendations in this respect appear in par. 94. In the determining of this starting point on the tax curve, the minimum subsistence level of a white family with two children, viz. R1,700, was taken as a guide.[5]

68. As the discussion of abatements for children, etc., in par. 95 to 105 will show, the Commission would like to acknowledge the fact that the standard of living of various income groups is different up to a certain level.

The Maximum Marginal Rate

69. As in the determining of the minimum exemption limit, the maximum marginal rate and the applicable level of income vary from country to country in accordance with the stage of economic development, the social attitudes, the needs of the fiscal authority, and the possibilities of tax evasion especially through the forming of companies. Although in the highly developed economies the maximum rate is set at more than 50 per cent, it is applied to much higher incomes than in the Republic and other less developed economies.

70. Two main reasons are usually put forward as to why the maximum marginal rate of income tax on individuals should preferably not exceed 50 per cent. The first is of a psychological nature, and the second is related to the question of tax evasion. Evidence on both these considerations was received from various national organisations. It is often stated that in an economy based on private enterprise a marginal rate of more than 50 per cent has a dampening effect on personal effort since the Government becomes the senior partner in earnings above this maxi-

[4] Not only is this limit particularly high in certain Western countries with a high income per head, but it is even being considered to introduce a negative income tax for the benefit of minority groups with incomes below this exempted level.

[5] This figure is based on an investigation by the National Bureau for Educational and Social Research, Department of Higher Education.

mum.[6] Although this proposition is not denied, it must at the same time be borne in mind that the income level at which this maximum is reached, and thus the number of taxpayers involved, must also be taken into account.

71. Should the maximum marginal rate be reached fairly quickly, it would imply that the rate of progression on the preceding and especially middle income groups would have to be accelerated, and this would result in a higher average or effective tax. The Commission is convinced that as South Africa progresses economically, the ideal of a maximum marginal rate of 50 per cent and an increase in the income level at which it is reached, can and should be pursued.[7] The Carter Report indeed recommended 50 per cent as the maximum rate for the taxation of the income of individuals and companies.

72. The Commission received much evidence on the tax evasion aspect of an excessively high marginal rate on individuals. It was contended that the current large difference between the maximum rate of 66 per cent with regard to individuals and 36¾ per cent in the case of companies provides considerable scope for tax evasion through the forming of companies.[8] This aspect was referred to in par. 63.

73. In formulating its own recommendations with regard to a suitable maximum rate, the Commission took note, amongst other things, of the recommendations of previous income tax investigations. In *Report No.* 7 of the Social and Economic Planning Council (U.G. 48/1945) it was recommended that the marginal rate of income tax on persons (other than companies) should not exceed 70 per cent, whereas the Committee of Inquiry into the Income Tax Act (the Steyn Committee) found in 1951 that this recommended maximum was too high for a young developing country. This Committee recommended a maximum of 62½ per cent at an income of R24,000, and this recommendation was also accepted in principle by the majority of the Income Tax Commission (the Diederichs Commission). A minority recommended 75 per cent at an income of R28,000.

74. It is the considered opinion of the present Commission that the Republic's current maximum rate of 66 per cent (the maximum rate currently being levied in the Transvaal) is too high if the State wishes to encourage maximum effort and saving in the higher income groups. The Commission does not believe, however, that a return to the earlier rate of 62½ per cent would provide sufficient relief. In the opinion of the Commission the new maximum would have to be set at 60 per cent.[9] The income limit at which the maximum rate is reached should at the

[6] In the *Report of the Royal Commission on Taxation* (Chairman: K. LeM. Carter) Ottawa, Canada, 1966, Part I, p. 20 this aspect is also strongly emphasised. Hereinafter this publication will be referred to as the Carter Report.

[7] In their evidence before the Commission five national organisations recommended that a maximum marginal rate of 50 per cent be introduced in the Republic at this stage.

[8] The Carter Report refers to the existing Canadian maximum rate of 80 per cent as follows: "By transforming income into non-taxable forms and through a myriad of tax avoidance techniques, the 80 per cent rate can be effectively circumvented, so that the effective marginal rate is much lower." Part I, p. 21.

[9] Should the maximum be fixed at 50 instead of 60 per cent, with a tax progression in accordance with the rates recommended in par. 83, the additional loss of revenue tò the fiscus would be about R2½ million. The number of taxpapers involved are 1,200.

same time be raised from R18,000 to R28,000 for married and R24,000 for unmarried persons. The Commission *recommends accordingly.*

The Progression in the Tax Schedule

75. When the starting point and the maximum marginal rate, as well as the income level at which the latter is applicable have been determined, the rate of progression relating to all the income categories between the lowest and highest income levels has to be decided upon. If it is assumed that taxpayers' ability to pay increases uniformly with increases in their income, it would mean that the marginal tax rate between the initial and maximum levels could increase by an equal amount (number of percentage points) for every uniform percentage increase in income.[10] In practice, however, there may be good reasons for deviating from this type of straight-line progression in the marginal rate. For example, should the fiscal authority believe that the distribution of income in the country concerned is very uneven and that the advantages of Government expenditure on social services have not yet been sufficiently extended to the lower group of taxpayers, the degree of progression might be kept fairly low up to a certain income level and be accelerated after that. Another important consideration in retarding the rate of progression at the beginning of the tax curve could be that the lower income groups already pay substantial taxes in the form of indirect taxes which are, with few exceptions, regressive by nature. There may also be other considerations, e.g. the promotion of immigration, the maintenance of a traditional pattern which may be politically difficult to change, and so forth.

76. But whatever the particular reason, the fact remains that a retardation in the degree of progression in the lower income brackets necessarily implies an acceleration at some higher income levels, if a given total tax revenue is to be collected. This so-called "bulge" in the marginal tax curve is to be found in most countries, although, of course, in different forms and positions. In less developed countries the "bulge" problem may not be so serious because the acceleration of the progression would affect only a very small proportion of taxpayers in the highest income groups. As the average income per capita rises, however, and a larger proportion of the population enters the middle and higher income groups, the economic disadvantages of the "bulge" will tend to increase sharply while its social acceptability will decline. People who originally, for economic and even social reasons, were never meant to be subject to the "bulge area" rates will, however, in a growing economy with continuously rising per capita incomes, increasingly enter this area unless the existing marginal rates are adjusted gradually. Maintaining an existing progression has the advantage, indeed, of providing the fiscal authority with a very productive source of taxation. For the private sector this elasticity in the total tax revenue of the Government will, however, in the course of time bring about increasing economic and social disadvantages.

77. A temporary solution is to shift the stage of acceleration outward to higher income levels. Unfortunately the remaining income range up to the maximum or the terminal point of the tax curve is hereby reduced

[10] In a semi-logarithmic diagram (for an example of this type of diagram see the first diagram in par. 83) the progression between the initial and maximum tax rates would then assume the form of a straight line.

and the so-called "bulge" intensified. Another way out of this difficulty would be a periodic proportionate adjustment in the existing tax schedule, including its maximum point, i.e. without changing the rate of progression. This too would, however, be merely a temporary solution.

78. A third alternative is to effect a proportional adjustment from time to time not only to the existing progression with its built-in "bulge", but also to diminish the "bulge" itself gradually. As an economy grows, the average taxpayer's ability to pay increases while the advantages of social services are increasingly being extended to the lower income groups. In any case, there is, moreover, the tendency for the inequality in the distribution of income to diminish, at least after a certain stage.

79. In view of all the above considerations, the Commission is convinced that the gradient of the Republic's tax curve must be reviewed from time to time. Furthermore, the Commission is of the opinion that in the course of time the so-called "bulge" in the marginal rates should be diminished. In this connection, reference may once again be made to the evidence of a large number of national bodies and responsible persons on the desirability of reducing the sharp progression in respect of incomes of beyond R5,000 in the Republic.

80. There is, however, no purely objective method to determine precisely what is to be regarded as an *"equitable rate of progression"*. Nevertheless, there are fundamental criteria, such as the ability to pay, the promotion of economic growth, and fiscal productivity in terms of which the progression in the rates can be gauged.

81. Firstly, it must be admitted that beyond a certain income level the fiscus can decide almost arbitrarily what portion of an individual's "surplus" or discretionary income it wishes to tax away. In practice, however, this amount will be determined by the fiscal needs and its social acceptability. Secondly, the promotion of the higher income groups' ability to save must be borne in mind. A high rate of progression will increasingly hamper personal saving and, consequently, economic growth as well.[11] An excessive rate of progression will also restrain labour effort and mobility. In par. 61-63 mention has already been made of the effect of high marginal rates on work effort, especially in the case of those income groups whose incomes can be varied fairly easily.

82. The premise of a satisfactory income tax system is the general stage of economic development already attained by the country concerned. Although the progression must necessarily be steeper in the Republic than in most more highly developed countries, mainly because of its particular distribution of income, the progression should not be of such a nature as to be at variance with the conditions necessary for the maintenance of a high rate of economic growth. As has been mentioned in par. 79, it is also important that the existing progression in South Africa, which is developing rapidly, should be adapted from time to time specifically with a view to lowering the rate of progression.

[11] According to the official survey of family expenditure in 1966 undertaken by the Bureau of Statistics, clearcut proof of a "surplus" of income over expenditure only emerges at an income (before tax) of R3,500 per year, and at an income (after tax) of R5,500 per year.

The Commission's Recommendations Regarding the Republic's Tax Schedule

83. The recommendations of the Commission are as follows—

(a) *that a new comprehensive tax schedule, in which the State and Provincial taxaton is merged, be introduced;*

(b) *that the progressive bracket system of taxation and differentiated rates as regards married and unmarried persons be retained;*

(c) *that the existing normal and provincial rates be replaced by the rates contained in the accompanying tables.*

(The above-mentioned tables are followed by two diagrams showing how the recommended tax rates compare with the existing rates.)

NORMAL TAX RATES RECOMMENDED BY THE COMMISSION.

Married Persons.

Taxable Amount.	Tax Rate.
Where the taxable amount— does not exceed R1,000;	0·7% of the taxable amount.
Exceeds R1,000 but not R2,000	R7 + 10% of the excess above R1,000
,, R2,000 ,, ,, R3,000	R107 + 10% ,, ,, ,, ,, R2,000
,, R3,000 ,, ,, R4,000	R207 + 10% ,, ,, ,, ,, R3,000
,, R4,000 ,, ,, R5,000	R307 + 12% ,, ,, ,, ,, R4,000
,, R5,000 ,, ,, R6,000	R427 + 14% ,, ,, ,, ,, R5,000
,, R6,000 ,, ,, R7,000	R567 + 16% ,, ,, ,, ,, R6,000
,, R7,000 ,, ,, R8,000	R727 + 18% ,, ,, ,, ,, R7,000
,, R8,000 ,, ,, R9,000	R907 + 20% ,, ,, ,, ,, R8,000
,, R9,000 ,, ,, R10,000	R1,107 + 22% ,, ,, ,, ,, R9,000
,, R10,000 ,, ,, R11,000	R1,327 + 24% ,, ,, ,, ,, R10,000
,, R11,000 ,, ,, R12,000	R1,567 + 26% ,, ,, ,, ,, R11,000
,, R12,000 ,, ,, R13,000	R1,827 + 28% ,, ,, ,, ,, R12,000
,, R13,000 ,, ,, R14,000	R2,107 + 30% ,, ,, ,, ,, R13,000
,, R14,000 ,, ,, R15,000	R2,407 + 32% ,, ,, ,, ,, R14,000
,, R15,000 ,, ,, R16,000	R2,727 + 34% ,, ,, ,, ,, R15,000
,, R16,000 ,, ,, R17,000	R3,067 + 36% ,, ,, ,, ,, R16,000
,, R17,000 ,, ,, R18,000	R3,427 + 38% ,, ,, ,, ,, R17,000
,, R18,000 ,, ,, R19,000	R3,807 + 40% ,, ,, ,, ,, R18,000
,, R19,000 ,, ,, R20,000	R4,207 + 42% ,, ,, ,, ,, R19,000
,, R20,000 ,, ,, R21,000	R4,627 + 44% ,, ,, ,, ,, R20,000
,, R21,000 ,, ,, R22,000	R5,067 + 46% ,, ,, ,, ,, R21,000
,, R22,000 ,, ,, R23,000	R5,527 + 48% ,, ,, ,, ,, R22,000
,, R23,000 ,, ,, R24,000	R6,007 + 50% ,, ,, ,, ,, R23,000
,, R24,000 ,, ,, R25,000	R6,507 + 52% ,, ,, ,, ,, R24,000
,, R25,000 ,, ,, R26,000	R7,027 + 54% ,, ,, ,, ,, R25,000
,, R26,000 ,, ,, R27,000	R7,567 + 56% ,, ,, ,, ,, R26,000
,, R27,000 ,, ,, R28,000	R8,127 + 58% ,, ,, ,, ,, R27,000
,, R28,000	R8,707 + 60% ,, ,, ,, ,, R28,000

NORMAL TAX RATES.

UNMARRIED PERSONS.

Taxable Amount.					Tax Rate.						
Where the taxable amount—											
does not exceed R500;					0·6% of the taxable amount.						
Exceeds	R500	but	not	R1,000	R3 + 11%	of	the	excess	above	R500	
„	R1,000	„	„	R2,000	R58 + 12%	„	„	„	„	R1,000	
„	R2,000	„	„	R3,000	R178 + 13%	„	„	„	„	R2,000	
„	R3,000	„	„	R4,000	R308 + 14%	„	„	„	„	R3,000	
„	R4,000	„	„	R5,000	R448 + 16%	„	„	„	„	R4,000	
„	R5,000	„	„	R6,000	R608 + 19%	„	„	„	„	R5,000	
„	R6,000	„	„	R7,000	R798 + 22%	„	„	„	„	R6,000	
„	R7,000	„	„	R8,000	R1,018 + 25%	„	„	„	„	R7,000	
„	R8,000	„	„	R9,000	R1,268 + 28%	„	„	„	„	R8,000	
„	R9,000	„	„	R10,000	R1,548 + 30%	„	„	„	„	R9,000	
„	R10,000	„	„	R11,000	R1,848 + 32%	„	„	„	„	R10,000	
„	R11,000	„	„	R12,000	R2,168 + 34%	„	„	„	„	R11,000	
„	R12,000	„	„	R13,000	R2,508 + 36%	„	„	„	„	R12,000	
„	R13,000	„	„	R14,000	R2,868 + 38%	„	„	„	„	R13,000	
„	R14,000	„	„	R15,000	R3,248 + 40%	„	„	„	„	R14,000	
„	R15,000	„	„	R16,000	R3,648 + 42%	„	„	„	„	R15,000	
„	R16,000	„	„	R17,000	R4,068 + 44%	„	„	„	„	R16,000	
„	R17,000	„	„	R18,000	R4,508 + 46%	„	„	„	„	R17,000	
„	R18,000	„	„	R19,000	R4,968 + 48%	„	„	„	„	R18,000	
„	R19,000	„	„	R20,000	R5,448 + 50%	„	„	„	„	R19,000	
„	R20,000	„	„	R21,000	R5,948 + 52%	„	„	„	„	R20,000	
„	R21,000	„	„	R22,000	R6,468 + 54%	„	„	„	„	R21,000	
„	R22,000	„	„	R23,000	R7,008 + 56%	„	„	„	„	R22,000	
„	R23,000	„	„	R24,000	R7,568 + 58%	„	„	„	„	R23,000	
„	R24,000				R8,148 + 60%	„	„	„	„	R24,000	

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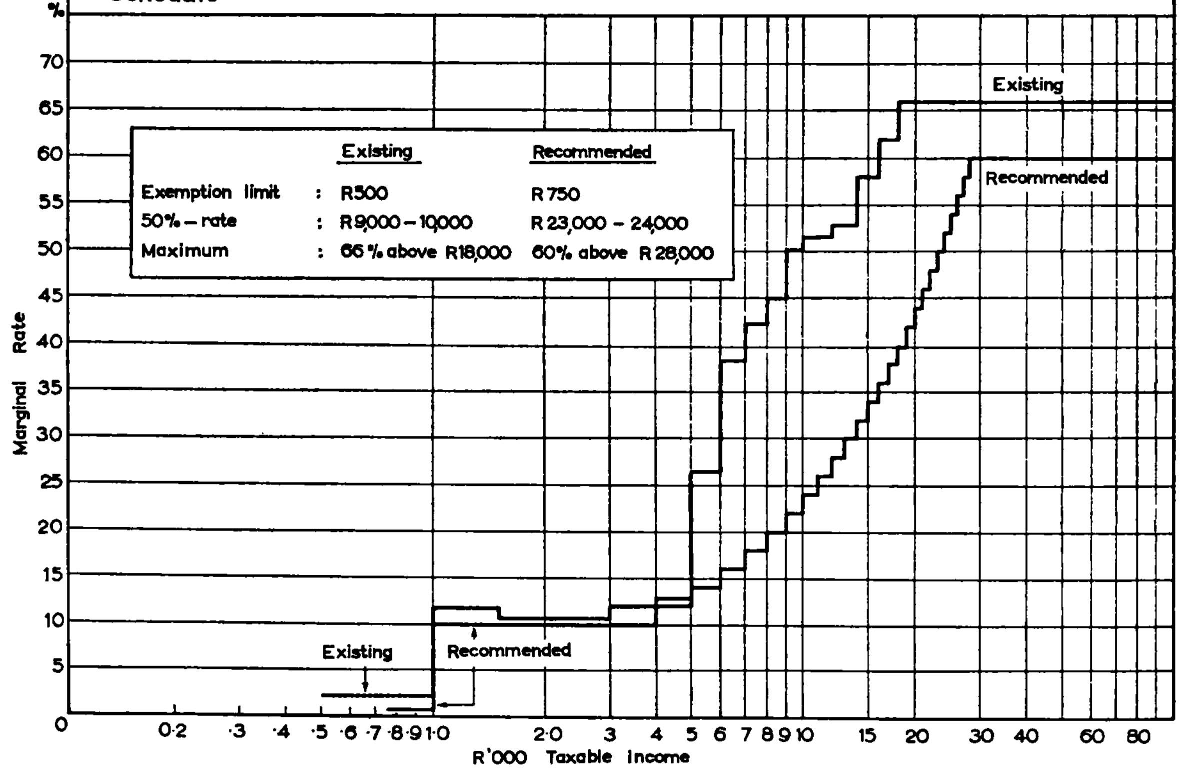
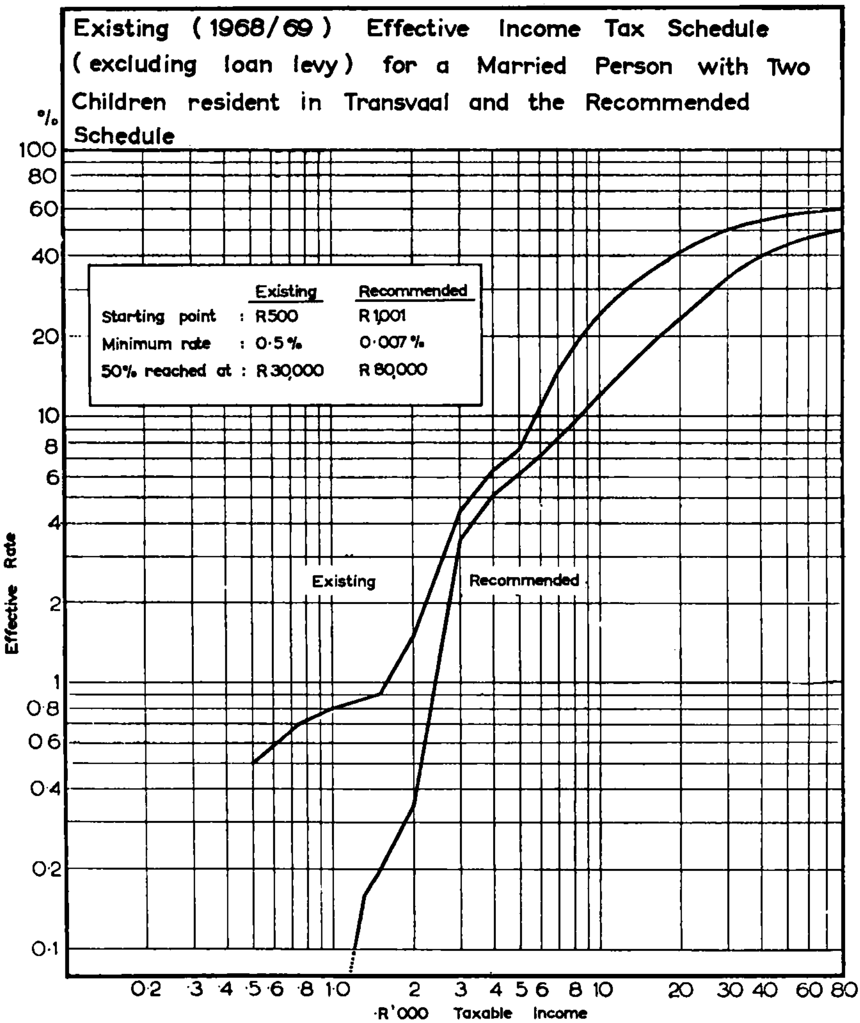
Existing (1968/69) Marginal Income Tax Schedule (excluding loan levy) for a Married Person resident in Transvaal and the Recommended Schedule




Existing (1968/69) Effective Income Tax Schedule (excluding loan levy) for a Married Person with Two Children resident in Transvaal and the Recommended Schedule
%
100
80
60
40
20
10
8
6
4
2
1
0·8
0·6
0·4
0·2
0·1
Effective Rate
Existing Recommended
Starting point : R500 R1,001
Minimum rate : 0·5% 0·007%
50% reached at : R30,000 R80,000
Existing
Recommended
0·2 ·3 ·4 ·5 ·6 ·8 1·0 2 3 4 5 6 8 10 20 30 40 60 80
·R'000 Taxable Income

THE SUBSTITUTION OF ABATEMENTS FOR THE EXISTING SYSTEM OF REBATES

84. The granting of rebates according to family circumstances is not primarily intended to reimburse a taxpayer for expenses incurred in supporting himself and his family. If full compensation were to be granted for this, the major part of the tax base would disappear. In any case, uniform rebates to all taxpayers cannot provide for the actual expenditure on necessities which vary from household to household according to circumstances.

85. The object of deductions or rebates in the determining of the ultimate tax liability of a taxpayer is to acknowledge the fact that a person's ability to pay decreases according to the number of children he has, the number of his dependants, his medical expenses, etc.

86. Between 1914, when the Income Tax Act came into operation, and 1940 a system of abatements was in force in South Africa. From 1941 onwards rebates have been allowed to taxpayers.

87. In most countries there is a system of abatements or personal allowances in force. In substance there is little difference between the *effect* of a system of abatements and that of a system of rebates except that an abatement amounts to a greater concession as marginal rates rise, unless it is reduced as income increases. Without this adjustment, it would not be a neutral concession, but would favour the higher income groups. A rebate, on the other hand, is less favourable to the high income groups in that the same amount is deducted from the tax regardless of the size of the taxable income.

88. In view of the above and the fact that a system of abatements is better understood and appreciated by the public in that the value of the concession is clearly shown in terms of taxable income, it is recommended that such a system be reintroduced in the place of the existing rebate system. From the evidence submitted to the Commission, it is clear that this amendment to the Income Tax Act would be generally welcomed.

89. A comparison of the effect of the two systems of tax concession, in terms of tax relief to the taxpayer, is shown below. The calculations are based on the following: (1) the tax schedule as recommended by the Commission in par. 83 above; and (2) the assumption that the rebate is equivalent to the tax value of the proposed abatement of R500 per child—i.e. R50 per child.[12] The abatement is calculated to illustrate firstly the application of the full amount of the abatement to taxpayers irrespective of the size of their incomes (Case I) and then the diminishing of the abatement by R1 for every R10 additional income above R6,000 (Case II).

90. In the light of Case I, it is clear that an abatement of a constant amount per child would, in view of the increase in marginal rates as incomes increase, benefit the higher income groups more than the lower.

91. If one, however, takes into consideration that in relation to income the support of a child weighs more heavily on the lower and

[12] The lowest marginal rate at which an abatement is effective is for all practical purposes 10 per cent; i.e. an abatement of R500 is equivalent to a tax rebate of R50.

COMPARISON OF TAX PAYABLE UNDER A SYSTEM OF REBATES AND ABATEMENTS BY A MARRIED PERSON WITH:

Income R	1 Child.			2 Children.			3 Children.			4 Children.		
	Without rebate.	With rebate.	With abatement.	Without rebate.	With rebate.	With abatement.	Without rebate.	With rebate.	With abatement.	Without rebate.	With rebate.	With abatement.
Case I. *Without Diminution of Abatements:*												
2,000	107	57	57	107	7	7	107	—	3.50	107	—	—
4,000	307	257	257	307	207	207	307	157	157	307	107	107
5,000	427	377	367	427	327	307	427	277	257	427	227	207
6,000	567	517	497	567	467	427	567	417	367	567	367	307
8,000	907	857	817	907	807	727	907	757	647	907	707	567
10,000	1,327	1,277	1,217	1,327	1,227	1,107	1,327	1,177	1,007	1,327	1,127	907
20,000	4,627	4,577	4,417	4,627	4,527	4,207	4,627	4,477	4,007	4,627	4,427	3,807
Case II. *With Diminution of Abatements by R1 for every R10 of the Taxable Income above R6,000:*												
8,000	907	857	853	907	807	763	907	757	679	907	707	599
10,000	1,327	1,277	1,305	1,327	1,277	1,195	1,327	1,177	1,087	1,327	1,127	987
20,000	4,627	4,577	4,627	4,627	4,577	4,627	4,627	4,477	4,585	4,627	4,427	4,375

middle income groups and that such support requires a smaller portion of the income of the high income groups, thus having a smaller effect on their ability to pay, the necessity of relief diminishes as income increases. The effect of an abatement that diminishes beyond a certain income level is shown in Case II of the table.

92. The Commission accordingly recommends *that the system of rebates be replaced by one of abatements and that, after a taxable income of R6,000 is reached, the abatements be reduced by R1 for every R10 of the taxable income above R6,000.* This diminution in the amount of the abatement for incomes above R6,000 applies specifically to the abatements dealt with below under paragraphs 93 to 104. The diminishing concession in respect of working wives rests on a different basis as will be set out in par. 130 (4) below.

Recommendations With Regard to Specific Abatements

Abatement in accordance with Marital Status (Primary Rebate)

93. Currently a primary rebate of R62 is allowed to a married person and R46 to an unmarried person. Since the purpose of the concession is to adapt the ultimate tax to the taxpayer's ability to pay, such a rebate is of greater importance to lower income groups.

94. The primary rebate is a *fixed* amount for every taxpayer, i.e. it does not vary like other rebates in accordance with the number of children or dependants, the amounts paid in insurance premiums, etc. Consequently, the purpose of the granting of a rebate can be achieved by adjusting the tax rates in the lower income groups in such a way that the necessary relief is thereby effected.

95. With a view towards simplifying the calculation of a person's tax liability, the Commission thus recommends *that a primary abatement should not be granted because the tax rates recommended in par. 83 already make provision for it.*

Abatement in respect of Children

96. As regards tax relief in respect of children the rebates granted at present for the first two children differ from those allowed in respect of the third and subsequent children. The Commission's finding is that on socio-economic grounds there is no compelling reason for maintaining such a differentiation.

97. Consequently the Commission recommends *that an abatement of R500 per child be granted regardless of the number.*

Abatement in respect of Dependants

98. The tax rebate currently varies according to whether or not a dependant is completely dependent upon the taxpayer for his support, and the effect, in terms of taxable income, varies according to whether the taxpayer is married or not. The income value of the rebate for the lowest income level is as follows: Not completely dependent: Married R78; Unmarried R66. Completely dependent: Married R203; Unmarried R177.

99. Since the support of a dependant has the same effect on a married person's ability to pay as on an unmarried person's, the Commission

recommends *that the abatement for a dependant be the same for a married as for an unmarried person and specifically as follows: completely dependent: R200; not completely dependent: R80, provided that the contribution of the taxpayer towards the support of such a dependant amounts to at least R200 and R80 respectively.*

Abatement in respect of Life Insurance Premiums

100. Currently a rebate equivalent to 8 per cent of premiums is permitted, with a maximum of R30. This maximum is reached when the premiums amount to R375. The Commission reccommends *that this rebate be transformed into an abatement equivalent to the actual premiums up to a maximum of R400.*

Abatement in respect of Medical Expenses

101. At present actual medical expenses subject to a maximum of R250 are permitted as a deduction from taxable income in the determining of the latter. This, however, is somewhat misleading since only expenses incurred in the generation of income as such should be taken into account in the determining of taxable income. An allowance for medical expenses is really a personal allowance and should therefore be permitted as an abatement.

102. Representations were made to the Commission to increase the maximum of medical expenses which can be permitted as a deduction. On the basis of a careful investigation into the medical expenses actually claimed by a large group of taxpayers, it was found that in the large majority of cases the existing maximum was adequate. Thus only in exceptional cases, i.e., when extraordinary expenses are incurred during a year, will an increase of the existing deductions be of any use.

103. The Commission took note of the large volume of administrative work involved in the checking of actual expenses submitted to the Receiver of Revenue. These administrative problems can be eliminated by granting taxpayers a fixed abatement. A reasonable amount appears to be R150 because it is at present substantially higher than the existing average of medical expenses actually incurred. An actual expenditure of more than this amount in any one year will automatically be compensated for should the actual expenses in the following year or years be less than the R150 concerned. The amount of R150 will also be large enough to provide for normal expenditure on medicine which is not currently permitted as a deduction. This concession will assist the elderly especially.

104. The Commission thus recommends *that in respect of medical expenses an abatement of R150 per year (regardless of the actual expenditure) be granted for a married person and R75 for an unmarried person, or R150 when an unmarried person is the only support of a dependant. Furthermore, an additional abatement of R100 for the year in which a child is born* is also recommended.

Exemptions

105. The existing Income Tax Act as well as two of the Provincial Ordinances with regard to taxation on persons contains certain statutory exemption limits. In the case of income tax the exemptions are R600 for a married and R500 for an unmarried person. In the Cape married persons

with incomes below R1,000, and unmarried persons with incomes below R600, are exempted from personal taxation. In the Transvaal the relevant exemption is R500 for a married and R300 for an unmarried person.

106. These exemption limits, however, do not imply that when a person's income exceeds these limits, the income up to the limit is free from taxation but are only a measure to determine at which level of income liability for taxation on the whole of the taxpayer's income starts. As a result of the effect of rebates, however, a married person starts paying normal income tax only when his income exceeds R972, and an unmarried person when his income is more than R612, but then he is taxable on his *total* income.

107. In all provinces there is an age exemption in respect of personal taxation with regard to (1) persons under 21 years, regardless of whether such persons are liable for normal taxation or not, and (2) persons above 60 years who are not liable for normal taxation. There is no justification for coupling the liability for income taxation with a minimum age of 21. The basis for this tax is after all *income* and not *age*. The Commission, however, found some merit in the representations made to it with regard to pensioners and elderly retired persons with a *fixed* income.

108. The Commission recommends that—

(1) *in the case of married persons the statutory exemption limit be set at R750;*

(2) *in the case of a married person above the age of 60, the exemption limit be set at R1,200;* and

(3) *in the case of unmarried persons the existing exemption limit be set at R500 for those under 60 years, and at R750 for those above 60 years.* The exemption limit for persons above 60 years ensures that they will not be worse off than they are at present.

Taxation of Married Couples when both Husband and Wife have an Income

109. Many representations were made to the Commission for a revision of the system of taxation of married couples when both husband and wife have an income. Amongst other things, it was suggested that (1) married couples be assessed separately; (2) marginal rates be diminished; (3) the existing tax relief in respect of married couples be extended; and (4) a deduction over and above the present rate concession be granted. This issue had already been considered by the Steyn Committee.[13] This Committee came to the conclusion that the system of joint assessment had to be retained.

110. In some countries such as Canada, Australia, and New Zealand, in which systems of separate assessment are applied, the full relief is in many respects not granted because all sorts of adjustments are made to the tax concessions applicable to married couples. In Canada for example, a deduction of $2,000 is permitted when a husband supports his wife. This deduction, however, is reduced by the excess of the wife's income above $250. In Australia a concessional deduction of A$286 is allowed to a married person who supports his wife. Here, too, the deduction is reduced by the amount by which the wife's income exceeds A$130. New Zealand

[13] Cf. paragraphs 58 to 61 of the *First Report* and par. 3 of the *Second Report.*

allows each husband a personal exemption of £468. If a husband supports his wife he receives a further exemption of £156, which is reduced by £1 for every £1 of his wife's income above £156.

111. In the U.S.A. and West Germany the husband and wife have an option to submit either a joint return or separate returns. Because the tax is calculated on an income distribution basis (i.e. the tax payable is an amount equal to twice the tax on half of the joint income—after deduction of personal exemptions) it sometimes happens that the submitting of a joint return gives rise to less taxation than would be the case if separate returns have been submitted.

112. Abatements or rebates for children also create problems. Thus, for example, in Canada an abatement for a child is allowed to the father (except that an abatement for an illegitimate child is granted to the mother). In Australia an abatement of A$182 for the first child and A$130 for the second and subsequent children (diminishing with income) is allowed to the parent who supports the child. When both parents support the child the tax authority has the right to divide the abatement between the parents. A similar system operates in New Zealand.

113. In the U.S.A. an abatement of $600 is allowed to a taxpayer who contributes more than half towards the support of the child. When more than one person contributes towards the support, the abatement is granted to only one, provided that he is responsible for more than 1/10th of the support and other persons who also contribute more than 1/10th agree not to submit a claim for the year concerned. In West Germany half of the children's allowance is apportioned to each of the parents.

114. In France the so-called family coefficient system applies. Broadly speaking, the income of the family (husband, wife, and children under 21 years, or in some cases under 25 years) is aggregated and then split into parts according to the taxpayer's marital status and number of children. An example will explain the effect of this system:

A single or divorced person or a widow/widower	1 part
Married couple without children	2 parts
Married couple with 1 child	2½ parts
Married couple with 2 children	3 parts
and for each extra child	½ part

The income of the husband, wife, and say, two children is divided into 3 parts, and the tax is calculated according to progressive rates and the result multiplied by three. Wherever a system of rates which accelerate as income rises is in force, it is clear that the higher the income, the larger will be the benefit *for the taxpayer.*

115. In all countries precautions are taken to some extent or other against the use of income distribution schemes between husband and wife for purposes of tax evasion.

Interim Relief Granted to Working Married Couples in the Republic

116. In the Republic the joint income of husband and wife is taxed as a unit, but from the beginning of the 1966 tax year a concession has been made to married couples when both the husband and wife have an income. According to this, a rate adjustment is made which is largely aimed at somewhat alleviating the impact of marginal rates on the addition of the wife's income to that of the husband.

117. If we assume, for example, that the husband's income is R4,000, the marginal rate on the upper R1,000 of his income is 11.88 per cent (Transvaal). Should his wife earn R2,000, this would mean that R600 of the above amount is taxed at 11.88 per cent, the next R400 at 13.2 per cent, and the balance of R1,000 at 26.4 per cent. The higher the joint income of husband and wife, the heavier the marginal rates resulting from addition of the wife's income. In order to meet this situation, the already mentioned adjustment was introduced in 1966. According to this, the total joint income of the husband and wife is taxed at a rate applicable to the sum of the following:

(*a*) *Up to a joint income of* R8,000: the larger of the two separate incomes plus one half of the smaller. Therefore, if the husband's income was R4,000 and the wife's R2,000, the total income of R6,000 was taxed at a rate applicable to R4,000 + ½ (R2,000) = R5,000. The latter is the so-called "rating amount", i.e. the amount on which the rate is determined at which the joint income is taxed;

(*b*) *If the joint income exceeded* R8,000, the amount on which the rate was determined was the larger of the two incomes plus one half of the smaller plus twice the difference between the taxable income and R8,000. Thus if the husband's income was R5,000 and that of his wife R3,500, the amount of R8,500 would be taxed at a rate applicable to R5,000 + R1,750 + 2 (R8,500 – R8,000) = R7,750.

118. This adjustment did provide some relief, but because the variation in rates served as the basis, the relief to the lower income groups where the marginal rate remained virtually constant was negligible. Furthermore, the rapid tapering off of the relief beyond a joint income of R8,000 brought about certain anomalies in respect of the marginal taxation payable.

119. With the purpose of providing further relief for the lower income groups and of ironing out the anomalies at the same time, the rate concession was further extended from the beginning of the 1969 tax year, and a new formula is currently being applied. According to this, the "rating amount" is determined as follows: for a joint income under R3,000 the rating amount is the larger of the two incomes; for a joint income between R3,000 and R8,000 the rating amount is the larger of the two incomes plus 40 per cent of the smaller of the two; and for a joint income above R8,000 the rating amount is the larger of the two incomes plus 40 per cent of the smaller, plus the amount by which the joint income exceeds R8,000.

120. It is important to bear in mind that this concession was directly related to the incidence of the existing high marginal rates on the wife's addition to the family income. *If, however, both the progression and the average tax rate should be diminished, the real reason for a special concession disappears.* The Commission, accordingly, had to consider the whole problem of separate assessment of husband and wife in the light of the considerable relief embodied in its proposals for reform.

121. A complete separation of the income of husband and wife would in the nature of the case bring about a considerable loss of revenue for the State and could lead to a higher tax burden for those who are the only breadwinners of the family should the tax rates have to be adjusted to keep the loss within limits.

122. From the point of view of fiscal productivity, the distribution of income in the Republic where 94 per cent of the taxpaying population have taxable incomes of less than R5,000, does not lend itself to a system of income division as in the U.S.A. and West Germany. It would also tend to favour the high income groups and would disturb the degree of equity embodied in the suggested amendments to the tax curve.

123. The Commission is of the opinion that the taxing of husband and wife as a family unit is an acceptable principle. In view of the economies of a combined household, it is logical that the ability to pay which arises from the joint income of husband and wife is greater than that of two unmarried persons with separate households who together earn the same income as the married couple.

124. A tax on income is based on the ability to pay of a taxpaying unit, i.e. on the unit which obtains the income and employs it to his own advantage. A taxpaying unit thus consists of either a company or a single person or a married couple. In the latter case the income of the unit is employed to the mutual advantage of the combined household. In the opinion of the Commission there is no justification for differentiating too much between families only by virtue of the fact that the wife is gainfully employed, since there would then be discrimination against the family if the wife, owing to various circumstances, is unable to work and the husband, as the only breadwinner, has to supplement the family's income by extra work and effort.

125. Complete separation of the income of married couples and the issuing of separate returns to each also bring about considerable additional administrative work, which would require additional personnel, office space, etc. The danger of taxpayers resorting to the splitting of income and other forms of tax avoidance would also increase.

126. Should the Commission's recommendations with regard to the lowering of the marginal rates be accepted, it would be tantamount to a consolidation of the existing rate concession and would relieve the marginal tax burden on the wife's income to such an extent that, in the opinion of the Commission, it would largely eliminate the discouragement of entering the labour market. It also would have the advantage of eliminating anomalies brought about by the present rate adjustment, viz. the differential tax burden on a given amount of joint income depending upon its composition.[14]

127. Normally it is a sound principle that any given amount of income, regardless of the private and household expenses of the taxpayer, should carry a given amount of tax and that the nature and composition of the taxable amount should not be taken into account.

128. It is, however, admitted that when a married woman has to leave her home in order to earn an income, the family has to do without her domestic services and thus has additional expenses, which it would not

[14] An example will illustrate the differentation that may occur:

	Income of husband	*Income of wife*	*Total income*	*Taxation*
First married couple	R3,500	R3,500	R7,000	R687
Second married couple	4,000	3,000	7,000	732
Third married couple	5,000	2,000	7,000	842

The Commission does not find it equitable that the first married couple should pay R155 less in taxation than the third married couple.

have had otherwise. Although an addition to the income of the family unit does then occur, it would be unjust not to admit that the additional income is gross and not net. In comparison with the family in which there is only one breadwinner, the tax ability of the family in which both husband and wife have an income is thus smaller in respect of an equal gross income. This is of special importance in the case of lower and middle income groups and diminishes in significance as income increases and the proportion between total income and additional expenses become less significant.

129. As regards the effect of the proposed tax relief on the labour market, evidence was submitted that it might encourage more women to seek work and that additional taxation would thus be forthcoming from the increasing income. The Commission cannot accept such a statement without further consideration, since there is no proof that this would indeed be so, especially if the education of growing families and other sociological aspects upon which the Commission does not wish to express itself, are taken into account. The 1966 family expenditure survey indicates that a comparatively high percentage of married women are already employed.

130. The Commission thus recommends that—

(1) *since the system of aggregating the incomes of married couples fulfils the test of the ability to pay and the reform of the tax rates proposed by the Commission would remove the sting from the existing progression, the present system of joint assessment be retained;*

(2) *the reduction of the tax ability of married couples as a result of additional financial obligations when both are working, be recognised and that in determining the family's tax liability, the wife's total annual taxable income be exempted up to at most R500 per year;*

(3) *the exemption in* (2) *above be applicable only to payments made to married women for services rendered, and the existing restrictions as contained in section* 5 (6) *of the Income Tax Act be retained;*

(4) *the exemption in* (2) *above be applicable to married couples with a joint taxable income of not more than R*8,000 *and should diminish thereafter by R*1 *for every completed R*10 *by which the joint taxable income of the married couple (before deduction of the exempted amount) exceeds R*8,000.

Central Government: Provincial Relations

Legal Position

131. By virtue of the South Africa Act, 1909, provinces were authorised to levy taxes in order to obtain revenue for provincial purposes. This authorisation was prolonged in the Constitution of the Republic (Act No. 32 of 1961), of which Section 84 (1) provides that except for the provisions of the Consolidation and Amendment Act on Financial Relations 1945 (Act No. 38 of 1945), a Provincial Council can make ordinances in respect of direct taxation within the province in order to obtain revenue for provincial purposes. The latter Act contains in its Appendix I a list of the sources from which provinces can obtain direct

taxation, and indeed item 8 of this Appendix provides that except for the provisions of Sections 8 (4) and 10 of the Act, provinces can levy:

(*a*) a personal tax on persons who have reached the age of 21 or more on the last day of the year of assessment and which tax can be established progressively according to income or otherwise, and

(*b*) an income tax on the income of persons (except companies) including a person as described in the Income Tax Act.

132. Section 8 (4) (*a*) of the Consolidation and Amendment Act on Financial Relations 1945 prescribes the way in which the personal tax can be levied, viz. on persons who have been resident in the province for not less than 90 consecutive days during the year of assessment. Section 8 (4) (*b*) of the above-mentioned Act provides that the provincial income tax can also be levied upon such persons and that it must be in the form of a single percentage (applicable to all persons) of the entire or any portion of the normal tax levied by virtue of the Income Tax Act. It is further provided that the Provincial Council of each province should annually determine the percentage of the provincial income tax.

133. Apart from the tax on persons, the provinces also had the right to levy a tax on the income of companies, mining companies excepted. This right was, however, withdrawn in 1957, and at present the provinces merely share in the normal tax levied on companies by the Central Government. The provincial share of the normal taxation of companies (at present 15 per cent) is divided among the provinces in the proportions provided by proclamation.[15]

The Pattern of Provincial Taxation

134. The total tax revenue of the Provincial Administrations shows a virtually constant proportion to that of the Central Government in the long run. It amounts to 18 per cent on average since 1960, which is the same as that for the nineteen-twenties. During the 'thirties the ratio was slightly higher, and during the war and until the end of the nineteen-fifties, as a result of a number of temporary circumstances the proportion was, however, substantially lower.

135. The share of the provinces in total State expenditure and hence their influence on the incidence of taxation in the Republic is, of course, considerably larger than the above-mentioned 18 per cent would indicate, because a particularly large part (usually more than 50 per cent) of their expenditure is financed by subsidies and transfers received from the Central Government.

136. An important change, however, has occurred in the composition of the taxation of the provinces, viz. a more than proportional increase in the revenue from *direct* taxes, which are mainly linked with the taxes of the Central Government, at the expense of the share of *indirect* taxes which the provinces collect directly and over which they can exercise direct control. Thus, for example, the share of direct taxes in the total

[15] At present these proportions are as follows (by virtue of Proclamation 310 of 1957):

Cape Province	33.7835%
Natal	15.8098%
Orange Free State	3.5767%
Transvaal	46.8300%

tax revenue of the provinces increased from approximately one-third immediately before World War II to two-thirds at the beginning of the 'sixties and at present it already amounts to more than three-quarters. The most important single reason for this change has been the yield from income tax on individuals, which is collected in the form of a surtax on the normal tax collected by the State. At the same time the direct tax revenue of the Provinces in relation to that of the Central Government increased from approximately 13 per cent just before the war to an average of 23 per cent since 1963. In the meantime, the responsibility for expenditure in connection with Bantu, Coloured and Indian education has, moreover, shifted from the provinces to the Central Government.

Should a comprehensive Tax System with regard to the Income of Individuals be introduced?

137. The Commission's proposed tax rates for individuals are based on a *comprehensive* rate, i.e. it does not provide for further additions by Provincial Authorities. The proposed basis removes defects in the present form of tax assessment especially in respect of the plurality of taxation and the differentiation by virtue of place of residence.

138. Where various tax authorities impose different taxes on the same persons and incomes, the maintenance of an integrated fiscal policy is impeded. It has happened in the past that increases in State taxation have occurred along with decreases in provincial taxation, and the other way round, or that both State and Provincial taxation has increased in the same year thus increasing the burden on taxpayers.

139. There is no legal limit to the extent to which Provincial Authorities can levy provincial income tax, and theoretically there is nothing to prevent them from imposing a 100 per cent levy on the normal income tax of the State.

140. The personal tax imposed by provinces not only differs from province to province but is also accompanied by age qualifications. In two provinces, viz. Natal and O.F.S., there is also no minimum income limit, and taxation is imposed from the first R1. The range of the personal tax, as well as the age qualifications, is not in accordance with sound norms of taxation of the income of individuals because (1) the criterion in levying income taxation on individuals should be the size of incomes only, and (2) the principle of equity should be thoroughly taken into account especially in respect of low income groups.

Administrative Aspects

141. From an administrative point of view there is not only the extra work involved in the application of different principles, for example, age, place of residence, etc., but the implementation of changes in taxation (through the P.A.Y.E. method of tax collection) is delayed because the announcement of provincial budgets (which usually occur after the State budget) has to be awaited.

142. In the case of employers who have employees in different provinces, and wherever transfers take place across provincial boundaries, the differences in taxation in the various provinces create many problems in the deduction of taxes according to the P.A.Y.E. method.

143. At present four different tax deduction tables (one for the residents of each province) have to be calculated, printed, and distributed. Not only does this create more work for the Department of Inland Revenue, but employers have to calculate deductions according to these tables and make provincial divisions of payments.

Recommendations

144. Although the Commission has not yet had the opportunity of examining the budget relations between the Central and Provincial Administrations, it has already become evident to the Commission that the current influence which the Provinces can exert on the average and marginal rates of direct taxation in South Africa creates very difficult problems for the application of economic policy, which is after all the responsibility of the Central Government. Specifically, there is great anxiety that the provinces, whose approach to tax revenue and tax rates is largely one of budget financing, might increase the combined direct tax rate during recessions and lower it during periods of inflationary pressure, i.e. when the Central Authority might be pursuing just the opposite in the interests of the general economic stability of the country.

145. The Steyn Committee recommended that the Central Government should transfer its power to levy normal taxation on the income of individuals to the Provinces and that the latter should in turn give up imposing personal taxation and taxation on companies. This recommendation was, however, rejected by the Diederichs Commission.

146. The present Commission took note of the Government's intention to release a White Paper on the Schumann Report in connection with the basis upon which the Central Government will subsidise the provinces and according to which the finances of the provinces will be co-ordinated with those of the Central Government. Should the new basis involve, amongst other things, the introduction of a standard method of control over provincial expenditure, the Commission is of the opinion that the standard percentage of this expenditure, which can be financed by transfers from the Central Government, can be expanded in relation to the provinces' own sources of income at less risk than would be the case under the present circumstances.

147. After, on the one hand, considering the implications of levying taxation separately on persons and the income of persons by the State and Provincial Authorities, and on the other, heeding the desirability of simplifying the tax administration both as regards the Department of Inland Revenue and employers under the P.A.Y.E. system, the Commission recommends that—

(*a*) *the rights of Provincial Authorities to levy personal taxation and income taxation on individuals be withdrawn;* and

(*b*) *Provincial Authorities share in the revenue from taxation collected by the Central Government on the income of individuals, as is already the case with company taxation.*

CHAPTER III

SALES TAXATION

The Case for Indirect Taxation in South Africa

148. The Commission is of the opinion, as has been indicated in Chapter I, that the time has arrived to place greater emphasis on indirect taxation in the South African tax system. A variety of considerations has led the Commission to this conclusion.

149. The fiscal productivity of the system at present in force is limited by the fact that by far the major part of the income tax on individuals is collected from a minimal portion of the population, viz. those in the higher income groups. For the reasons mentioned in Chapter II, the Commission recommended that relief be granted in respect of this tax. Government revenue which is thus sacrificed could be recouped partially by way of taxes on consumer goods, to which the consumer would contribute in accordance with his ability to afford the purchase of the taxed commodity. In this way the system is accorded a broader tax base, which would at the same time supplement the narrow base of the existing excise duties.

150. The indirect taxes levied by the Central Government are mainly customs, excise, stamp duties, transfer duties, and the marketable securities tax. Together they contribute about 30 per cent of current Government revenue. As has been indicated in par. 22, customs revenue has levelled off as a result of the policy of import substitution. In the composition of imports, low-taxed or tax-free industrial requirements currently play a greater role than before. Furthermore, customs duties are used as an instrument of foreign trade policy, and South Africa has already accepted certain international commitments in this respect, so that customs duties cannot be utilised as an effective fiscal weapon. Excise duties, again, are concentrated mainly on only four products, viz. liquor (estimated 1968/69 revenue: R101 million); tobacco (R85 million); petrol (R45 million); and motor cars and tyres (R38 million). The other indirect taxes also cover a very narrow field.

151. The private, as well as the public, sector would be able to administer a more general indirect tax without excessively high cost. This type of tax should fulfil the requirements of equity, if some degree of progression is built into the system.

152. In order to fulfil this requirement of equity, a sales tax will have to be levied selectively on consumer goods, although the Commission would like to allow for the possibility of its extension to certain capital goods. The selection will have to be such that all the major expenditure items in the family budget of the low income groups remain untaxed.

153. One of the most important advantages is the absence of a restraining effect on effort and on the willingness to risk and to save. In this respect a sales tax is superior to most direct taxes.

154. The fiscal authority does not at present have at its disposal a complete set of instruments to promote economic stability. This gap can be partly filled in an effective way by the introduction of a sales tax founded on a broader base than the present excise duties.

155. The dimensions of private consumption expenditure as a tax base are evident from the figure of approximately R5,900 million, which was the total amount involved in 1967. Even if food, clothing, and services, which together amounted to R2,578 million, are left out of account, a substantial tax base still remains.

156. Overseas, the disadvantages of high income taxation are also being increasingly emphasised, and a shift to indirect taxation is a worldwide tendency. Recently recommendations to this effect have been made in a number of official reports. The Ross Committee[1] in 1967 recommended a shift of emphasis in the New Zealand tax system from direct to indirect taxes. They recommended a considerable extension of the existing wholesale tax and a partial compensation of the increased tax burden on low incomes through improved children's allowances and State pensions. In Norway the Sandberg Committee[2] found that the existing Norwegian tax system had become too strongly progressive, especially as a result of the continuous decline in the value of money. It recommended a shift of emphasis toward indirect taxation and specifically in the form of a value-added tax.[3] Compensating measures in favour of low income groups and large families were also recommended.

157. In his Budget Speech of 18th March, 1968, the British Chancellor of the Exchequer, Mr. R. Jenkins, mentioned various reasons for his regarding indirect taxation as the most appropriate source for additional government revenue. He pointed out the detrimental effect, amongst other things, on effort and initiative of high direct taxation, the obvious preference of the public for additional taxation levied by means of an impost on the sales price of goods to taxation by means of deductions from income, and the choice which indirect taxation, to some extent, leaves the public to spend or to save.

158. In Canada, the Carter Commission,[4] in spite of preferring income tax to a sales tax because the former is better able to fulfil the criterion of ability to pay, has regarded the increase in tax rates which would be necessary to obtain sufficient revenue in the absence of a sales tax as unacceptable. Moreover, a sales tax can be so designed that it is virtually not regressive in its effect.

PREVIOUS RECOMMENDATIONS AND STATEMENTS CONCERNING SALES TAXATION

159. On more than one occasion South African Ministers of Finance have declared themselves in favour of the introduction of a sales tax. Such statements can, for example, be found in the Budget Speeches of 1951/52 and 1965/66, which have already been referred to in par. 40. In his 1952/53 Budget Speech, the Minister referred to a sales tax as a source

[1] *Taxation in New Zealand.* Report of the Taxation Review Committee. (Chairman: W. N. Ross) Wellington, New Zealand, October 1967, Chapter 17.
[2] *Instilling fra Skattenkomitén av* 1966. (Chairman: O. R. Sandberg). Oslo, Norway, 1968, page 231 et seq.
[3] A brief exposition of the value-added tax appears in Appendix C.
[4] *Op. cit.*, Pt. V pp. 3-6.

of revenue in the following words: "Should our expenditure increase further in an extravagant manner, we shall perhaps be obliged to resort to a purchase or a sales tax."

160. The Borckenhagen Committee[5] found advantages in a sales tax and added that it should not be levied by a local authority but by a "higher authority". The Committee suggested, however, that should the authorities find merit in the investigation of the possibility of a sales tax, a special Committee or Commission should be appointed for this purpose.

161. The Schumann Commission[6] found that a sales tax held advantages as a source of finance for provincial services such as education, health and roads, in view of the large proportion of the population who did not contribute towards the defrayment of the costs. To insure uniformity, the tax would have to be levied by the Central Government and not by the provinces themselves. None of these reports discussed the form which such a sales tax should take or the concomitant administrative problems.

162. As early as 1964 the introduction of a sales tax was the subject of a preliminary study by the Department of Customs and Excise. After studying the systems of sales taxation in foreign countries and the particular circumstances which have to be taken into consideration in South Africa, the Department came to the conclusion that such a tax would have to be levied at an early stage of production and exchange (i.e. at the factory-import stage). In fact, the Customs and Excise Act of 1964 was designed, with respect to classification and value formulas, to allow for the introduction of a sales tax within the framework of the existing Act.

Evidence in Connection with the Merit and Form of a Sales Tax

163. The evidence submitted to the Commission by more than a dozen national industrial and professional organisations in respect of the nature and extent of a sales tax indicated a large measure of unanimity. Although a sales tax in whatever form was not exactly welcomed, the majority of witnesses would not oppose it if it should prove to be the only method of recouping the government revenue which had to be sacrificed by way of relief of direct taxation that was regarded as essential. One of the advantages ascribed to a sales tax was that it could be used during inflationary periods as a measure to restrain excessive consumption expenditure.

164. As regard the scope of the sales tax, all the witnesses favoured a selective impost. Some wanted to exclude only the necessities of life and industrial requirements; others advocated a tax on luxury goods only or on certain durable consumer goods. According to the relevant evidence, the arguments in favour of a broad base are that it enables the alleged excessive tax burden on certain excisable articles to be relieved, the rate of taxation to be kept low, and the discrimination among industries to

[5] *The Main Report of the Committee of Inquiry into the Financial Relations between the Central Government, the Provinces and Local Authorities.* (Chairman: G. L. F. Borckenhagen) 1966/67, pp. 93-95.

[6] *Report of the Commission of Inquiry into the Financial Relations between the Central Government and the Provinces.* (Chairman: C. G. W. Schumann), R.O. 35/1964.

be restricted to a minimum. Those who advocated a strongly selective tax only on luxury articles wanted the cost of living to be affected as little as possible.

165. In answer to the Commission's questionnaire (See Appendix B), more detailed evidence was received from organised Commerce, Industry, and Agriculture. This reveals a difference between Commerce and Industry with regard to the levying stage. Organised industry prefers the levy at the retail stage. Provision could then be made for tax-free sales to businesses through a system of registration of firms. The agricultural sector also regards the retail trade as the most appropriate assessment stage. Organised Commerce, on the other hand, prefers the levy at the source (i.e. the producer and importer), despite the concomitant disadvantage of the increased cost of financing taxed inventories. The commercial organisations regard this system as the simplest to administer because the number of collection points are considerably smaller and it is easier to provide for exceptions. The possible increase of the amount of the tax through successive profit mark-ups, the so-called escalation or profit-on-tax-problem, is not regarded as a significant disadvantage, since the vigorous competition which is a feature of Commerce at present would militate against it. Collection at the retail level would create special problems with regard to exemptions and tariff differentiation since, in practice, it would simply not be practicable to record the tax with every sales transaction separately.

166. Some representatives of the business world suggested, as an alternative, the value-added tax with the proviso that it be levied only as far as the wholesale stage.[7] The Republic's trade with Rhodesia, in which country the introduction of a value-added tax had been recommended, and the growing trade relations with countries of the European Economic Community were advanced as reasons.

167. Prominent officials in the Civil Service who were consulted by the Commission emphasised the problem of escalation as a result of levying at the source, especially in the case of well-known brand articles and other products in respect of which competition is allegedly not very lively. Furthermore, cost increases could arise from the greater need for working capital to finance taxed inventories, while transport costs would also increase should motor cars, which, apart from the effect of a sales tax, are already becoming more expensive as the local content increases, be included. With regard to the possible effect, on the demand for local industrial products, of a reduction in direct taxation coupled with the introduction of a sales tax, it was submitted to the Commission that some industries might indeed experience a reduced turnover, while others again could profit from it. The marketing problems of the textile industry were specifically brought to the attention of the Commission.

Overseas Experience with Regard to Sales Taxes

168. In the simpler type of economy indirect taxes have been the major source of government revenue for many years. This can be attributed to the comparative simplicity and unambiguous character of a fixed levy

[7] The Commission investigated this variant of the value-added tax, and came to the conclusion that it does not deserve recommendation. A brief exposition appears in Appendix C.

on the exchange of goods or the rendering of certain services. In the last few decades and especially during recent years, however, there has also been in developed countries a noticeable tendency to prefer the financing of the constantly growing public expenditure in greater measure from indirect taxation, and specifically because direct taxation has reached an unacceptable level at certain income brackets.

169. In the course of time a sales tax of some sort or another has been introduced in various countries, and the purpose of the periodic amendments which have been effected has usually been to prevent the relevant tax from adversely influencing production costs or to counter distortion of the production structure. In other words, the fiscal authority invariably endeavours to confine the incidence of the tax to consumption. The most sophisticated form of sales taxes is the so-called value-added tax, which was accepted by the European Economic Community as the uniform system of sales taxation for the six member countries, to elminate amongst other things, the obstacles impeding the reciprocal flow of goods and services. To maintain the competitive position of their exports to the E.E.C., the Scandinavian countries are now also switching over from their existing excise, factory, or retail taxes to the value-added tax. This consideration is of obvious importance in the choice of a sales tax for South Africa, especially if a common market with neighbouring countries is envisaged for the future.

170. The Commission carefully examined the systems of sales tax in Ireland, Canada, New Zealand, Great Britain and Rhodesia, especially with regard to the practical aspects of the various systems which have significance for South Africa. Cognisance was also taken of the recommendations put forward by recent Commissions of Inquiry in four of the abovementioned countries. A few of the important points which emerged from this survey can be briefly mentioned here.

171. The Irish retail sales tax leaves small businesses the option of exclusion from the collection net. In the case of exempt firms, the tax is then collected from their suppliers. In Rhodesia a retail sales tax is also in operation but there its functioning is not regarded as entirely satisfactory, partly because of the obligation which it places upon the retail trade to distinguish between taxed and exempted articles. The introduction of a value-added tax is at present being seriously considered.

172. In New Zealand, as has been reported in par. 156, the Ross Committee recommended the extension of the existing wholesale tax to all consumer goods and certain services. In addition, increased children's allowances and pensions were recommended to relieve the tax burden on low income groups. As regards the Canadian sales tax at the factory stage, problems of the valuation of goods for tax purposes can sometimes arise because producers charge buyers varying prices, depending on the service element included in the price. This is one reason why the Carter Commission recommended a switching over to the retail sales tax. A similar valuation problem is being experienced in Britain with the purchase tax (on wholesale values) but on a smaller scale, since the tax encompasses only about one-fifth of all consumption expenditure. The strongly selective character of this tax, however, creates classification problems.

The Basis of a Sales Tax

173. Because the aim of a sales tax is to tax *domestic* consumption, goods which are exported as well as those which are used as inputs in the production process, i.e. intermediate goods and farming requirements, will have to be exempted.[8] For obvious practical reasons, those consumer goods and services which are not handled by the usual distribution channels would not be taxable. This means that, amongst other things, products which are consumed directly on farms owned by Whites and in Bantu areas would be tax-free. As regards the latter group, the implication is that the poorest section of the population would be favoured.

174. The total consumption which is realised via the market mechanism could serve as a possible tax base. In this case a uniform tax on all sales to consumers could be levied, which would present the private sector and the fiscal authority with no significant administrative problems. The tariff which would be required to provide the Treasury with a given revenue would also be low. It is felt, however, that at least certain basic necessities of life should be excluded from the tax base. Equity considerations also require that the tax, if it cannot be made progressive, does not place a relatively greater burden on the lower income groups than on the higher income groups, and that as far as possible it should exact only proportional amounts from various income groups.

175. With a view to placing the smallest extra burden on those who receive low wages in the community and to obtaining as large a proportion of the total tax revenue as possible from persons in the higher income groups, the Commission decided to exempt completely, with a few exceptions, all those expenditure items which constitute a comparatively large portion of the expenditure of the lower income groups. These are, amongst other things, food, rent, instalments on houses, insurance, repair and maintenance costs of houses, water, sanitary services and the removal of rubbish, fuel and light, clothing, footwear, and accessories. White families who earn less than R2,000 per year spend proportionately more than twice as much on these items as families with an income of more than R8,000. The first-mentioned groups spend 64.2 per cent of the family budget on these items as against 30.3 per cent spent by the latter group. As regards the expenditure pattern of the Bantu, it was found in a survey in the Port Elizabeth/Uitenhage area that no less than 70.7 per cent of the expenditure of the average Bantu family was on the above-mentioned items.[9]

176. Any increase in the cost of living which might arise from the tax on the remaining portion of consumption expenditure would be minimal and, as an argument in support of claims for higher wages, it would have little impact, as is explained in paragraphs 198-200.

177. Goods which are already subject to excise duty also deserve consideration. In the case of the traditional excisable goods, it is not considered advisable to superimpose a sales tax on the existing excise

[8] As has already been mentioned, the Commission does not wish to exclude the possibility of levying the relevant tax on capital goods, should it become necessary for revenue purposes. Especially on leased capital goods or on assets which can be written off over many years, a sales tax which would have only a very small effect on production costs could be levied.

[9] *Income and Expenditure Patterns of Urban Bantu Households* (Port Elizabeth/Uitenhage Survey) Research Report No. 17, 1967, Bureau for Market Research, University of South Africa.

duty. This would involve additional administration and would cause further distortion of the production structure. Where the excise duty is relatively low, however, a further contribution might well be possible, but not necessarily through the levying of a sales tax over and above the excise duty. Because of the administrative complexity of the excise system, a measure of discretion in handling this problem will have to be left to the Department of Customs and Excise.

178. In the light of the foregoing, the Commission recommends *that the private domestic consumption, with the exception of food, clothing, footwear, cost of housing, certain health expenditures and certain excisable goods, be the basis of the sales tax.*

SALES TAX SYSTEMS CONSIDERED BY THE COMMISSION

179. Apart from the evidence elicited on the principle of introducing a sales tax in South Africa, the Commission paid special attention to the manner of implementation and application. As has been mentioned in par. 165, a questionnaire was sent to a few national organisations, and Profs. Reynders and Pistorius were specially commissioned to investigate the practical problems of a sales tax at the retail level. (See Appendix D). At the request of the Commission, the Bureau of Statistics also kindly compiled detailed tables with regard to the structure of the retail trade and the expenditure categories in the family budget survey. The latter information was used to study the distribution of the total tax burden (including income tax) in respect of the different expenditure items and income groups with a view to achieving an equitable tax system. Administrative aspects of alternative systems of sales taxation were also discussed with, and studied by, senior officials of the Department of Inland Revenue and the Department of Customs and Excise.

180. The different types of sales taxes are distinguished according to the stage in the production-distribution process at which they are levied. A single-stage tax can be levied at the source (factory, farmer, or importer), the wholesale stage, or the retail stage. A multi-stage sales tax, on the other hand, can be levied at two or more stages. The tax can be either *cumulative* by nature, that is, the tax is calculated on the price at each successive stage, including the tax paid in the previous stage (the so-called cascade system), or it can be levied on a *net* basis, that is, only the *value-added* is taxed at each successive stage (the so-called value-added tax). A sales tax could thus assume the following forms—

(*a*) an extension of the list of goods included under the existing excise system;

(*b*) a sales tax on specific goods at one of the following three stages, viz. (i) production/import, or (ii) wholesale trade or (iii) retail trade;

(*c*) a tax on turnover, with or without exemptions, at any one of the above three stages, which can under certain conditions correspond with system (*b*);

(*d*) a two-tier system, consisting of a sales tax on specific goods at the production/import stage together with a comprehensive turnover tax at a low tariff at the retail stage;

(*e*) a value-added tax which is levied at all stages or only at the production/import and wholesale stage.

181. A clear distinction must be made here between (1) a tax on a commodity basis, such as system (*a*), (*b*) and the first part of (*d*), and (2) a tax on a turnover basis, such as (*c*), the second part of (*d*), and (*e*). This distinction has important administrative implications because a tax on a commodity basis, which is thus related to excise duties, requires a very different administrative approach, viz. that of the Department of Customs and Excise, compared to a tax on a turnover basis, which, administratively, is related to company taxation and thus resorts rather with the Department of Inland Revenue. These matters shall be reverted to later in the discussion of individual systems.

182. The Commission is not in favour of an extension of the existing excise system. Its objections to this system are, amongst other things, the administrative complications involved, the narrow base which it would probably involve, and the potential further distortion of the production structure.

183. Neither can the Commission support a suggestion put forward that a sales tax assessed at the wholesale stage be introduced. Its main objection to this system is that a large and growing proportion of consumer goods are not handled by ordinary wholesale concerns so that an effective system would in any case have to include producers who sell direct to retailers.

184. As regards a value-added tax, it would appear, as far as the Commission is able to judge at this juncture, that the advantages which it offers over the other systems would not at present compensate for the higher administrative costs which it involves. Since South Africa has not had any practical experience of a sales tax, it would be advisable to start with a reasonably simple system. In Europe the value-added tax was introduced after the administrations concerned had already gained experience of less sophisticated systems.

185. Consequently the Commission found that a meaningful comparison between alternative forms could be limited to that between a First Stage Selective Sales Tax and a Retail Turnover Tax. *The First Stage Selective Sales Tax* (referred to after this as a selective sales tax) is levied at the production/import stage in respect of a limited number of goods which are selected in such a way that they are unlikely to be used, or used only to a small extent as production goods by businesses. In this way the problem of distinguishing between goods destined for final consumption and the so-called intermediate goods which are subjected to further processing is eliminated to a considerable extent. Goods destined for export would obviously be exempted from the tax, since the aim is, after all, to draw only local consumption into the tax net.

186. *A Retail Turnover Tax* (referred to after this as a turnover tax) is a tax on the turnover of goods which are delivered to the public for final consumption. Producers and wholesalers who participate in this process would also be involved. The basis of the tax is—

(i) the turnover of retailers (including pharmacies, garages, and petrol stations) minus their sales of producer goods, exports, and certain exempted consumption articles (human and animal food, medicine on prescription, orthopaedic articles, spectacles and related goods);

(ii) the sale of non-exempt consumer goods to the public by producers and wholesalers who, in this respect, thus fulfil a retail function.

Criteria Involved in the Choice of a Sales Tax for South Africa

187. The sales tax which, in the judgment of the Commission, merits careful consideration is the selective sales tax. The Commission attempted to examine the operation of this kind of sales tax in the light of a few criteria.

Administrative Efficiency

188. Administrative considerations played a very important part in the Commission's recommendations with regard to the form of a sales tax. It goes without saying that the introduction of such a new tax requires that the fiscal authority does not underestimate the nature and extent of the administrative problems which can crop up in practice. One aspect, for example, is the number of people who would be required in the public and private sector to administer the new tax.

189. As a result of the comparatively small number of tax points and the possibility of exempting as far as possible, through judicious selection, goods which serve as inputs, the administrative costs of a selective sales tax would be much lower than that of a turnover tax. The Department of Customs and Excise, under which the administration of the former tax would resort, estimated that about 70 additional staff units would be required. The much larger number of collection points in the case of a turnover tax and the poorer quality of the records of some retailers would have brought about higher administrative costs and problems. A turnover tax would be integrated with the activities of the Department of Inland Revenue, and that Department considers that about 240 additional staff units would be required for this purpose.

190. The Commission made contact with the Department of Inland Revenue of Canada with regard to the administrative aspects of a sales tax at the source because the Department concerned has already had about fifty years of experience of what is known there as a "manufacturer's sales tax". According to this Department, the low cost of collection is indeed the main attraction of this particular form of tax collection. At present the Department concerned collects \$2.4 billion under this heading at a minimal cost.

191. In the case of the selective sales tax, only luxury goods and less essential consumer goods could be included. In this way a degree of progression in the incidence of this tax can be achieved, or regression can at least be obviated. In the case of the turnover tax, selection results in serious administrative problems and high costs. Without selection the latter tax would be regressive. Even if great care were taken to include only consumer goods, this would not prevent inputs from being affected to some extent by the selective sales tax. To exempt such goods altogether would demand a very high standard of administration or otherwise would diminish the tax base considerably, with resulting higher rates. Because of the early stage of collection unconditional exemption can only be granted according to the nature (and not to the use) of the goods.

192. As a result of the early stage of assessment in the case of the selective sales tax and the widely differing practices which manufacturers follow in the pricing of products, difficulties arise with regard to the basis of calculation of the value for tax purposes. These problems do not arise

in the case of the turnover tax because the actual retail prices represent a reasonably neutral value basis for tax assessment.

193. The selective sales tax would fit in more easily than the turnover tax with the Republic's existing financial arrangements with Botswana, Lesotho and Swaziland (countries with which the Republic is associated in a customs union) and with South West Africa and the Transkei.

194. As in the case of excise duties, the selective sales tax would give rise to problems, which would have to be ironed out, in connection with the prices of goods which have already passed the levying point and are in the distribution channel when the tax is introduced, amended, or abrogated. The only solution would be to allow traders to increase the prices of such goods immediately in the case of an increase of rates together with the requirement that prices also be immediately lowered in the case of a reduction of rates.

195. The total administrative costs of the *private sector* should be much smaller under the selective sales tax than under the turnover tax because considerably fewer firms are involved. Evidence submitted to the Commission and the special investigation already referred to, undertaken by experts, instructed by the Commission, confirmed that the turnover tax had very serious administrative implications for Commerce should exemptions or tariff differentiation have to be fitted in. Given the administrative experience, capabilities, and facilities of many retailers, it would not be possible in practice to enforce separate bookkeeping, invoicing, and handling of taxed and untaxed goods, and the tax records would be of doubtful value. The exemption of certain goods and certain groups of consumers would create almost insuperable problems even for the more specialised businesses and for the smaller concern it would involve a serious cost burden. In order to overcome the problems of the smaller firms the method of the Irish fiscal authority would have to be employed, viz. to tax the goods delivered to the former by wholesalers or manufacturers in the hands of the latter.

Influence on Prices

196. To the extent that it is shifted on to the final consumer, a selective sales tax would lead to an increase in the relevant consumer prices. In view of the customary percentage mark-up on purchase prices in determination of selling prices, an assessment at the production/import stage would tend to increase the amount of the tax slightly as the taxed article moves through the wholesale and retail trade channels. Let us assume, for example, that the price of a durable consumer article at the point of manufacture or import is R100 and that it is subjected to a 10 per cent levy. If the total profit margin in respect of this article between the first and the retail stage is 50 per cent, the final consumer would pay R150 for the article if no tax is levied at the source, and R165 if there is a 10 per cent levy at the source and the distributors also add to the price a profit margin of 50 per cent on the R10 tax. In other words an extra R5 is added to the price.

197. It would be difficult to say beforehand precisely what the price-increasing effect of the tax for every individual taxed product would be, because this would be determined largely by the nature and extent of competition in the relevant classes of products. The two extreme cases

are either a 100 per cent incidence or no incidence at all on the final consumer, but in practice the price-effect will probably lie somewhere between these two extremes.

198. In paragraphs 37-42 it has been submitted that a sales tax as a source of revenue has become necessary to compensate in part for the suggested income tax relief in respect of individuals. Income tax appears as an expenditure item in the family budget of the individual. Should considerable relief in respect of this item thus appear in his family budget, he would have no reason to complain if the cost of purchasing certain durable consumer goods which are also items in his family budget, increased slightly. In any case he would still be able to exercise a choice as to whether he wants to buy the taxed articles or not.

199. The Commission would like to emphasise that the change in prices arising from the introduction of a sales tax is a *once-and-for-all* effect, and that this price-effect would be the outcome of fiscal action and not of additional inflationary pressure in the economy. To base wage demands on such price increases would thus not be justified. This issue was discussed when the representatives of the employee organisations gave evidence before the Commission. Although these witnesses could not, of course, predict what the reaction of the workers of the Republic to the price-effect of a selective sales tax would be, they were of the opinion that the workers would adopt a responsible attitude if it could be explained to them that the influence of a sales tax on their family expenditure would be more than compensated for by relief in the burden of the existing income tax on their weekly or monthly earnings.

200. In recapitulation it can be said that the effect which this tax would have on the consumer price index is related to the rate at which the tax is levied and the share of the taxable items in total consumption expenditure. Should the tax be levied at a rate of (say) 10 per cent on all durable consumer goods, which constitute about 13 per cent of consumption expenditure, it would imply that the consumer price index would increase once-and-for-all by about 1.3 per cent. However, since the suggested tax would not be applicable to all durable consumer goods but only to the items of a more luxurious nature, the price-increasing effect would in all probability be smaller.

Influence on the Production Structure

201. By levying a selective sales tax on luxuries and less essential goods, the pattern of consumption is affected and consequently also the production structure which is derived from this consumption. In relation to other sectors the flow of economic resources to those sectors which are taxed, or taxed more highly than the rest, is restricted. The Commission would, however, like to emphasise that the aim in the selection of taxable goods is precisely to effect an equitable distribution of the tax burden. Luxury and less essential goods are thus included in the tax base because they have a comparatively small influence on the family budgets of the lower income groups.

202. After careful consideration of the above aspects, the Commission came to the conclusion *that a selective sales tax is the most appropriate system of sales taxation for South Africa.*

VALUE-ADDED TAX

203. The Commission also gave some attention to the value-added tax. This system avoids the disadvantages of the selective sales tax, but, industrial inputs apart, exemptions cannot easily be fitted into such a system. Because of the great administrative demands made by the value-added tax, it can be considered for practical application only at a stage when Commerce and Industry, as well as the fiscal authorities, are capable of handling it.

204. The Commission is aware of the fact that a transition from the selective sales tax, which rests on a commodity basis, to a value-added tax, which is essentially a turnover tax, implies important administrative changes. It is felt, nevertheless, that the value-added tax merits further study.

THE ADMINISTRATION AND IMPLEMENTATION OF THE SELECTIVE SALES TAX

205. Although the Commission does not wish to pronounce on all the administrative details of the suggested tax, it would like to draw attention to certain aspects.

Rebates

206. The ideal would have been to grant no rebates (i.e. conditional exemptions) at all, because one rebate might lead to another, and the basis of the tax might soon be eroded to such an extent that rates would have to be increased or more essential goods included in order to provide the necessary revenue. The administration also becomes more difficult and more expensive.

207. Indeed, the experience of other countries shows that those classes of goods in respect of which rebates are insisted upon should rather be exempted unconditionally from the tax (circumstances permitting) or be subjected to a low tariff. Only in the most urgent cases should rebates to avoid double taxation be considered.

Graduation of Rates

208. In view of the requirements of equity, a graduation of the rates of taxation is desirable. Experience elsewhere, however, indicates that rates should be restricted both as regards number and level, in order to avoid problems of substitution among products and tax evasion.

Value of Locally Produced Goods

209. Taxable value for the purpose of a selective sales tax should be considered against the background of the policy of price determination followed by manufacturers. As in other industrialised countries conditions of imperfect competition are being experienced in South Africa.[10]

[10] Prevailing price determination policies in the U.S.A. are described by W. J. Schultz as follows:— "Most American manufacturers operate under circumstances of quasi-monopoly. Hence they have considerable freedom to utilise varying techniques of pricing, to set multiple prices for particular items, to apply or not to apply 'single pricing', to set different prices for different classes of customers, to establish various kinds of discounts, to treat shipping costs in varying ways, and to apply resale price maintenance if that enters into their pricing." William J. Schultz: *Outline of Marketing*, p. 141. Littlefield, Adams & Co., New Jersey, 1964.

210. The actual prices of manufactured goods cannot be regarded, without further consideration, as an appropriate basis for the levying of a sales tax. For the purpose of determining the value base for the latter, the prices in the open market between two unassociated businesses should serve as a basis.

211. The Commission, therefore, recommends that *the value of the goods at the point of manufacture be derived from the cash price f.o.r. negotiated in the open market between a manufacturer and a wholesaler who are completely independent of each other, i.e. at arm's length, with the exclusion of quantity and trade discounts but including any excise duty which might be payable.*

Value of Imported Goods

212. The levying of a contra duty[11] on imported goods subject to the selective sales tax requires that the value of such goods be determined free-on-board at the port of entry and inclusive of customs duty. The starting point for the determination of value for purposes of customs duty is the free-on-board value in the country of origin, to which must be added the freight, insurance, wharfage, and other fees payable between the two points. Not only may the determination of the separate amounts be cumbersome but any mistake discovered later on would affect the amount of the tax.

213. A sales tax also burdens local manufacturers with additional administrative costs which do not affect importers, for example, additional returns and bookkeeping in respect of the materials, processes, and products involved in manufacturing. As has been mentioned in par. 211, quantity and trade discounts with regard to locally manufactured goods cannot be permitted.

214. Although the amount cannot be accurately calculated, freight, insurance, wharfage and clearance duties alone already amount, on the average, to more than 12 per cent of the free-on-board price of all imports. The Commission recommends *that an equitable contra duty on taxed goods which are imported be calculated on the basis of the customs value of the goods plus a reasonable cost mark-up plus customs duty.*

Choice of Commodities and Rates of Taxation

215. The Commission did not find it feasible to provide a final answer in connection with the consumption items to which the tax should apply and the precise rate at which each should be taxed. The Department of Customs and Excise has the necessary expertise which is required in this connection. The Commission, however, ascertained through the use of control data that it would be possible, within the limits set by the conditions mentioned below, to obtain the government revenue required.

216. The most important consideration in connection with a selective sales tax is to build into it the greatest measure of progressivity possible through a selection of the commodities as well as rate differentiation. The burden of the tax on the less privileged must be kept low by exempting food and clothing and taxing other necessities at a reasonable rate, as has been mentioned in par. 175. Less essential goods which are bought mainly by the well-to-do, can be taxed at a higher rate.

[11] I.e. a duty similar to that applicable to domestically produced goods.

217. The Commission recommends *that in the choice of commodities the expenditure pattern of Whites as well as non-Whites be taken into consideration.*

218. Where the intermediate use of goods predominates, exemption of the whole class of goods is preferable to rebates. As regards traditionally excisable goods it has already been pointed out in par. 177 that, as a general principle, these goods should not be involved in a sales tax. Two taxes on the same product would also result in extra work and expense for the government departments and manufacturers. The other group of excisable articles, such as motor cars in the case of which the excise duty is much lower, does, however, deserve consideration. Economic considerations render it advisable to substitute a higher sales tax for the excise duty, should administrative circumstances permit; otherwise a sales tax superimposed on the existing excise duty would be permissible.

Putting the Tax into Operation

219. The Commission is of the opinion that the disruption of Commerce, through the movement of inventories and imprudent purchases by consumers in expectation of the introduction of a sales tax, could be largely avoided by making the first announcement in the budget speech and enforcing the tax immediately, which can indeed be contrived by virtue of the Customs and Excise Act.

Effect on Neighbouring and Enclave Areas

220. The 1910 Customs Union Agreement between South Africa, Botswana, Lesotho, and Swaziland provides for the free reciprocal exchange of imported and locally manufactured goods and a common outside tariff. The levying of an additional indirect tax on commodities by only one of the member countries would disturb the trade among the four member countries and create considerable administrative problems. The Commission is of the opinion that before the introduction of the tax it would have to be agreed in principle with the other members of the Customs union that the tax shall be applied in all four countries. Details in connection with the distribution of the revenue can be worked out after the tax has been put into operation.

221. Prior notification to South-West Africa would also be advisable since a portion of the customs and excise duties is paid to the territory. The determining of the relevant share due to the territory could, however, be undertaken after the tax has been put into operation. With regard to the Transkei no identified amount of customs and excise duties is transferred, and there is therefore no need for special advance notification.

CHAPTER IV

TAXATION OF CAPITAL GAINS

THE TAX LIABILITY IN RESPECT OF CAPITAL GAINS IN THE REPUBLIC—THE PRESENT POSITION

222. According to the wording of Section 1 (xi) of the Republic's Income Tax Act (Act 58 of 1962), the ordinary taxpayer, who may be an individual or a company, could draw the conclusion that it is not the intention of the legislator that he should pay normal income tax on "capital gains". This section declares that only receipts or accruals *which are not of a capital nature* should be regarded as "gross income" and are thus subject to normal taxation.

223. In practice, however, the taxpayer would not be able to depend on such a literal interpretation of the words "which are not of a capital nature". He would also certainly have to take note of the interpretation which the South African courts have given to the wording of the relevant section.

224. The attitude of the South African courts in respect of capital gains is based on the interpretation which the British courts have given of the British Income Tax Act. According to the British approach there are many forms of profit, especially fortuitous profits or accruals, which are not subject to taxation because they do not form part of the proceeds which are normally associated with a trade or occupation. Such profits are known in common parlance as "capital gains" in order to distinguish them from "income gains". In English Law the only real test, as will become evident later, is whether the gain constitutes earnings or proceeds from a trade or not.

225. The reason for this narrow approach to the fiscal income concept is that under the British Income Tax Act, taxation is not levied on the total income but on different components which are classified under so-called "schedules", the sum of these different "schedular incomes" comprising the total income. Schedule D of the Act levies a tax on "the annual profit or gain arising or accruing . . . from any kind of property whatever—and from any trade, profession, employment or vocation. . . ."

226. Consequently, the British courts in their interpretation of this wording did not concern themselves so much with the general nature of "income" but rather with the determination of the nature of the annual profit or gain from a trade or an occupation. This limited approach in British court decisions was summarised as follows in the report of the *1920 Royal Commission on the Income Tax:* "Casual, non-recurring or occasional profits arising from transactions that do not form part of the ordinary business of the person who makes them are accordingly held not to be within the scope of the Income Tax, and consequently escape taxation."[1]

227. In the South African courts the following British court decision (California Copper Syndicate v. I.R.) also served as a basis:

[1] *Op. cit.*, Note 8, Section 85.

"It is quite a well-settled principle in dealing with questions of income tax, that where the owner of an ordinary investment chooses to realise it, and obtains a greater price for it than he originally acquired it at, the enhanced price is not profit in the sense of Schedule D of the Income Tax Act, 1842, assessable to income tax. But it is equally well established that enhanced values obtained from realisation or conversion of securities may be so assessable, where what is done is not merely a realisation or change of investment, *but an act done in what is truly the carrying out of business.*"[2]

228. In following the above and other British decisions the local courts employ a number of "tests" in order to determine the nature of a profit. These "tests", however, are none other than factors which have to be taken into account to determine the *intention* of the taxpayer and can all be referred back to the underlined section of the above quotation from the Copper Syndicate case. Should the taxpayer thus look and work for a profit in a calculated way, the relevant profit is of an income nature and thus subject to normal income tax. If not, it is of a capital nature and thus exempt from this tax.

229. Thus the current tax practice in South Africa is that the Secretary for Inland Revenue can subject an individual or company to normal taxation on profits made from the sale or exchange of shares and/or real property on the basis of the nature and scope of the relevant transactions.

230. With the increasing sophistication of investment practices as reflected by the establishment of unit trusts, subsidiary investment companies, the popularity of private placings of new share issues, etc., the dividing line between speculative and investment transactions drawn in particular cases by the Secretary for Inland Revenue is a matter which directly concerns a continually growing proportion of the general public. Investors are not only interested in the expected return on their shares and other investments but also in possible profits should they realise the assets.

231. In the oral and written evidence submitted to it, the Commission encountered many conflicting and divergent opinions in connection with the desirability of an extension of the scope of taxation on "capital gains". Nobody, however, argued that the existing levying of taxation on the transactions of speculators and/or traders in "capital assets" should be abolished. It was contended, however, that there is a considerable measure of uncertainty and even confusion among investors as to how far profits from the realisation of shares or real property during a particular year are taxable or not. The reason is that the determining of the intention and, consequently, the possible tax liability of the owner of the realised assets depends on all sorts of "tests" which have been developed in decided cases.

232. In the next section the points which served as background to the Commission's consideration of the desirability of an extension of tax liability in respect of "capital gains" will be further explained.

233. Before the Commission could formulate its recommendations with regard to a tax on capital gains it first had to investigate how the courts have interpreted the meaning of the concepts "capital" and "income".

[2] 41 Sec. L.T. p. 694.

234. From a study of the "tests" (as is explained in Appendix F) which the courts have used to determine intention, it appears that in due course a greater measure of clarity has been achieved in connection with the question of whether a profit is of a capital nature or not. It must also be remembered that the taxpayer's own statement about his intentions in purchasing an asset is not summarily accepted by the court. The burden of proof rests on the taxpayer, and he must convince the court on a balance of probability that his asserted intention is true.

235. The Commission thus wishes to recommend *that the existing legal position with regard to normal taxation on "capital gains" be maintained.*

Should the Scope of the Tax Liability in respect of "Capital Gains" in the Republic be extended to include also Transactions which are not Taxable according to Decided Cases?

236. The attitude which the fiscal authority should adopt in connection with capital gains is a subject which has enjoyed and still enjoys the attention of legislators, official commissions, and tax experts in a large number of countries. The present Commission also obtained much evidence in connection with the subject, and the most important aspects will be discussed later.

Magnitude of Tax-free Profits on certain Transactions

237. The attention of the Commission was drawn to the amount of the profit, during the past three years, on certain transactions, concerning which the taxpayer argued in each case that the profit was of a capital nature and should thus be exempt from taxation. Of these transactions the following are cited by way of illustration:

(i) A wealthy family and another business together obtained a number of city properties through several private companies. The properties were let on a profitable basis, and reserves were built up in the private companies. A few years later the shares in the private companies were sold to another investor at a price which exceeded the cost price of the shares by about R13 million.

(ii) A company which operated through various companies had a number of large buildings erected through these companies. The company established a new public company for the purpose of taking over the shares of the relevant companies which owned the buildings and, afterwards, offering shares to the public. The price at which the shares were sold to the public company realised a profit of approximately R4 million for the sellers.

(iii) A foreign company established a South African subsidiary company, with a paid-up share capital of R1 million, which bought shares in South African companies. Recently a portion of the shares were sold at a profit of R275,000. The remaining portion of the shares were sold to the foreign holding company at a profit of R1.6 million.

(iv) A group of private companies in the building sector established further companies from time to time for the purpose of owning office blocks which were erected, so it was contended, for investment purposes. The group recently established a new public company in order to take over the shares in the various property companies. The shares in the latter companies were sold to the public company at a profit of approximately R2 million.

(v) Through one of his private companies a taxpayer bought a piece of ground in a popular residential area for R60,000. Within a few years he sold the shares in the private company for R560,000.

Is a Tax on Capital Gains necessary in order to make the Tax System more Equitable; and if so, how wide should the Net be cast?

238. One of the most extensive inquiries into the capital gains question undertaken in recent times has been that of the Carter Commission to which reference has been made earlier in this report. That Commission was instructed to make recommendations for the reform of the Canadian tax system in order to effect greater equity in the system amongst other things. The views of the Commission are of importance to the South African legislator because the Canadian courts, for the same historic reasons as their counterparts in the Republic, have adopted the same point of view as the British courts in connection with the taxability of capital gains.

239. The Carter Commission summarily rejects the traditional approach that taxation should be levied only on "income" or components which may comprise "income". Instead, it recommends that taxation be levied upon the "annual changes in the economic power of each unit" or, to use its own terminology, upon the so-called "comprehensive tax base". This implies that all capital gains, whether of an isolated or a recurring nature, are automatically included in the tax base. The Carter Commission formulates its point of view as follows: "Adoption of the comprehensive tax base requires the taxation of not only income from property, but also 'capital' gains on the disposition of property. Almost everyone is familiar, at least in a general way, with the difference between 'income' and 'capital', even though the words seem to be incapable of precise definition. Capital is the source of income. By levying a tax on 'income' the distinction between the two concepts takes on great significance, for if the courts find a particular gain to be 'capital' the transaction is not now taxable. *There is an enormous incentive for the taxpayer to try to transform 'income' gains into 'capital' gains.* However, it is impossible to draw an unambiguous distinction between 'capital' gains and 'income' gains and the attempt to do so necessarily results in great uncertainty for the taxpayer because a particular transaction may or may not be found by the courts to fall on one side of the line or the other. After the most careful and exhaustive consideration of this complex question, we have arrived at the conclusion that the present distinction between kinds of gain is inconsistent with our concept of what we believe 'income' is for purposes of determining the individual's capacity to pay tax . . . A dollar gained through the sale of a share, bond or piece of real property bestows exactly the same economic power as a dollar gained through employment or operating a business."[3]

240. The Carter Commission argues further that equity and uniformity can only be obtained by taxing capital gains at exactly the same rate as the earnings from work or business activity. The Commission declares amongst others: "To tax the gain on the disposal of property more lightly than other kinds of gains, or not at all, would be grossly unfair . . . These radical reforms are advocated because equity can be achieved in no other way, because in our opinion there would be no

[3] *Op. cit.*, Part II, pp. 13-14. Own italics.

adverse economic effects through their adoption when combined with our other proposed changes, and because they would simplify the tax system and reduce uncertainty."[4]

241. The present Commission is not prepared to support the all-embracing approach advocated by the Carter Commission. In par. 235 it has been recommended that the existing legal position be maintained in respect of taxpayers whose "capital gains" are taxed as ordinary income.

242. Thus the question of what to do in connection with the capital gains of the rest of the taxpayers has not yet been resolved but, as will become evident later, a much less drastic course of action is recommended than that which is advocated by the Carter Commission.

243. The present Commission is of the opinion that in the interests of tax equity, amongst other things, and to combat tax avoidance, the time has arrived for the Republic to broaden its fiscal income concept through the introduction of a separate capital gains tax which, subject to certain conditions, would affect those taxpayers who are not at present taxed when they realise their negotiable securities or fixed property.

244. The present Commission does not, however, endorse the point of view advocated, for example, by the Carter Commission, that all capital gains should be taxed at the same rates as earnings from work or business activity and it *recommends accordingly*.

245. The recommendation of the present Commission is thus tantamount to adopting a middle course between the current system of taxation of profits from "capital transactions" in the Republic and the system which has for many years existed in the U.S.A.[5] and also since 1962, with extension in 1965, in the United Kingdom.

246. In the U.S.A. and the United Kingdom comprehensive systems of capital gains taxation are in operation. Short-term capital gains are taxed at normal income tax rates, while long-term capital gains (except in the case of British companies) are taxed at *special* rates. Capital losses can be carried forward and even partly set off against ordinary income. The American Act also provides a definition of a capital asset which is extremely complicated because of the many exceptions. On account of their far-reaching nature these systems cannot be adopted by the present Commission.

247. The comprehensive system in force in Sweden is also too drastic for South African conditions because (1) long-term transactions in fixed property are affected too heavily and (2) capital gains are included in normal taxable income.

[4] *Ibid.*, p. 14.

[5] Already in the *Revenue Act of* 1862 which introduced the first American income tax, the Act was made applicable to profits from the selling of fixed property and securities. The current American Act, which came into operation in 1913, does not specifically mention "capital gains" but right from the start this statute was interpreted in such a way that its scope also included such gains. This is evident, for example, from the judgment in the case of *Stratton's Independence v. Howbert* where it was stated: "income may be defined as a gain derived from capital, from labour, or from both combined, provided it be understood to include profit gained through the sale or conversion of capital assets". In the *Mercantile Loan and Trust Company v. Smietanka* case the court found that this principle should also apply in the case of an isolated sales transaction. According to the relevant judgment, there is " . . . no essential difference in the nature of the transaction or in the relation of the profit to the capital involved, whether the sale or conversion be a single, isolated transaction or one of many."

248. In respect of individuals, the scope of the German and French systems is somewhat limited, thus facilitating tax avoidance. A summary of the position in a few countries appears in Appendix E.

WHAT SORT OF CAPITAL GAINS TAX WOULD BEST SERVE THE COMMISSION'S AIM OF ACHIEVING GREATER EQUITY BY MEANS OF A BROADENING OF THE TAX STRUCTURE IN THE REPUBLIC?

Considerations underlying this Commission's Recommendations

249. In par. 243 the Commission supported the principle that a capital gains tax be introduced in the Republic because, in its opinion, such a tax would ensure greater equity in the existing tax system. In that paragraph the Commission has stated that the new tax should be levied only on two specific kinds of assets at special rates instead of the progressive normal tax rates. The Commission's preference for a capital gains tax which is limited in its scope and levied at a moderate rate is based upon the evidence obtained in connection with the possible effect of such a tax on the savings and investment decisions of the community, the share and property market, the investment activity of entrepreneurs, risk-taking, the foreign investment image of the country, administrative aspects, etc.

250. The most important points mentioned in the evidence and considered by the Commission can now be briefly discussed.

The Influence on Savings

251. Some witnesses asserted that the economic effect of a capital gains tax would be the same as expecting the community to consume a part of its wheat seed. It is true that a capital gains tax would reduce those realised capital gains of an *individual* which are higher than the proposed exemption limit (cf. par. 296) by an amount equivalent to the tax. Although for the individual concerned the command over funds would thus be slightly diminished, this does not mean that the real capital of the community would be affected. A community can only consume its real assets by neglecting its maintenance and replacement, as might, for example, happen during times of war. The continued creation of new real assets is mainly determined by the underlying productivity and profitability of the employed *assets* rather than by the market value of interests in businesses as represented by issued shares.

252. Although the proposed capital gains tax would thus result in a slight encroachment upon the enrichment or growth of the wealth of the individuals concerned, this effect is broadly compensated for by the Commission's recommendation in connection with a reduction in the present high marginal rates of income tax. Every income-tax payer, such as the salaried employee and the professional man, has to pay tax annually on that part of his salary or earnings which he saves, in other words, on the addition to his *capital* or wealth. The fact that the maintenance of the highest possible rates of individual saving is a necessary condition for economic growth in a young country was indeed one of the reasons why the Commission advocated a reduction of income tax rates in chapter II. Just as an income tax which is too high would undermine the ability of the ordinary public to save from current income, so might a capital gains tax which is *too high* have a similar effect.

253. It would, however, not be in the interest of the fiscus only to grant relief on the income tax level and not to introduce a capital gains tax at the same time. Should the latter tax not be introduced it would be tantamount to openly favouring those who are in the happy position of being able to transform taxable savings into untaxed capital appreciation because of their better knowledge and contacts. If capital gains are not also taxed, the system would permit a continuation of the present situation under which investors can increase their wealth through untaxed capital appreciation while the ordinary salaried man, who also wishes to build up his savings, first has to hand over part of his current earnings to the fiscal authority as income tax before he can employ his savings.

254. Under the existing system there is considerable scope for the *avoidance of tax liability* through schemes which, on the one hand, limit taxable income to a minimum and, on the other, aim at the maximum non-taxable capital appreciation. Shares in private companies, for example, are sold to public companies in order to pay out undistributed profits *tax free*. A well-known accountant testified before the Commission as follows: "Two or three years ago I would have opposed a capital gains tax, but I feel that at the present time the whole trend is towards converting income into capital gains. This is exhibited, for example, by the demand for equities showing a ridiculously low yield. Investment in equities is no longer predominantly a question of the protection of capital."

255. The argument was also adduced that the receiver of capital gains eventually pays tax in any case when the capital gains produce taxable income. This argument, however, does not hold good because too many instances are known of capital gains being simply ploughed back with the purpose of earning more capital gains. The argument that these profits would ultimately be assessed in the form of estate duty is sometimes merely cold comfort.

256. By way of recapitulation, it can be said that it is the considered opinion of the Commission that the modest capital gains tax which it proposes together with its proposals in connection with relief of the income tax on individuals would not harmfully effect the public's willingness to save. Some witnesses who are strongly opposed to a capital gains tax in its own right were prepared to recommend such a tax provided that it is coupled with considerable relief in the individual marginal tax rates. The proposed capital gains tax would meet the genuine long-term saver in various important ways because (1) only realised capital gains are taxable; (2) the tax rate diminishes as the assets are kept for longer periods; and (3) assets which are kept for 9 years and then realised are not subject to the new tax at all. In short, it would be the speculative rather than the investment element in capital transactions which would be taxed.

The Influence on Investment Portfolios

257. Several witnesses expressed the opinion that a tax on capital gains might lead to undue locking in of financial assets, i.e. that taxpayers might tend to postpone the realisation of assets. Such a course of action in turn might cause a disturbance of the market mechanism. An additional possibility which was mentioned is that a shift might take place from investment in shares to investment in fixed interest bearing assets.

258. It would appear to the Commission that the extent to which these possible side effects might arise would depend on the specific *form* of the capital gains tax. The recent introduction of a capital gains tax in the United Kingdom indeed led to many adjustment problems for the financial market in that country.

259. However, as is evident from par. 246 and will be evident from par. 307 (in which the details of this Commission's recommended tax are discussed) this Commission does not advocate such drastic tax reforms as those introduced by the British Government. In fact, much of the criticism of the idea of a capital gains tax in the Republic voiced by some witnesses was founded on the presumption that the present Commission might possibly recommend a system similar to that of the United Kingdom.

260. According to the scheme proposed by the present Commission, the tax would only come into operation on a given D-day. Assets which were obtained at any time before D-day would thus fall outside the scope of the new tax so that only a portion of the transactions on the Stock Exchange and in the property market would be affected by tax considerations. Valuation problems, uncertainty and inconvenience to investors who had been in possession of the relevant assets for many years, would be obviated. It is true, however, that taxpayers who obtained their assets before D-day would now have a once-and-for-all advantage over those who purchase similar assets after D-day. One method of overcoming this problem, as has been mentioned above, is to make the tax retroactive. The Commission, however, is not in favour of such a course of action.[6]

Influence on Investment and Risk-taking

261. Some witnesses were of the opinion that the Republic as a young, developing country was not yet ready for the introduction of a capital gains tax, because it would curb the flow of funds to risk-bearing ventures. It was also contended that long-term capital profits comprise both real and inflationary profits, i.e. paper profits. To draw these paper profits inside the tax net would be tantamount to a levy on the taxpayer's capital.

262. The Commission's proposed capital gains tax provided for the above objections in four ways, viz. (1) the set-off of capital losses against capital gains is recommended; and should capital losses exceed capital gains in a given year, then they can be carried forward; (2) expenditure on capital improvements is allowed as a deduction against the selling price of a capital asset; (3) the rate of taxation which is recommended is much lower than the rate payable by companies or individuals in the higher income groups on their taxable income; and (4) the profit from the sale of assets which have been held by the owner for a period of more than 9 years is exempt from the tax, and because the tax is levied at a diminishing rate, the "paper profit" element in the taxable amount will be correspondingly small.

263. Certain tax experts testified before the Commission that the introduction of a capital gains tax will not curb risk-taking because there would then be greater certainty among investors and entrepreneurs about the tax implications of new ventures which they undertake. At present

[6] The Carter Commission adopted the same attitude. It is stated in their Report that: "We have no intention that the taxation of property gains should be retroactive. Accordingly we propose that only gains accruing after the effective date of the legislation should be subject to taxation" . . . *Op cit.*, Part 1, p. 15.

it is difficult for an entrepreneur to determine *beforehand* his potential tax liability in respect of "capital gains" because the tests employed by the courts for this purpose are for the taxpayer rather vague. (cf. par. 228). Under the system which the Commission proposes, the present dividing line between taxation of "capital gains" at the full normal income tax rates and *no* tax liability, would be replaced by taxation of "capital gains" at the *full* rate or a *special* rate depending on whether the transaction was undertaken by a speculator or an ordinary investor.

264. The experience of the U.S.A. is often cited as proof that a capital gains tax does not curtail risk-taking. American entrepreneurs and investors have the reputation of being prepared to accept great risks despite the fact that capital gains have been regarded as part of taxable income by legislators and courts in the United States ever since 1862.

Effect on Non-Residents

265. A statement was made before the Commission to the effect that immigration and capital inflow from abroad would be adversely affected by a capital gains tax because the latter would harm South Africa's favourable "investment image".

266. The Commission would like to point out that capital gains taxes are already in operation in the most important countries from which South Africa draws investment funds. Provided that the total tax burden in South Africa is not higher than in other countries and that the necessary double taxation agreements exist, it is the yield before tax which would be of decisive importance. In the case of the majority of direct investments from abroad, income tax on companies and the non-resident shareholders' tax would remain the dominant fiscal factors, and the existence of a capital gains tax, especially in the form proposed by the Commission, would seldom be taken into account.

267. In any case it is not mere capital funds but entrepreneurial ability and skilled labour which are the scarcest factors of production in South Africa, and according to the evidence of a national body representing an important sector of industry, some immigrants are indeed deterred by the present high individual income tax rates. Thus any relief in individual income tax enabled, amongst others, by the use of taxation of capital gains as an additional source of revenue, can promote the economic development of South Africa.

Administrative Efficiency

268. Evidence was submitted that from the point of view of fiscal efficiency a capital gains tax is not to be recommended, because control by the fiscal authority would result in great costs while the revenue from the tax is uncertain and may initially be small. The Commission admits that it is difficult to estimate at all the amount of revenue which would accrue to the Treasury, but it is of the opinion that during times of high activity the accrual might be considerable.

269. From the available tax statistics concerning the U.S.A. it appears that the taxable income from the sale of capital assets by individuals (after allowing for capital losses) came to about $10 billion in 1965. This amount did not differ much from the taxable income of individuals in the form of dividends or interest which amounted to approximately $13 billion and $11 billion respectively.

270. As will become apparent later, the Commission attempted in its recommendations to limit administrative complications to a minimum through the restriction of the tax base and through certain exemptions which involve no essential inequities. The Commission also concluded from departmental evidence that the proposed system would be administratively manageable.

ALTERNATIVE PROPOSALS TO THE COMMISSION

271. On account of administrative problems foreseen by some witnesses in respect of, for example, the British type of capital gains tax, they recommended alternative methods of partly achieving the same result as aimed at by a capital gains tax. The following proposals were made to the Commission in this connection:

Overhauling of the Anti-avoidance Machinery

272. Witnesses were worried about the fact that under the present system certain taxpayers are able to transform profits which are essentially of an income nature into tax-free capital gains, as, for example, in the sale of shares in a company which had followed a conservative dividend policy in the past, thus yielding considerable capital gains partly represented by accumulated profits. It was further held that at present a substantial amount of revenue is being lost because profits realised by individuals, other than recognised dealers, on speculative transactions in shares and immovable property, are not assessed as taxable income while such profits obviously fall within the definition of gross income.

273. To prevent these avoidance practices, so it was argued, it is not necessary for the fiscal authority to resort to a capital gains tax. This authority should rather overhaul its administrative machinery. In this connection and especially with a view to surplus stripping, it was also proposed that section 103 of the Income Tax Act should be amended and extended in such a way that it could curtail tax avoidance to a greater degree than at present.

274. If note is taken of the recorded experience of the Canadian tax authorities with section 32A and a subsequent section (138A) of their Income Tax Act, it seems very unlikely that the relevant problem can be solved satisfactorily and permanently along these lines because taxpayers apparently always find loopholes through which tax liability can be avoided.

275. The Commission is satisfied that the above-mentioned forms of avoidance cannot be exercised in this way and that the introduction of a capital gains tax appear to be unavoidable.

Increase of Taxation on Share and Property Transactions

276. It was also suggested to the Commission that instead of the introducing of a capital gains tax, it would be better to increase transfer duties and stamp duties on transactions, while in the case of share transactions either the securities tax or the stamp duty which would then be paid by both the buyer and seller could be increased. The administration of such a system would be simple and could produce considerable revenue.

277. In support of the above proposal it was pointed out by some of the witnesses that the war-time fixed property profits tax led to tax avoidance and malpractices in the documentation of transactions.

278. The Commission would like to point out that its proposals in connection with a capital gains tax were not in the first instance intended merely as an additional source of revenue for the State, since it would be possible to achieve such an aim in an administratively simpler way. By its proposals, however, the Commission wished to remain within the limits of the enrichment principle as basis for the tax. This cannot be achieved by taxing the *total* transaction as such, irrespective of whether profits or losses are realised, i.e. irrespective of the measure of enrichment attained from the transaction. Moreover, such a levy would be tantamount to a tax on a particular type of economic activity.

The Abolition of Estate and Donation Taxes and the introduction of a Capital Gains Tax

279. Some of the witnesses suggested that estate and donation taxes be abolished and that a capital gains tax be introduced instead. In this way the tax system would be simplified while the revenue sacrificed by the abolition of one tax could be made up by the introduction of the other. It was also pointed out that the spendthrift who squanders his assets during his lifetime and leaves a small estate would be hit by a capital gains tax.

280. Against this, however, it was alleged that the two forms of taxation differ so fundamentally from each other that one cannot replace the other.

281. The Commission is of the opinion that an estate tax and a capital gains tax should not be regarded as alternative fiscal measures. The first-mentioned is a tax on the full amount of the property owned at death, while the latter tax is based only on the *profit content* of a transaction when the owner of an asset disposes of it so that it can be justifiably accepted by the tax collector as an increase of the owner's ability to pay.

282. The Commission's specific recommendations concerning the nature and scope of the tax on capital gains will now be set out.

Recommendations of the Commission

Taxpayers

283. An important matter which the Commission found necessary to consider was whether, for the purpose of taxation of capital gains, any distinction should be made between companies and individuals. Since the motives, decisions and actions of the company are in the final instance nothing but those of its managers and directors a distinction would (1) be an unreasonable discrimination against or in favour of a particular form of business enterprise, and (2) give rise to avoidance procedures.

284. The Commission regards a slight distinction between companies and individuals for administrative reasons as permissible, and its recommendations in par. 296 give effect to this.

285. The Commission thus recommends that *subject to the exemptions mentioned hereinafter, the tax be applicable to:* (1) *all persons, other than companies, who are ordinarily resident in the Republic or were ordinarily resident in the Republic during any part of the tax year in which the capital gain accrued to them;* (2) *all companies which are managed and controlled in the Republic; and* (3) *all other persons, including companies, who realise capital gains on assets situated in the Republic.* (The words *ordinarily resident* and *resident* shall have the same meaning as for purposes of normal taxation.)

Taxable Base

286. If a capital gains tax were to meet the objectives of neutrality in respect of the form of business enterprise, reduction of administrative uncertainties, points of dispute and avoidance possibilities, general equity, fiscal productivity, etc., it would appear that the base of the tax should be as comprehensive as possible. It would then include profits on marketable securities, immovable property, fixed movable assets and goodwill, and other similar invisible assets and advantages.

287. After careful consideration the Commission came to the conclusion that to exclude some of the above-mentioned assets would make no material difference to the above-mentioned aims and that there would be a greater measure of clarity about the scope of the tax should the base be limited to profits on the two more obvious assets, viz. immovable property and marketable securities.

288. Profits on current marketable assets such as stock in trade are already subject to normal taxation and are, for that reason and for the present purpose, not of any relevance.

289. It is conceded that theoretically capital gains can be made on movable fixed assets, such as machinery and equipment, when these assets are realised at an amount in excess of the original cost price. Such cases are regarded by the Commission as highly exceptional. More often a recoupment of written-off depreciation takes place, but such recovery is then also subject to normal taxation.

290. The Commission concedes that invisible assets and advantages of an enterprise (hereinafter referred to as goodwill) may constitute a significant portion of the selling price of that enterprise. Neither can it be denied that the goodwill of a company is often essential in the valuation of the shares of the company and that profits on shares could thus actually include a profit on goodwill.

291. On the other hand the Commission is convinced that the phenomenon of goodwill as a separate identifiable asset for the purpose of the tax, would on a balance of probability be limited to the relatively smaller, non-company forms of enterprise and that its value would consequently be comparatively modest in amount. Goodwill, where it is relevant, usually builds up slowly in the course of time while the tax rate which is recommended here diminishes in the course of time. The net tax revenue from this source would thus tend to remain relatively limited as measured against the administrative effort which would be required to unravel the variety of goodwill arrangements. The Commission is also convinced that it is possible for the Secretary for Inland Revenue to effect suitable anti-avoidance measures if and when taxpayers use the exclusion of goodwill for avoidance purposes.

292. The Commission also considered the question whether the tax should be levied on *unrealised* appreciation in values. Because the taxpayer's ability to pay actually results from the realisation of the assets concerned, the Commission is of the opinion that inconvenience and inequity would probably be caused in a large number of cases should unrealised appreciation in values be made subject to the tax. Moreover, a tax on unrealised profits would raise almost insurmountable valuation problems.

293. The Commission thus recommends: *That the base of the tax be limited to capital gains from the realisation of—*

(1) *marketable securities and rights or options which in the case of their being exercised, imply the acquisition of marketable securities, rights, or options, or might lead thereto;* and

(2) *immovable property and rights or options which in the case of their being exercised, imply the acquisition of immovable property, rights, or options, or might lead thereto.*

Exclusion of certain Profits and Losses

294. In evidence submitted to the Commission a convincing case was made out for the exemption of profits realised on the only or main residence of a taxpayer. In order to effect administrative relief the Commission also regards it as desirable to exclude relatively insignificant transactions or to exempt profits up to a limited amount.

295. It is also regarded as feasible that transactions in certain fixed interest-bearing investments be excluded from consideration for purposes of the tax. In conformity with the existing position in respect of normal tax, the Commission finds it necessary to exclude capital gains from abroad.

296. The Commission therefore recommends *that there be excluded from the tax on capital gains—*

(1) *profits and losses which qualify for normal taxation;*

(2) *the realisation of property on which the taxpayer's only or main residence is situated and which is used by the taxpayer exclusively or mainly for residential purposes for himself or his wife or his dependent children;*

(3) (*a*) *should the aggregate gross proceeds from the realisation of taxable assets of a taxpayer, excluding a company, during a tax year not exceed the amount of R2,000, all capital gains and capital losses from such realisations, unless the taxpayer can prove to the satisfaction of the Secretary for Inland Revenue that his capital losses, after the setting off of capital gains, exceed during the tax year the amount of R1,000;*

(*b*) *should the aggregate gross proceeds from the realisation of taxable assets of a taxpayer, excluding a company, during a tax year exceed the amount of R2,000, such a portion of the taxable capital gain for the tax year as does not exceed R1,000;*

(4) *the realisation of securities and debentures issued by the State, Local Authorities and other non-profitseeking organisations which are specifically exempted from normal taxation;*

(5) *the realisation of assets situated outside the Republic;* and

(6) *the transfer of a business concern by a foreign parent company to a South African subsidiary company, should the provisions of section* 28 bis *of the Income Tax Act* (58 *of* 1962) *be applicable to the company.*

Other possible Exemptions and Exclusions considered by the Commission

297. The Commission considered a proposal that the taxable capital gain which might arise from the realisation of immovable property which is used for business purposes should be set off against the cost price of a replacement asset of the same class and serving the same purpose as the realised asset.

298. Although the Commission is not unsympathetic towards the principles of this proposal, it is of the opinion that—

(*a*) such a concession becomes less urgent if the taxable amount, as proposed, tapers off to zero within a relatively short period of nine years; and

(*b*) although the tax involved in this regard would be relatively insignificant, a large number of special cases would have to be considered from time to time and, consequently, the administrative effort would be out of proportion to the object which is to be attained.

299. The Commission therefore does not deem it necessary to make any recommendations in this respect.

300. It was also submitted to the Commission that an amount of up to R20,000 be excluded from the taxable capital gain when an individual, because of poor health or on reaching the normal retirement age, realises assets which have been his main source of income for a period of at least five years. It was contended that such an arrangement exists in the United Kingdom and that such a concession could even be granted as an alternative to the partial exemption of lump sum benefits from pension and provident funds.

301. The Commission finds a degree of merit in this proposal but for the same reasons as mentioned above, it did not regard it as necessary to make any recommendations in this respect.

Definition of the Concepts "Realised Gains and Losses"

302. The Commission deems it desirable to explain the interpretation which it attaches to the words *realised gains and losses,* because assets can be acquired and disposed of in different ways.

303. By *realisation* is meant full or partial surrender of ownership or future or potential ownership through sale or exchange for a consideration, but it does not include donations and it also excludes dispositions in terms of a will or rules of succession at the death of the predecessor.

304. In the determining of *gain* or *loss* it would obviously be necessary to reduce the proceeds of sale or the market value of the consideration in respect of exchange, by

(*a*) (i) the pure cost price of the asset; if the asset is acquired in a way other than through sale or exchange, the pure "cost price" should be the fair market value of the asset at the time it is acquired;

(ii) additional expenses incurred in connection with the acquisition of the asset such as transfer duties, transfer fees, commission, broker's fees and expenses of a similar nature, which are regarded as essential to establish or defend the title in respect of the asset or the right thereto; and

(iii) expenses incurred with the object of improving the asset or of increasing its value, and the cost of such improvements of or additions to the asset shall *mutatis mutandis* be determined in the same way as the pure cost price of the asset;

(*b*) expenses incurred which are regarded as essential to owning or retaining the asset, such as property taxes, interest on bonds and other expenses of a similar nature unless such expenses are regarded as an allowable deduction for normal tax purposes or unless such expenses are of a private or domestic nature; and

(*c*) expenses incurred in order to realise the asset, such as valuation costs, advertisements, surveying costs, sales commission and expenses of a similar nature.

305. If the proceeds from the realisation of an asset or the market value of the quid pro quo exceeds the costs in (*a*), (*b*) and (*c*) above, the surplus would represent a capital gain, and should it be smaller the deficit would represent a capital loss.

306. The Commission regards it as essential that all its recommendations in connection with the tax on capital gains should be read together with and be regarded as subject to the meaning of *realised gains* or *losses* as it has been explained above.

Tax Rate

307. In view of the Commission's recommendations that only realised gains and losses be considered for the tax on capital gains, it is admitted that realisation may take place a few years after acquisition and that the levying of taxation on gains in one year could be of doubtful equity. The Commission was also impressed although not convinced by a point of view that the longer the asset is held the further it is removed from a mere speculation. It is thus deemed desirable to build a levelling effect into the tax. It was strongly argued before the Commission that a relatively high tax rate would have a discouraging effect on healthy risk-taking and that it would place an excessive burden on the small investor and consequently counteract a wider distribution of shareholding. Moreover, a relatively high rate could give rise to the tendency among taxpayers to postpone realisation unduly, which in itself might have an unhealthy effect on share and real property prices. In view of the foregoing it is recommended—

that a tax at a comparatively modest rate of 20 per cent be levied upon taxable capital gains and that a levelling off effect be obtained *by decreasing the capital gains to the percentages which are indicated below. If the asset is realised: more than 3 years but not more than 6 years after its acquisition: 66⅔ per cent of the capital gain; more than 6 years but not more than 9 years after its acquisition: 33⅓ per cent of the capital gain; more than 9 years after its acquisition : nil.*

Capital Losses

308. The Commision is aware that taxpayers may realise a capital loss in some tax years, and since the intention is not that such capital losses may be set off against normal taxable income, it is recommended with a view to consistency and equity that—

(i) *capital losses be determined in the same way as capital gains and be diminished in a similar way to the same percentages as above in order to obtain an assessed capital loss for a particular tax year;*

(ii) *assessed capital losses may be set off against capital gains, as diminished above, to obtain the taxable capital gain for a particular tax year;* and

(iii) *if the assessed capital losses together with the balance of assessed capital losses of previous years exceed the capital gains as diminished above, such new balance of capital losses may be carried forward to a subsequent tax year.*

Date on which the Tax becomes Effective

309. In almost all representations made to the Commission and in almost all evidence heard by the Commission it was emphasised that making the tax applicable to profits which are built up before the tax comes into effect should be avoided. The Commission found that this was a reasonable request and in keeping with the traditional policy in the Republic of, as far as possible, not resorting to retroactive tax measures. The obvious way to attain this purpose would be to recommend a valuation of all marketable securities and immovable property. Although such a procedure would raise no fundamental problems for quoted securities and would, in fact, probably have the most equitable effect, the Commission found that the valuation of other assets, especially immovable property, would be impracticable in view of the time and cost which it would involve. The Commission is of the opinion that the only way in which a retroactive tax can be avoided is to recommend, as it here does, that—

(i) *the tax be applicable only to capital gains from the realisation of assets (recommended in the tax base) acquired during a period with effect from the date on which the announcement in connection with the intended introduction of a tax on capital gains is made in Parliament;* and

(ii) *where certain assets are acquired before the above-mentioned date and other assets of identical class acquired on or after the date, the last-in-first-out method be followed in the case of the realisation of a portion of such assets.*

Exemptions

310. Apart from capital gains on certain assets which, according to the recommendations, ought to be excluded from the taxable base, the Commission admits that there may be valid grounds on which certain

persons, in the sense and meaning as intended in the normal income tax legislation, ought to be specifically exempted from normal taxation. The Commission is unanimous in the opinion that should valid grounds exist for such specific exemption from normal taxation, the same grounds should also extend to such persons specific exemption from taxation on capital gains.

311. The Commission thus recommends—
that persons, in the sense and meaning as intended in the normal income tax legislation, who specifically enjoy complete exemption from normal taxation also be exempted from the tax on capital gains.

Concluding Remarks

312. An evaluation of any tax viewed in isolation can easily lead to either condemnation or excessive commendation of the tax beyond the limits of the impact and purpose intended. The proposed tax on capital gains should be seen as part of a comprehensive arrangement in connection with a reformed tax system of which other parts are discussed elsewhere in the present report. When relief of normal taxation on earned income and profits which are not of a capital nature is recommended, it follows that a broader base will have to be sought in order to maintain the fiscal productivity of the system as a whole and to build equity into the system as a whole.

MINORITY REPORT BY MR. H. S. MABIN

Although my colleagues on the Commission have taken pains to produce a set of capital gains tax proposals which are designed to avoid retroactive operation, application to assets held for long-term investment purposes, or—to a limited extent—appplication to "gains" arising in the main from inflation only, it is regretted that I cannot associate myself with these proposals, and must recommend against their adoption.

The following arguments, among others, are advanced by myself against the imposition of a capital gains tax:

(1) *The Proposals are contrary to the Evidence*
The proposals run counter to the bulk of the evidence received by the Commission. Of 8 national organisations representative of the main segment of the private sector, 6 advised against the introduction of a capital gains tax. Only two of these organisations appeared to favour the principle of a capital gains tax.

(2) *Double Taxation*
The introduction of a capital gains tax will result in a considerable element of double taxation. The owner of a capital gain will in many cases invest his proceeds in some income-earning asset, and will be taxed by way of income tax upon the earnings from that asset. In many cases, too, the person or firm purchasing the securities or land (the sale of which gave rise to the capital gain) will earn income from the asset acquired, and will be taxed upon that income.
Indeed, the reason for an increase in the money value of a capital asset is usually an increase in the earning capacity of that asset. The matter was well put in the evidence received from one of the national organisations, who stated:

> "The Association feels that because capital is a factor of production which gives rise to income, and as the income is taxed, an impost on the capital also would impose a double contribution from the same source which would discourage saving and enterprise. The value of a capital asset is nothing other than the discounted value of the anticipated stream of income to which it is expected to give rise. A 'gain' involved in the sale of a capital asset implies the existence of an upward shift in these expectations which, if justified, would mean a larger stream of income in the future. This additional stream will attract additional tax and therefore the 'unearned gain' does not, over time, in fact, escape the net. If the anticipation proves unjustified, a capital loss is implied and the net effect on the wealth of the capital-owning sector of the economy is zero. Were the gain at time of sale of the asset to have been taxed, a cardinal principle of income taxation (i.e., that tax should not exceed income) would have been broken."

(3) *A Capital Gains Tax can prove to be a Tax on Capital*
The realisation of a capital gain makes no direct contribution to the gross domestic product. A capital gains tax is thus unrelated to the gross domestic product or its growth. In these

cases, the increased *money* value received for an asset upon realisation will not purchase an increased physical volume of similar assets, because the money values of all similar assets will have risen correspondingly. Contrary to the indications in the Report, therefore, a tax on so-called capital gains can thus, in fact, represent a tax on actual capital. A tax on capital would be a new concept in South Africa's Central Government fiscal policy—a concept which would require most careful consideration before being adopted, and consideration of a type which the present Commission has not had time or opportunity to devote to the matter.

(4) *Effect of a Capital Gains Tax upon Inflation*
Under inflationary conditions, when the market is by definition a seller's one, sellers of assets may successfully endeavour to raise the prices of such assets by amounts corresponding to the capital gains tax payable. This would tend to raise still further already high land values, and also the capitalisation of various business enterprises. Thus a further cost-push inflationary effect upon prices would be exercised. A capital gains tax is pro-cyclical, not anti-cyclical.

(5) *Discrimination against smaller Businesses*
The proposals of the Commission may tend to discriminate against younger or smaller businesses, in that a capital gains tax would tend to retard their further growth rate whereas their older or larger competitors have been able in past years to grow without being subjected to such taxation.

(6) *The proposed Tax will not eliminate the area of doubt between Capital and other Gains*
The introduction of a capital gains tax may open up disputes and possibly litigation in respect of transactions such as some carried on by investment dealing companies, which transactions may at present be subject to ordinary income tax, but which may then become the subject of claims for transference to the sphere of capital gains tax and thus taxation at lower rates.
The successful transference of such profits to the field of capital gains would, in addition, presumably produce a net loss for the Treasury.

(7) *Shortage of trained Staff*
Points such as that mentioned in the last paragraph, and other practical administrative difficulties, are likely to create a great deal of new work, to be undertaken against a background of serious shortage of appropriately trained, skilled personnel.

(8) *No assurance of Equity*
There is no assurance of equity; the proposed tax would become payable only upon realisation and realisation may be influenced by chance factors.

(9) *The Yield is unknown*
It is impossible to assess the revenue likely to result from the proposals. The proposals thus cannot be regarded as part of the Commission's plan to replace the losses expected to result from

the recommendations in regard to income tax on individuals. In fact, the capital gains tax proposals might over periods result in considerable Exchequer liabilities as a result of capital losses.

(10) *Agricultural Co-operatives*

The proposals can also be objected to on the grounds that, as worded, they would exempt agricultural co-operative organisations from liability to the tax, notwithstanding the fact that some such organisations, by reason of their exemption from income tax, have been able to build up assets more rapidly than competing non-co-operative businesses.

CONCLUSION

For reasons such as the above, my recommendation is that a capital gains tax should *not* be introduced.

CHAPTER V

TAXATION OF INTERCOMPANY DIVIDENDS[1]

Implications of the Commission's Tax Reform Proposals for the Company Sector[2]

313. It will be recalled that the various tax relief measures recommended by the Commission will result in an estimated overall revenue shortfall of R140 million (see par. 30). Under the Commission's proposals, R50 million of this amount will have to be raised in the company sector (see par. 43) and the balance by means of a sales tax. The nature of the proposed sales tax was discussed in Chapter III, and attention must now be focused on what changes are called for in the company sector.

314. The Commission is still engaged in a detailed study of all the complex aspects of company taxation, but it has come to the conclusion that a part of the additional revenue will have to be found by taxing a new source of income, viz. that part of the undistributed profits in the hands of public companies which at present escape tax liability. Owing to the nature and composition of the bulk of their profits, those public companies commonly designated as "financial companies" will be the principal source of the relevant tax receipts. It is believed that in a full tax year this new tax will yield about R15 million.

315. The imposition of this new tax means that the fiscal authorities will have to raise a further amount of approximately R35 million in order to balance their accounts. At this stage the Commission would like to point out that a relatively small upward adjustment of the normal company tax rate from its present level of 36¾ per cent would provide the fiscus with the necessary room to manoeuvre in seeking to achieve a balanced budget.

316. The rationale of the Commission's proposed tax on certain undistributed profits of public companies is that the fiscus is entitled to share in those intercompany dividends which the recipient companies do not pass on to the ultimate shareholders, and for this reason the dividends escape tax. Factual evidence on the nature of intercompany income flows (based on returns received from a representative sample of firms) will be cited in paragraphs 326-331 below. Of particular interest, in this connection, are the dividend declaration policies pursued and the final destination of dividends distributed by financial and investment companies. Before the details of the new tax measure are discussed, a brief resumé of the present system of company tax is called for.

The Taxation of Non-Mining Companies

(i) *Taxable Profits*

317. For taxation purposes a distinction is made between—

(*a*) public companies, which are companies in which the general public owns directly or indirectly more than 40 per cent of the

[1] Apart from intercompany dividends, the tax base will include net branch profits from abroad (cf. par. 335).

[2] The reservations of Mr. Mabin and Prof. Lombard follow immediately after this chapter.

ordinary shares if the shares are quoted, or more than 50 per cent if the shares are not quoted, and

(*b*) private companies, which are companies which do not qualify as public companies.

318. Both public and private companies are subject to *normal tax* at a rate of $36\frac{2}{3}$ per cent of taxable income. The addition of a repayable loan levy increases the effective rate at which taxable income of companies is transferred to the State to 40 per cent.

319. Subject to certain exemptions, private companies are liable to a *tax on undistributed profits* at a rate of 25 per cent of the amount by which distributable income (including dividends received) exceeds dividends paid over a period of twelve months, the latter terminating six months after the end of the company's financial year.

(ii) *Dividends*

320. Except in the case of certain dividends received from a "fixed property company" by a management company in property shares, companies are exempted from normal tax on dividends received. (Private companies in the Republic may, however, be liable for taxation at a rate of 25 per cent on dividends not distributed). Companies which are not registered in the Republic, or which do not do business here, and non-resident individuals are subject to a *non-resident shareholders tax* at a rate of 15 per cent (with certain exceptions) of dividends received from South African companies. Resident individuals are subject to normal tax on a maximum of two-thirds of net dividends received.

The Double Taxation of Company Profits and Dividends

321. A tax on company profits influences not only the amount regarded as available for distribution but also, in the final instance, the undistributed amount forming part of the shareholders' interest in the company. Acceptance of the company's and shareholders' joint interest in company profits is one of the reasons for the general international practice of providing, in one way or another, for concessions as regards company profits which are distributed. The concessions range from a lower rate of company tax on distributed profits, as in West Germany, to a complete or partial exemption of dividends in the hands of shareholders, as in the Republic, to a form of tax credit in the hands of shareholders, as in France.

322. In the evidence submitted to the Commission, the double taxation aspect of company profits (first at the source and then on dividends in the hands of individual shareholders) was repeatedly stressed. It is, however, a rather one-sided approach to hold that complete or partial exemption of normal tax on dividends should be granted because normal tax is levied at the source, if it is not conceded at the same time—

(i) that the level of the company rate is so determined that it is related to the potential tax payable on the undistributed portion of the company profits of tax paying companies; and

(ii) that the interposing of another company between the distribution company and its shareholders distorts the fiscal basis on which the company rate and the partial exemption of dividends is based unless such an intermediate company serves mainly as a conduit in so far as it distributes the major portion of the dividends it receives to its shareholders (in whose hands it is subject to normal taxation). In the event that it does not voluntarily perform this conduit function, it must be encouraged through appropriate measures to do so.

Criticism of the Current Tax System

323. It can be said that the current system of taxation of company profits measured against the requirements of a sound tax system, exhibits the following shortcomings:

(*a*) It is not reasonably neutral as regards the form of business enterprise especially in view of—

(i) the difference of 30 per cent in the maximum marginal rate applicable to the taxable income of companies (viz. $36\frac{2}{3}$ per cent) and that for taxpayers other than companies (viz. 66 per cent.);

(ii) the basis of differentiation in the classification of companies in public and private companies. A company in which no shareholder owns more than 2 per cent of the shares, is classified as a private company if it is registered as such under the Companies Act, while another company in which a single shareholder may own just under 50 per cent of the shares, or in the event of the company having an Exchange quotation, just under 60 per cent of the shares, can be classified as a public company; and, following from the above,

(iii) the absence of any statutory measure to induce a public company towards a reasonable distribution of profits, *especially in so far as the company itself did not have to pay tax on such profits.*

(*b*) Taxation of company profits is used for tax avoidance schemes on a far larger scale than that which can be regarded as equitable or reasonable for those taxpayers who for some professional and/or legal reason or other cannot employ the company form of business. Especially referred to here are:

(i) schemes by means of which accumulated profits of the company through a sale of shares effectively reach the hands of the shareholders but are not (as capital gains) subject to taxation at the appropriate normal tax rate;

(ii) the considerable difference of 30 per cent in the marginal rate of taxation of company profits as opposed to the profits of other forms of business enterprise;

(iii) the exemption of dividends in the hands of companies in so far as these dividends are not distributed to the taxpaying shareholder; and

(iv) certain loopholes in the Income Tax Act.

International Comparison

324. A study of the systems employed in a number of comparable countries, indicates that—

(*a*) the excessive retention of tax-free dividend income by companies is almost universally regarded as a problem;

(*b*) the measures employed to combat the problem of the excessive retention of dividend income by companies can be reduced to—

(i) the subjection of dividend income to normal taxation as in West Germany, the Netherlands, and as recommended by the Carter Commission, in Canada;

(ii) a withholding tax by the distributing company as in the United Kingdom;

(iii) the employment of a tax on undistributed profits with or without a concession with regard to normal tax on dividend income, as in the United States;

(*c*) the measures mentioned in (*b*) above are also applicable to public companies in a significant number of countries;

(*d*) the normal tax rates for companies in the Republic are relatively low, especially if the fact is taken into consideration that the basis for normal tax in the Republic does not include capital gains and that public companies are not subject to a tax on undistributed profits;

(*e*) taxes are levied on both company profits and dividends paid out to *individuals*, but it is significant that tax relief is accorded either in respect of individuals or in respect of the company rate on distributed profits. Notable exceptions in this connection are the United Kingdom with no real relief and the U.S.A. with the insignificant relief of $100 (±R70).

Representations and Evidence by National Organisations

325. From an analysis of representations and evidence by national organisations it is evident that—

(*a*) shortcomings in the present system, some of which are mentioned elsewhere in the chapter, are admitted;

(*b*) the maintenance of the current exemption of dividends in the hands of companies is preferred;

(*c*) various procedures were suggested by the organisations in order to prevent a high combined taxation of company profits and the dividends derived from it; and,

(*d*) in the opinion of the majority of organisations, either a drastic increase of company rates or a system which strongly stimulates the distribution of profits, may have a detrimental effect on economic growth, but a moderate increase in company rates would have no material effect.

The Retention of Profits (including Dividends) by Companies

326. Of the profits which companies disclose as *distributions*, approximately R300 million[3] annually *never actually leaves the company sector*. The explanation for this is that—

(i) some dividend-receiving companies pay out nothing or only a part of their dividend receipts to *individual shareholders*; and

(ii) a form of circular distribution based upon cross shareholding takes place so that the distributing company later on actually receives a part of its own initial distribution.

327. An investigation requested by the Commission, into the dividend flow of a selected number of listed financial companies, confirmed both of the above statements. It was particularly noticeable that the dividend flow often circulated to a significant extent merely among company members of the same group. A superficial survey of the published data of some of the selected financial companies leaves the impression that approximately 75 per cent of their dividend receipts were distributed. When, however, that portion of dividend receipts distributed by members of the same group to one another, either directly or through nominee companies, is eliminated, only 50 per cent of dividend receipts was distributed to *shareholders* outside the group. Practically, that part of the dividend flow which circulates within a closed group must be seen in the same light as the direct withholding of dividend receipts so that there can be little or no possibility of the fulfilment of an obligation towards an *outside shareholder* (even if it is a company) who can make a *second independent* decision about the most economic use of the distributed funds for the economy as a whole.

328. Apart from the concentration of investment decisions within a group of companies, there is a distinct possibility that companies may not, at a given time, be interested in expansion but merely in maintaining a state of high liquidity. The funds in question can then be channelled into future projects. The existence of such "pools of liquidity" might create important problems for monetary and stabilisation policy.

329. From a comparison of the dividend flow of 131 selected industrial companies and 48 selected financial companies the following average results—which do not conform to what could reasonably have been expected—were obtained—

(i) the percentage of after-tax profits distributed to *shareholders outside the company sector* is smaller in the case of financial companies (25 per cent) than in the case of industrial companies (27 per cent);

(ii) the percentage of after-tax profits retained is larger in the case of financial companies (47 per cent) than in the case of industrial companies (46 per cent) in spite of the fact that the percentage of already surrendered tax is much larger in the case of industrial companies; and

(iii) the percentage of after-tax profits distributed to other *companies* is larger in the case of financial companies (28 per cent) than in the case of industrial companies (27 per cent).

[3] Commission's own calculation.

330. It could indeed have been expected that financial companies, which do not pay normal tax on the larger part of their profits, would have had a smaller percentage retention of profits and that the larger part of their distributions would have gone to shareholders outside the company sector.

331. In acknowledging the existence, in the case of certain companies, of a problem of excessive retention of profits on which neither they nor their shareholders have paid tax, the Commission does not wish to imply that—

(i) the distribution of profits should be *unduly* stimulated, since there is always some risk that economic growth can be hampered in so far as a part of the distribution can be absorbed by consumption;

(ii) it has ignored the cost and lapse of time involved if a company wants to raise additional funds after it has distributed its profits; and

(iii) a reasonable retention of profits is not permissible, especially where it is likely to be employed in the interests of economic growth.

Reasonable Retention of Profits

332. The investigation mentioned above indicated that, on the average, 80 per cent of the after-tax income of financial companies consisted of dividends. According to the Stock Exchange returns published weekly by various local newspapers, the average dividend cover[4] for the three classes of listed financial companies as at November 17, 1968, was as follows:

Financial	— mining	1.4
	— industrial	1.5
	— investment trusts	1.2

333. In the absence of any taxation of the undistributed profits of these listed financial companies, it follows automatically that other factors and other considerations influence the dividend policy of these companies. If the highest average dividend cover of $1\frac{1}{2}$ (in the case of financial-industrial companies) is accepted as an indication of what company managements themselves regard as a reasonable retention of profits and it is increased to $1\frac{2}{3}$ to provide for the small number of companies in this section with little or no dividend cover, the implication is a distribution of 75 per cent of the average financial company's tax-free profit in order to give that company a dividend cover of $1\frac{2}{3}$.[5]

Rate of Taxation of Undistributed Profits

334. The basic fiscal consideration for the introduction of a tax on undistributed profits is related to the taxation of dividends in the hands of individual shareholders. This cannot be achieved in an equitable and effec-

[4] When a company distributes the whole of its after-tax profits, the dividend cover is 1.0.

[5] Taxed profit: 20, tax-free profit: 80, in other words total after tax profit is 20+80=100; if 75% of the tax-free profit is distributed, then the dividend is 60; consequently the dividend cover is $\frac{100}{60} = 1\frac{2}{3}$.

tive way unless measures are taken to persuade companies to distribute to shareholders a reasonable portion of profits which would otherwise be tax free. This implies that the company itself must pay a tax on the excessive retention of such profits at a rate which is approximately equal to the rate at which individual shareholders would have had to pay had it been distributed. It was calculated that individual shareholders would have paid on the average approximately 25 per cent normal tax on dividends if the new tax rates with regard to individuals recommended by the Commission had already been in operation.

Recommendations of the Commission

335. *The existing provisions of the Income Tax Act* (58 *of* 1962) *in connection with the taxation of undistributed profits must be amended in such a way that public companies will be subject to the taxation of undistributed profits at a rate of* 25 *per cent on the excess of distributable income over distributions, provided that—*

(*a*) *distributable income for this purpose will be only that part of a public company's net profit for a tax year which consists of net branch profits from abroad and net dividends from all sources, after such portions of the net profit for a tax year have been reduced by not more than* 25 *per cent;*

(*b*) *assessed losses and/or accumulated deficits are taken into consideration in such a way that there will be no distributable income for this purpose until the assessed losses and/or accumulated deficits of the company have been eliminated by net profits; and*

(*c*) *for this purpose net branch profits from abroad and net dividends do not include taxation which might have been levied abroad.*

Concluding Remarks

336. The Commission would like to point out that—

(i) tax avoidance is restricted by the extension of the taxation on undistributed profits to include certain undistributed profits of public companies, especially if the recommendations are considered in conjunction with the Commission's recommendations with regard to the introduction of a tax on capital gains;

(ii) a permissible retention of 25 per cent of that portion of the *net* profit of the public company which consists of dividends is roughly in agreement with the 33⅓ per cent exemption of dividends in the hands of shareholders, other than companies, if it is taken into consideration that companies set off certain administrative expenses against gross dividend receipts; and in the case of shareholders, other than companies, these expenses are normally not of the same magnitude;

(iii) the rate of 25 per cent with regard to the amount subject to taxation on undistributed profits is lower than the average *marginal* rate at which normal tax is payable on dividends received by persons other than companies, but the Commission regards a small marginal advantage in favour of companies, as permissible;

(iv) obvious tax avoidance possibilities through the establishment of branches immediately outside the boundaries of the Republic and the resulting loss of State revenue, are discouraged by the inclusion of net income from abroad in the distributable income of the company; and

(v) a larger measure of neutrality with regard to the form of business enterprise is attained, especially if the recommendations are considered in conjunction with the Commission's recommendation in respect of the reduction of the maximum marginal rates applicable to persons other than companies.

RESERVATIONS BY PROFESSOR J. A. LOMBARD IN REGARD TO CHAPTER V

Although I do not oppose the taxing of public company dividend receipts not passed on to ultimate shareholders, I am of the opinion that, for a number of reasons, such a tax would be unnecessarily discriminatory if not extended to undistributed profits of all companies from all sources (excluding gold mining). Moreover, I am of the opinion that the revenue yielded to the state by such extension should obviate an increase in the normal company tax rate, and should be used to lower this rate as far as possible in order to achieve a meaningful "split-rate" effect in the South African system of company taxation.

RESERVATIONS BY MR. H. S. MABIN IN REGARD TO CHAPTER V

While not prepared to associate myself with the whole of the supporting argument or all the statements in Chapter V, I do not wish at this stage to oppose the recommendations in that Chapter.

I do not find it possible to come to final conclusions on this matter before other aspects of company taxation have been dealt with. However, at this stage I would be prepared to endorse the recommendations in Chapter V only upon the following conditions—

(*a*) that the basic rate of taxation upon the taxable income of companies should not exceed 40 per cent;

(*b*) that the retention of "source profits" (that is, profits derived from sources other than dividends or net profits from outside South Africa), in the hands of any company, should not be made subject to any form of undistributed profits tax; and

(*c*) the presently existing table of percentages of dividends deducted in the determination of the taxable income of individuals (reflecting various percentages of dividends deducted, down to a minimum deduction of 33⅓ per cent) should remain unaltered.

QUESTIONNAIRE CONCERNING THE SYSTEM OF TAXATION

A. *Determination of the taxable income of all taxpayers*

1. *Gross income as defined in section* 1 (xi):

(*a*) What comments do you wish to offer on the problem of distinguishing between capital profits and other profits? (See also A. 1 (*b*) below.)

(*b*) Give your views as to the merits or demerits of broadening the tax base by the inclusion in the concept of gross income of capital profits and other gains. (See also A. 1 (*a*) above.)

(*c*) Receipts and accruals:
Should certain types of income be taxed on the receipt basis and others on the receipt and accrual basis?

(*d*) Should the taxpayer's source of income or residence be the basis of liability to tax?

2. *The allowance of deductions from gross income*:

(*a*) Are the general and specific allowable deductions (See Sections 11 and 23) adequate?

(*b*) What are the merits of special deductions, such as initial and investment allowances, incentive allowances in economic development areas, expenses on and donations to scientific research, etc.?

B. *Taxation of individuals*:

Comment on the following:

1. The taxation of husband and wife, with particular reference to earned income of wives. (Sections 7 (2), 68 (1), 5 (3)-(7).)

2. The allowance of special deductions from taxable income in lieu of or in addition to rebates from assessed tax. (Sections 6, 18 and 23 (*a*).)

3. The equitability of the present system of tax progression with regard to the distribution of the tax burden according to the ability to pay.

4. The taxation of "fringe" benefits. (Section 1 (xi) (i).)

C. *The taxation of Companies*:

1. The merits of and problems in connection with the classification of public and private companies. (Section 38.)

2. The merits of the exemption of dividend income in the hands of companies. (Section 10 (1) (K) (i).)

3. The desirability of narrowing the gap between the rates of taxes applicable to companies and individuals, respectively.

4. The effectiveness of the undistributed profits tax in view of the present exemptions contained in the Act. (Sections 48-53.) (See also C. 3 above.)

5. The provisions relating to the taxation of non-resident shareholders and the adequacy of the applicable rates. (Sections 41-47.)

D. Special provisions for specific classes of business, e.g.

1. Farming.
2. Mining operations.
3. Financial institutions, e.g. insurance business, building societies.
4. Shipping and aircraft operations.
5. Co-operative societies, buying associations.
6. Township development.
7. Cable and wireless business.
8. Hotels.

TAXATION ON CAPITAL

E. The merits or demerits of estate duty and donations tax.

INDIRECT TAXATION

F. The effect of customs and excise duties on productivity and the stability of prices.

G. Should the scope of the existing South African tax system be broadened by the inclusion of sales or "value added taxes"? What would be its effects on employment, living standards, savings and investment, industrial productivity, and the distribution of the tax burden?

QUESTIONNAIRE CONCERNING INDIRECT TAXATION

1. Should taxes on consumer goods be confined to "luxuries" or not? If not, should foodstuffs be included in the tax base?

2. Should rates of taxation be uniform for all goods or differentiated according to types of consumer goods?

3. At which level should the tax be imposed—

(*a*) at the source, i.e. at the manufacturing stage or, in the case of imported goods, upon importation;

(*b*) at the wholesale level;

(*c*) at the retail level; or should a value-added system be adopted?

4. What drawbacks or difficulties do you foresee as possible in respect of consumption taxation upon the base mentioned by yourselves as preferable under question 3?

(*a*) Escalation of the burden of the tax, if imposed at manufacturing or import, or wholesale level, through the mark-ups added by distributors, or by reason of increased costs incurred by distributors in financing the tax;

(*b*) Would a tax at manufacturing or import level apply, unintentionally, to certain goods which enter into the costs of various industries?

(*c*) Might the tax possibly be avoided in the case of sales to consumers by non-retailers? Do you visualise that there would be considerable administrative costs or administrative difficulties incurred by the private sector of the economy?

5. Do you visualise administrative difficulties from the point of view of the relevant tax authorities? If so, what difficulties?

6. Would costs and administrative difficulties in the private sector be increased by confining the tax to selected rather than all consumer goods?

7. Do you feel that consumer taxes could be self-assessed?

8. Should the amount of the tax applicable to any particular article be clearly stated to the purchaser of the goods, on the invoice or other sales document, either at retail level only in the case of a retail tax, or otherwise at both wholesale and retail levels in the case of a tax at an earlier stage?

9. Do you consider that consumption taxation should be applied to services as well as to goods? If so, to what services?

10. What do you consider might be the effects of consumption taxation upon—

(*a*) the size of the market for the goods taxed;

(*b*) employment in affected industries or trades;

(*c*) investment in affected industries or trades;

(*d*) growth of the affected industries or trades, or in the economy generally?

11. What might the effect of consumption taxation be upon—

(*a*) input costs to various industries;

(*b*) wages and salaries;

(*c*) the gold mining industry; and

(*d*) other export industries?

VALUE-ADDED TAXATION

The Commission could not recommend a system of taxation on value-added because of the considerable administrative burden which would have resulted for the private as well as the public sector. Nevertheless, this kind of tax has the advantage of avoiding the taxation of the inputs of any particular business to a greater extent than is possible with most other systems of turnover or purchase taxation. With only exports exempt, the incidence of the tax can be on domestic consumption alone. The importance of this is obvious when the key role of the export trade in the South African economy is borne in mind.

The form of consumption tax recommended by the Commission allows of an extension in due course, if deemed desirable, to a value-added tax. In those countries of the European continent in which the value-added tax is in force the historic development followed this same pattern. For this reason the most important characteristics of such a tax is briefly outlined below.

(*a*) *Most Important Characteristics*

The value-added tax is a multi-stage turnover tax with tax credits for the purchase of taxed input goods and services at all stages of production and distribution. It thus affects the value added by the various processes of manufacturing or distribution, i.e. the difference between the value of total sales and the cost of purchased goods and services rendered by factors of production outside the concern. The tax due is calculated by deducting the tax included in purchases from the tax on sales realised. Thus at each stage of exchange the tax is shifted forward until it reaches the final consumer. Services can readily be included in this system. As in the case of goods, the tax on services sold is calculated and transferred to the Exchequer after deducting taxes paid on services received.

(*b*) *Different Tariffs*

Tariff differentiation complicates all turnover taxes but especially the value-added tax, which is levied at every stage in the production-distribution chain. When an article is taxed at a tariff lower than the "general" rate, say, the special tariff has to be applied at every successive stage to prevent the concession from being lost. For that reason a reduced tariff or an exemption should preferably be applied at the last stage. When a dealer's tax credits exceed the tax payable on his turnover, refunding of the difference by the state is essential to enable the tariff reduction or exemption to operate effectively.

(*c*) *Exemptions*

In order to exempt particular goods and services completely from the value-added tax, the tax included in the inputs must be refunded to the firm concerned. For administrative reasons this procedure is only applied to exports.

A simpler but incomplete exemption is effected by levying no tax on the sale of certain items and also granting no tax credits in respect of the inputs used in these items. Taxation of the latter then becomes a cost factor. Goods exempted in this way are nevertheless cheaper for final consumers but not for business consumers because for the latter the increased price resulting from taxed inputs does not create tax credits.

(*d*) *Exemptions for Small Businesses and Farmers*

Relief in the tax administration for small businesses can be brought about by giving such businesses the option of either obtaining exemption of their sales, in which case the tax credits also fall away or operating within the tax ring and being subject to the general rules. As has been argued above, the first alternative would be advantageous only if their customers are mainly final consumers.

Small farmers may also benefit from such exemption but there are also larger ones whose bookkeeping is not adequate for the handling of the administration. For them the following simplified system could be useful. On the assumption that the value of inputs is approximately half the value of sales, half the usual tariff is levied on their sales while the tax credits fall away. No bookkeeping is required; only half the usual tariff is added to the sales, which compensates the farmer for the tax which he pays at the full tariff on his purchases. If his customers are dealers or manufacturers, the government sacrifices no revenue since the customers again calculate the full tax on their sales. A loss of revenue for the state results only when the farmer sells to final consumers, and the loss is limited to half the tax which would otherwise have been collected.

(*e*) *Administrative Aspects*

The system of value-added taxation requires that the tax be indicated separately on all invoices. The total of the amounts included in incoming invoices during the course of a particular month would, for example, constitute the tax credit for set-off in the following month. On the other hand, the total amount of tax appearing on outgoing invoices constitutes the gross tax liability, and the difference between the two is paid to the tax authority during the next month. Here it is assumed that tax liability and credits arise when goods are delivered or received, but in the alternative case, actual "receipts" and payments could be employed as the basis.

If part of the turnover should consist of exempt goods, the tax paid on purchases must be apportioned to the corresponding portions of the sales so that the tax credit can be determined accurately, since no tax credits are granted in respect of exempt goods. A separate column in the books is used for recording the tax amounts. Sales to final consumers involving small amounts for which no invoices are normally made out are effected at a price including tax. The businessman can deduce the amount of collected tax from the monthly total of non-invoiced sales. In transactions among firms there is little incentive to avoid taxation, because the tax which the seller charges creates a tax credit in favour of his customer. The incoming invoices against which a tax credit is claimed enables the tax authority to check whether the supplier has accounted for all taxes received. Only in the case of sales to final consumers and to other parties who can claim no tax credits does the incentive exist to withhold the tax. Here turnover figures will have to be used to check the tax obligation. From the foregoing it is clear that in the case of a value-added tax administration, inspection and auditing by the tax authority assume considerable proportions.

(f) Could this system exclude the retail trade?

A case presented to the Commission was that in view of the large number of retailers the system of value-added taxation could be simplified by applying it only to producers, importers, and wholesalers. Mention was made of the French system which, at the time of its introduction in 1954, applied to manufacturers only, but was later extended to wholesalers and only recently included retailers as well.

There are serious objections to a limited system of value-added taxation, of which only a few can be mentioned here. In the first place there is the implication that the value added by the retail trade is not taxed so that the tariff would have to be higher, and this in turn increases the pressure for exceptions. Secondly, the tax burden increases because the profit mark-up in the retail trade is calculated on tax-paid purchases. Thirdly, and what is most important, the concept of "wholesale trade" cannot be demarcated. Many retailers buy directly from manufacturers and perform the wholesale function themselves. In this case the value added by both the retail and wholesale trade escapes the tax. Goods handled by such integrated retailers could thus be delivered more cheaply to consumers. This discriminates between certain channels of distribution. All manufacturers and genuine wholesalers could possibly be registered, and it could be stipulated that sales by manufacturers to non-registered customers are taxable at the wholesale value. This concept would often have to be determined arbitrarily. It would be preferable to simplify the system by excluding businesses with a turnover below a certain margin as indicated in (*d*) above.

APPENDIX D

SOME ADMINISTRATIVE ASPECTS OF A TAX ON PART OF THE SALES AT RETAIL LEVEL

PROFS. C. W. I. PISTORIUS AND H. J. J. REYNDERS

THE RETAIL TRADE UNIVERSE

1. The most recent published data relate to the census of retail trade for 1960/61. For the year 1966/67 a trade census was again taken, and the Director of Statistics was able to provide certain preliminary statistics relative to it, based on the most recent returns. Although a considerable number of returns in connection with the latter census are still outstanding, we were advised that the data of most of the large concerns were included.

2. Before an analysis of the available statistics is attempted, it is necessary to note the following:

(*a*) The census was conducted on the basis of establishments, i.e. individual shops, and not on the basis of firms. This means that the data for branches of firms are treated as being separate and are not aggregated to one total figure for the firm. For instance, the statistics for a big chain-store do not appear as one figure, but each branch is viewed as a separate establishment and is treated separately.

(*b*) The Bureau of Statistics defines a retail dealer (1960/61 census) as "a trading establishment which sells more than 25 per cent of its total sales direct to the consumer for personal or domestic use" ("trading establishment" is not defined). In 1966/67 the percentage was raised to 50 per cent. We were advised that this did not involve a lack of comparability with previous years in any significant sense.

(*c*) Sales of agricultural machinery and farming requisites (fertilizers, seed, agricultural implements, etc.) to farmers are regarded as wholesale transactions. The same applies to the sale of building materials to building contractors.

(*d*) The definition of the term "food" by the Bureau of Statistics is rather vague. Certain specific items such as meat, eggs, fresh fruit and vegetables, and sweets and chocolates are categorically mentioned by name, but then follows the omnibus phrase "all other food products".

(*e*) The classification according to kinds of business is made primarily on the basis of "the preponderating kind of merchandise" sold, but there is a long list of rules, not relevant here, for those instances in which the classification does not follow obviously from the data (submitted in the returns). Catering establishments dealing mainly in groceries are regarded as dealers; numerous so-called cafés are included.

TABLE 1.

The Size of Business (Measured in Terms of Trading Revenue) of Retail Dealers in South Africa 1960/61 and 1966/67.

Size Group (Trading Revenue).	1960/61				1966/67			
	Number of Businesses.		Trading Revenue.		Number of Businesses.		Trading Revenue.	
	Absolute.	% of total.	Absolute (R'000).	% of total.	Absolute.*b*	% of total.	Absolute.*b* (R'000).	% of total.
0— 1,999*a*	1,292	3.5	1,889	0.1	874	2.7	1,265	0.1
2,000— 4,999	3,118	8.6	10,801	0.7	2,030	6.4	6,986	0.4
5,000— 9,999	4,852	13.4	36,455	2.4	2,931	9.3	21,972	[illegible]
10,000— 19,999	8,044	22.1	118,510	7.7	5,588	17.7	82,907	.2
20,000— 49,999	11,657	32.1	371,051	24.0	10,300	32.6	337,528	17.1
50,000— 99,999	4,688	12.9	321,337	20.8	5,823	18.4	402,332	20.4
100,000—199,999	1,820	5.0	246,408	15.9	2,579	8.2	353,637	17.8
200,000—499,999	626	1.7	181,939	11.8	1,054	3.3	310,923	15.8
500,000—999,999	155	0.4	101,976	6.6	267	0.8	181,012	9.2
1,000,000 and more	78	0.3	155,558	10.0	130	0.4	273,416	13.9
Total	36,330	100.0	1,545,925	100.0	31,576*b*	100.0	1,972,078*b*	100.0

a Except where the establishment was part of a firm, figures of establishments with a total trading revenue of less than R1,000 during the census year were not included.
b Cannot be compared with 1960/61, because all returns have not yet been received.

(*f*) *Sales* are the actual sales of merchandise by establishments and do not include goods transferred to subsidiaries (branches), workshop revenue, sales of refreshments, commission received, or goods taken for the personal use of the owner.

(*g*) *Trading Revenue includes*:

(i) sales of merchandise, including finance and other charges;
(ii) workshop revenue;
(iii) transfers-out to the firm's own retail outlets and other establishments belonging to it;
(iv) revenue from catering and other services which are conducted as an integral part of the trading establishment and within the scope of the census;
(v) rent of fixed property and equipment;
(vi) commission on the purchases and/or sales of merchandise;
(vii) commission on insurance and other services;
(viii) revenue of a non-recurring and casual nature;
(ix) other trading or operating revenue (Note that this concept was not demarcated except that interest and dividends received were explicitly excluded).

3. In the following paragraphs the retail trade universe will be described in greater detail.

(*a*) *Some Trends in Retail Trade*

4. The question arises as to whether the present retail trade universe differs appreciably from that which obtained in 1960/61. The Bureau of Statistics has made available data relating to the size groups in the retail trade as reflected in the returns already received in respect of the 1966/67 census. No other data for that year are as yet available. In Table 1 the distribution is set out for 1960/61 and 1966/67. The most important conclusion from this table is that retail establishments apparently grew in size in the period between the relevant years. Thus, establishments with a trading revenue of less than R10,000 accounted for 3.2 per cent of the total in 1960/61 but included 25.5 per cent of the total number of establishments; whereas in 1966/67 the figures were 1.6 per cent and 18.4 per cent respectively. Establishments with a trading revenue of between R10,000 and R100,000 accounted for 52.5 per cent of the total in 1960/61 and numbered 67.1 per cent of the total number of establishments; whereas in 1966/67 the figures were 41.7 and 68.7 per cent respectively. 7.4 per cent of the establishments had trading revenues in excess of R100,000 in 1960/61, and contributed 44.3 per cent to total trading revenue; whereas in 1966/67 the relevant figures were 12.7 per cent and 56.8 per cent respectively. One reason for this phenomenon was the persistent inflation; another was the growth of chain-stores.[1]

5. In 1965/66 Professors Lombard and Reynders conducted a survey of a number of retail firms for the years 1960/61 and 1965/66. The results for these two periods were compared with

[1] In this connection, see also paragraphs 551-592 of the report of the *Commission of Inquiry into Trade Licensing and Allied Problems* (R.P. 85/1964 Government Printer, Pretoria, 1964).

each other as well as with the 1960/61 Census data. The sample was found to be biased in favour of large concerns. The data indicated amongst other things that *no significant change in the composition* of sales had taken place between the years in question. For instance, in the census as well as the sample survey, food accounted for 35 per cent of total sales, and clothing and textiles for 25 per cent. It appeared, further, that *chain-stores* had become increasingly important: in 1952 the most important chain-stores had 186 branches with sales of R60 million, or 5 per cent of the overall total, whereas by 1964 the corresponding figures were 423, R188 million, and an estimated 10 per cent, respectively. Next, it became evident that *general dealers* had come to fulfil an ever diminishing role in the economy: in 1946/47 there were 5,212 general dealers, and they handled 17 per cent of retail sales, whereas in 1952 the respective figures were 7,381 and 19½ per cent, and in 1960/61, 5,050 and 14½ per cent. What is also known is that new *kinds of retail dealers* have come to the fore, especially the so-called discount stores, and that *selfservice* has acquired increasing importance. Finally, it can be mentioned that the gross profit margin declined between the said years from some 30 per cent to some 27 per cent, whereas the net profit margin remained constant at 5 per cent.

(*b*) *The Retail Trade Universe reflected in the* 1960/61 *"Census of Retail Distributive Trade"*

(1) *The Kind of Goods sold*

6. With a view to the possibility of excluding food (for human and animal consumption) and intermediate products and farming requisites, retail sales were classified into ten categories. The categories and their percentage contributions to the total are shown in Table 2.

7. The Bureau of Statistics maintains an index of the "Value of retail sales". The average for 1960/61 (with 1958=100) was 102.6, and for 1966/67 143.3. Assuming that the sales shown in Table 2 had increased to the same extent (viz., by about 40 per cent), total sales in 1966/67 would have amounted to R2,050 million, and those of food, to R725 million. A sales tax of 3 per cent could produce a total of R61.5 million, and R21.75 million in respect of food. The three agricultural items are so small that they can be ignored for the present purpose. The same applies also to the possible intermediate products, capital goods, and building materials and hardware.

(2) *The Kind of Establishments*

8. Retail dealers were classified into three categories for the purpose in view, viz. those dealing in food only (butchers, dairymen, fruit and vegetable dealers, fish shop owners, dealers in confectionery and sweets) (Category A); those dealing in non-food items (Category B); and in miscellaneous goods (Category C). Included with the latter are grocers, provision dealers, department stores, general dealers, and Bantu trading stores. The share of each category in the total is as follows:

Category	*Amount (R'000)*	*Percentage*
A	208,320	14.2
B	598,962	40.9
C	656,964	44.9

TABLE 2.

The Composition of Retail Sales in South Africa, 1960/61.

Kind of Goods.	Amount (R'000)	% of Total.
Food	518,059	35.40
Agricultural and pastoral produce	866	.06
Agricultural and pastoral produce (not for human consumption)	11,768	.80
Agricultural and pastoral produce (excepting food)	14,526	1.00
Tobacco and cigarettes	37,440	2.55
Beverages (non-alcoholic and other)	66,449	4.50
Metals and metal products	693	.05
Machinery, apparatus, implements, etc... ..	568	.04
Building materials and hardware	41,984	2.90
Other	771,893	52.70
Total	1,464,246a	100.00

a Owing to classification problems this total does not agree with the aggregate given by the Bureau of Statistics.

TABLE 3.

Composition of the Sales (according to Kinds of Food) of the three Categories of Retail Dealers in South Africa, 1960/61.

Kind of Foods.	Category A.		Category B.		Category C.	
	Amount (R'000)	% of total.	Amount (R'000)	% of total.	Amount (R'000)	% of total.
Food	202,029	97.1	85	.0	315,945	48.3
Agricultural and pastoral produce	660	.3	206	.0	—	—
Agricultural and pastoral produce (not for human consumption)	2,596	1.2	—	—	9,172	1.4
Agricultural and pastoral produce (excepting food)	—	—	2,783	.4	11,743	1.5
Tobacco and cigarettes ..	1,985	.9	1,462	.2	33,993	5.0
Beverages (non-alcoholic and other)	936	.4	59,522	9.9	5,991	.9
Metals and metal products..	—	—	693	.1	—	—
Machinery, apparatus, implements, etc.	—	—	568	.1	—	—
Building materials and hardware	—	—	27,251	4.5	14,688	2.2
Other..	114	.1	506,392	84.8	265,432	40.7
Total	208,320	100.0	598,962	100.0	656,964	100.0

9. The composition of the sales (according to kinds of goods) of these three categories appear in Table 3.

10. The distribution of the sales (according to kinds of goods) among the three categories is shown in Table 4.

11. Category C deserves special attention, because shops in this category may encounter considerable problems if food, intermediate products, capital goods, and farming requisites are to be excluded. Twenty-

TABLE 4.

The Distribution of Retail Sales Among the Three Categories of Retail Dealers in South Africa, 1960/61.

Kind of Goods.	Category A.		Category B.		Category C.		Total.	
	Amount (R'000).	% of total.	Amount (R'000).	% of total.	Amount (R'000).	% of total.	Amount (R'000).	% of total.
Food	202,029	39·0	85	—	315,945	61·0	518,059	100·0
Agriculture and pastoral produce..	660	76·2	206*a*	23·8	—	—	866	100·0
Agricultural and pastoral produce (not for human consumption) ..	2,596	22·1	—	—	9,172	77·9	11,768	100·0
Agricultural and pastoral produce (excepting food)	—	—	2,783*b*	19·1	11,743*c*	80·9	14,526	100·0
Tobacco and cigarettes	1,985	5·3	1,462	3·9	33,993	90·8	37,440	100·0
Beverages (non-alcoholic and other)	936	1·4	59,522	89·6	5,991	9·0	66,449	100·0
Metals and metal products.. ..	—	—	693*d*	100·0	—	—	693	100·0
Machinery, apparatus, implements, etc...	—	—	568*e*	100·0	—	—	568	100·0
Building materials and hardware..	—	—	27,246*e*	65·2	14,688	34·8	41,984	100·0
Other..	114	·0	506,392	65·6	265,432	34·4	771,893	100·0
Total	208,320	14·2	598,957	40·9	656,964	44·9	1,464,246*f*	100·0

a Fuel.
b Florists.
c At grocers and Bantu trading stores.
d Hardware dealers.
e Hardware dealers and variety shops.
Owing to classification problems this total does not agree with the aggregate given by the Bureau of Statistics.

nine per cent (R190.3 million) of the sales in this category are accounted for by grocers and provision dealers; 23.2 per cent (R152.3 million) by department stores; 33.2 per cent (R216.7 million) by general dealers; and 14.6 per cent (R97.7 million) by Bantu trading stores. The composition of the sales in this category is shown in Table 5.

12. One would expect that the larger firms would keep departmental accounts, so that food sales could possibly be shown separately. Classified into size groups (according to trading revenue) the pattern is that shown in Table 6.

13. Assuming that establishments with a revenue in excess of R199,999 or R499,999 keep departmental accounts, the revenue of Category C that cannot readily be separated can be presented as follows (i.e. after deduction of the sales of establishments in the relevant two size groups):

Revenue of establishments in Category C with a revenue of less than R200,000	R366 million, or approximately 25 per cent of the total sales of all categories together.
Revenue of establishments in Category C with a revenue of less than R500,000	R507 million, or approximately 35 per cent of the total sales of all categories together.

14. It is interesting to note the number of establishments in the relevant category that had a revenue in excess of R199,999 or R499,999.

Kind of Business.	Number of Establishments with Revenue in excess of R199,999.	Number of Establishments with Revenue in excess of R499,999.	Total Number of Establishments.
Grocers and provision dealers	55	2	6,695
Department stores — —	156	99	192
General stores — —	426	120	5,050
Bantu trading stores — —	97	1	4,568

15. Since 1960/61 shops have in general become larger (in terms of their trading revenue), and one can therefore expect that the percentage of shops that maintain departmental accounts must also have increased. Inquiries at the two largest chain-stores in South Africa and one large supermarket in Pretoria, however, brought the following to light:

(i) *Chain-Store* A.

The supermarket, at which food is sold, includes certain types of soap, detergents and related items, but these items make up only a relatively small part of the total sales of the supermarket. If the cash register is equipped with a separate key, the food sales can be recorded separately. The operators of the cash registers, however, already make many mistakes (especially during busy periods), and with an additional key they will make even more mistakes.

(ii) *Chain-Store* B.

At Chain-store B the same comments were elicited as at chain-store A, but with the difference that food sales there are

TABLE 5.

Composition of the Sales of Category C Retail Dealers in South Africa, 1960/61.

Kind of Goods.	Grocers and Provision Dealers.		Department Stores.		General Dealers.		Bantu Trading Stores.	
	Amount (R'000).	% of total.	Amount (R'000).	% of total.	Amount (R'000).	% of total.	Amount (R'000).	% of total.
Food	153,375	80·5	44,138	29·2	83,671	38·6	34,761	35·6
Agricultural and pastoral produce	—	—	—	—	—	—	—	—
Agricultural and pastoral produce (not for human consumption) ..	—	—	—	—	9,172	4·2	—	—
Agricultural and pastoral produce (excepting food)	3,298	1·7	—	—	—	—	8,445	8·7
Tobacco and cigarettes	15,302	8·2	2,634	1·7	11,205	5·1	4,852	4·9
Beverages (non-alcoholic and other)	4,775	2·5	—	—	—	—	1,216	1·2
Metals and metal products	—	—	—	—	—	—	—	—
Machinery, apparatus, implements, etc...	—	—	—	—	—	—	—	—
Building materials and hardware ..	—	—	5,236	3·4	8,045	3·7	1,407	1·4
Other	13,531	7·1	100,296	65·7	104,564	48·4	47,041	48·2
Total	190,281	100·0	152,304	100·0	216,657	100·0	97,722	100·0

Table 6.

Size of Business of Retail Dealers in South Africa in Category C, 1960/61.

Size Group (Trading Revenue).	Grocers and Provision Dealers.		Departmental Stores.		General Dealers.		Bantu Trading Stores.		Total.	
	Number.	Revenue as % of total.	Number.	Revenue as % of total.	Number.	Revenue as % of total.	Number.	Revenue as % of total.	Number.	Revenue as % of total.
0— 999*a*	305	·2	—	—	5	·0	10	·0	320	·07
1,000— 1,999	648	1·2	—	—	92	·0	269	·3	1,009	·43
2,000— 4,999	949	3·7	—	—	312	·5	611	2·1	1,872	1·5
5,000— 9,999	1,757	13·6	—	—	570	2·0	827	6·2	3,154	5·5
10,000— 19,999	2,151	34·8	—	—	1,076	7·6	1,157	16·9	4,384	14·8
20,000— 49,999	663	23·3	4	·2	1,747	25·4	1,298	39·8	3,708	20·9
50,000— 99,999	165	11·4			822	26·0	299	19·5	1,290*d*	14·6*d*
100,000—199,999	45	7·3	32	3·2	306	19·1	77	10·1	460	10·6
200,000—499,999	12*b*	4·5	59	11·7	102	12·9	20*c*	5·1	190	31·6
500,000 and over			97	84·9	18	6·5			118	
Total	6,695	100·0	192	100·0	5,050	100·0	4,568	100·0	16,505	100·0

a The figures in this line relate only to those establishments that are branches of a firm. See footnote *a*, Table 1.
b Ten each had a revenue of R200,000—R499,999, and two of R500,000—R999,999.
c One had a revenue of between R½ million and R1 million, and 19 a revenue of between R200,000 and R499,999 each.
d Including the 4 department stores.

separated by means of estimates for purposes of budget control. The estimates, however, are regarded as approximately correct.

(iii) *Supermarket in Pretoria.*
No separation of sales is attempted at all.

Conclusion

16. On the basis of the data in paragraphs 1-15 the most important conclusion that can be drawn for the present purpose is that a sales tax on retail sales, from which food, farming requisites, intermediate goods, and capital goods are excluded, will undoubtedly give rise to numerous accounting problems, even for the larger firms that might already be keeping departmental accounts or will be able to do so. The problem involves mainly the Category C establishments. In number they were 45 per cent (16,500) of the total in 1960/61, while in the same year they accounted for 45 per cent of the total sales at retail level (as reflected by sales in the retail distribution trade census).

17. In the following section the nature of the possible problems involved as well as the possible "solutions" to them will be considered in greater detail.

SPECIAL PROBLEMS OF A SALES TAX AT RETAIL LEVEL

(i) *Food*

(*a*) *The Problem of separating Goods Exempt from Tax* (*Exempt Goods*)

18. As has been remarked problems of separation will arise especially in Category C, although Category A also has sales other than those of food only. The latter amount is, however, relatively small (2.9 per cent of the total in 1960/61—see Table 3). There are establishments in Category C (such as grocers and supermarkets) of which the food sales will represent by far the major proportion of their total turnover (see Table 5), and which will, on the face of it, have a less serious problem to contend with. Nevertheless the problem remains a problem for the establishments concerned. In the following discussion catering establishments, such as cafés, are left out of consideration except in so far as they are already covered. They will be considered under point (*j*) in the discussion on service establishments.

19. If it is assumed, provisionally at least, that a practically useful definition of the concept "food" can be given, the separation of food sales will give rise to considerable difficulties for the trade. Such separation can be brought about—

(*a*) by the legislator's compelling firms to keep separate accounts; or

(*b*) by the tax authorities' acceptance of data in respect of food sales that are not based on proper departmental accounts.

Ad (*a*)

20. The question as to whether the legislature should compel all retail dealers to keep separate accounts of food sales in one way or another must be answered in the negative. A large number of smaller concerns will simply not be able to afford such a practice or will otherwise

not be able to organise something of this nature. Moreover, the keeping of departmental accounts will still be no guarantee of the reliability of the data obtained, because the purpose for which the data will be introduced, i.e. taxation, will give rise to the temptation to report taxable sales as being as low as possible.

21. An establishment with sales of R100,000 per annum is not a large business. A net profit of 5 per cent on sales yields an income of R5,000 for the owner.[2] In 1960/61 the retail distribution trade census enumerated 33,651 (92.6 per cent of the total) such establishments, and they accounted for 45.7 per cent of the total sales. The 31,576 returns already received in respect of the 1966/67 census indicate 27,546 (87.1 per cent) such establishments, with a turnover of 42.3 per cent of the total. From Table 6 it appears that the position in Category C is as follows:

Establishments with trading revenue less than R100,000.	Grocers and Provision Dealers.	Department Stores.	General Dealers.	Bantu Trading Stores.	Total.
Number — — —	6,638 (99 %)	4 (2 %)	4,624 (91 %)	4,471 (98 %)	15,737
Trading revenue as percentage of total —	78·2	·2	61·5	84·8	43·2

22. The above particulars, it is true, concern establishments and not firms, but it is unlikely that this would have a decisive bearing on the figures (and accordingly, on the scope of the problem). Moreover, it is particularly in the case of department stores that large numbers of branches will be met with, and as appears from the above figures, there were only four establishments in the category of department stores with a trading revenue of less than R100,000 in 1960/61.

Ad (*b*)

23. Should the fiscus also be prepared to accept sales of exempt goods on a basis other than a departmental one, several alternatives present themselves. (The small number of businesses we visited in Rhodesia indicated at least three methods by which registers, supported by the necessary vouchers, are kept.) The sales can, for example, be calculated in one of the following ways:

(*aa*) Purchases at purchase prices plus an agreed margin.

(*bb*) Calculation of the cost price of goods sold (opening stock plus purchases minus closing stock, all at purchase price) plus an agreed margin.

(*cc*) Calculation of figures on the basis of quantities instead of calculation in money terms as in (*bb*):

Opening stock
plus Purchases
minus Closing stock
= Quantity sold

[2] See par. 5 above.

The quantity sold can then be multiplied by the actual selling price, or the purchase price plus a margin, so that one can arrive at the sales in money terms.

(*dd*) In instances where the food sales represent by far the major proportion of the turnover (e.g. grocers and supermarkets), the relevant amount can be calculated by *determining the sales of non-food merchandise* (the taxable goods). This separation can be effected in any of the ways mentioned in (*aa*)-(*cc*), or it can be effected by making out the invoice at the time of the actual sale (e.g. on the invoice there would be columns for taxable and tax-exempt goods) and, where cash registers are used, by providing the cash register with an extra key for tax-exempt goods.

24. Obviously there are other possibilities, but enough has been said to indicate the nature of the calculations, and it will now be more fruitful to consider some of the complications arising from the above calculating procedures.

Ad (*aa*)

25. (1) Unless purchases are equal to sales, or very nearly so, (as might obtain in the case of perishable goods or goods with a very high rate of turnover), there will be inaccuracies in that the calculated sales figure will then be higher or lower than the actual amount. Over a period (e.g. one year) the plusses and minuses should more or less cancel one another. Moreover, the necessary correction can be made once a year by means of stocktaking.

(2) The crucial problem here is the determination of a margin that will be acceptable both to the fiscus and to the firm. There can be a margin for *each* kind of article which will in the nature of things involve much work for the fiscus as well as for the firm (every month or quarter). It would be possible to resort to an *average margin*, but how can this be determined? Margins vary from product to product, from shop to shop, from region to region, and from one period to the next (e.g. on account of changing competitive conditions and/or on account of price adjustments by suppliers). Moreover, the product mix of all shops are not the same, and it may also vary from time to time in the same shop. In addition there are also the problems associated with mark-downs, "specials", and sales. The solution is, therefore, to be sought in *a weighted average for each shop, to be revised periodically*. (Particularly in firms with large turnovers and narrow margins, even changes as small as 1/10th of one per cent can be significant.)

Ad (*bb*)

26. (1) Here too we encounter the problems associated with the determination of an acceptable margin (see (*aa*) point (2) above).

(2) If the tax must be paid monthly, there are also the extra costs involved in monthly (or at least periodical) stocktaking in one way or another. This will give rise to problems, or it may even be impossible, particularly in the case of smaller businesses (e.g. on account of the time factor or manpower shortages), and many businesses will have to rely on estimates, checks being carried out once a year.

Ad (cc)

27. The calculation of margins once more gives rise to difficulties, as in the above instances. The same applies to the periodic stocktaking.

Ad (dd)

28. (1) The problems that arise here are basically similar to those already discussed above in respect of margins and stocktakings.

(2) If the sales of tax-exempt goods are to be calculated with the aid of invoices and cash register slips, further complications arise:

(*aa*) Tax evasion may occur, because the sole purpose of the separation will be to calculate the taxable amount. For the fiscus this will be very difficult (if not impossible) to check, except if recourse is had to the customer.

(*bb*) The note on invoices specifying whether goods are taxable or not will increase administrative costs and cause delays in making out the invoices. This arises because sales clerks must now separate the taxable from the tax-exempt goods in advance and must also distinguish between them in making out the invoice or in registering the items on the cash register. In Rhodesia, where the exempt food group is relatively small, we were told by a supermarket that the delay per transaction involves between one half and one minute, and even then many errors are still made by sales clerks. The cost involved in this is, however, not very large; for example, on a turnover of R500,000 per annum and an average sales transaction of R5, the total extra hours per annum are some 1,000, which at 170 hours per month, represents half the salary of one clerk or about 0.1 per cent of sales. In respect of cash sales it must also be pointed out that they can be registered by means of cash invoices or a cash register. In the former case provision will have to be made on the invoice for a separate column which will make the determining of the figure for taxable goods possible. If a cash register is used, a more "sophisticated" one will now be required, with an extra key and with a built-in mechanism to determine at the end of each day the total figure for taxable goods (failing which, the cash register roll will have to be analysed laboriously every day). It is also to be expected that in registering sales on this cash register, sales clerks will make more mistakes than are made now—particularly during peak hours. (We were told by two large South African firms that even with a separation of only soft goods and other goods, sales clerks make many mistakes.) There is also the question of whether the fiscus will be prepared to accept a cash register roll as a voucher. (In Rhodesia we came across an instance in which the fiscus was prepared to do so; in another instance the roll was not accepted.)

(*cc*) Every clerk involved will have to be thoroughly acquainted with the definition of the concept "food" and particularly with the interpretation of the concept in terms of specific items. This can, of course, be solved partly at the time of marking the price on each article, e.g. by means of code numbers for taxable and tax-exempt items.

Conclusion

29. Even when the fiscus would be prepared to allow firms to determine sales figures for taxable and tax-exempt goods in a manner other than through departmental accounting, there will be numerous complications. With reference to the practice in Ireland as well as Rhodesia, by which firms with sales below a given amount are exempted from tax collection, we should like to offer certain comments in terms of the following possibility:

(1) All firms with an annual turnover of less than R20,000 (in Rhodesia the amount is R10,000 and in Ireland R18,000) are exempted from the liability of collecting taxes, and this obligation is assigned to their suppliers.

(2) Firms with annual sales of between R20,000 and R200,000 are allowed to determine taxable sales in another way than through departmental accounts.

(3) Firms with an annual turnover of more than R200,000 are compelled to keep departmental accounts, at least for tax purposes. It can be argued that these firms are in any event placed in a turnover category in which they ought to keep such accounts for purposes of the management.

30. Before the problems arising from this line of thought are discussed, the remarks that follow are necessary. *First,* the fiscus will have to register firms in the three size groups annually (say, on the basis of the figures for the previous year) and assign to them registration numbers in code. *Secondly,* the number of firms involved and the possible amounts of tax revenue can be noted. The position can be stated briefly as follows:

Category A establishments are not really relevant, their sales of goods other than food being rather small. No food sales are involved in *Category B establishments,* and such establishments can also be ignored for the moment. As regards *Category C establishments* it must be pointed out that there are no readily available data for the separation of the food sales of the different size groups. Consequently, the calculations were carried out on the basis of total trading revenue, and on the assumption of a sales tax of 3 per cent, the position for 1960/61 would be as follows:

Size Groups.	Number of Establishments.	Total Trading Revenue (R'000).	Tax (R'000).
Less than R20,000 turnover p.a. —	17,306	167,655	5,026
R20,000—R200,000 turnover p.a. —	18,165	938,796	28,164
More than R200,000 turnover p.a. —	859	439,473	13,184

Ad (1) *Businesses with Annual Sales of less than* R20,000

31. The exemption of some firms from the liability to collect the sales tax can, amongst others be justified on the following grounds—

(*aa*) the costs entailed in the collection compared to the volume of sales;

(*bb*) the costs entailed in inspection by the fiscus (e.g. the numbers involved, and the fact that most of these establishments are located in rural regions in the White and Bantu areas);

(*cc*) the inevitable inability of the owners of these businesses (e.g. Bantu) to handle the problems associated with a sales tax as such (not even to mention one that involves tax-exempt goods), or at least to do so in a reliable manner.

32. Collection is now assigned to the supplier, and aspects to be borne in mind here are the following, amongst others:

(*a*) The supplier must keep separate account of sales to these firms. This need not, however, be difficult, but it nevertheless has an effect on administrative costs.

(*b*) The tax will possibly have to be levied on the selling price of the supplier; hence an amount of tax will be foregone, but the amount involved should not be large and will in any case possibly not compensate for the trouble and costs arising from its collection.

(*c*) Although the sales of these businesses can fluctuate from year to year this difficulty can be overcome, as has already been mentioned, by means of a system of registration.

(*d*) It is possible that suppliers may refuse to supply these businesses on account of the nuisance of collecting and paying over the tax. Many of these businesses settle in cash, however, and in view of competitive conditions, it is unlikely that such a situation will arise.

(*e*) The retail dealer now pays tax on his purchases to the supplier, who then transfers it to the fiscus. The retail dealer must now recoup the tax from his customers in one way or another and this may especially in the Bantu trade, give rise to malpractice and, in other cases, to a situation in which the dealer, possibly because of ignorance or owing to competitive conditions, will suffer (and he may be precisely the type of dealer that cannot afford to).
The investigation to which reference was made in paragraph 2 brought to light the fact that the net profit on the sales of dealers who have an annual turnover of less than R20,000 was only 1.7 per cent in 1960/61 and 3.8 per cent in 1965/66.

Ad (2) *Businesses with Annual Sales of between R*20,000 *and R*200,000

33. In principle the same possibilities and difficulties apply here as have already been discussed in paragraphs 20-27 (viz. those cases in which the Receiver is prepared to accept in respect of *all* businesses a calculation on some basis other than a departmental one).

Ad (3) *Businesses with an Annual Turnover of more than R*200,000

34. Should the fiscus compel firms to keep departmental accounts at least for tax purposes, the following aspects should nevertheless be borne in mind:

(*a*) To allow for the specification of the taxable sales on a separate basis, sales invoices (cash and credit slips) will have to be designed to this end (or at least be marked in one way or another), and cash registers will have to be provided with an additional key and will also have to record the total sales of taxable or tax-exempt goods. Difficulties of the same nature as discussed in paragraph 28 will now arise and costs will also be increased.

(*b*) As in the case discussed in paragraph 28, accurate identification of taxable and tax-exempt goods by sales clerks is also essential here.

(*c*) Apart from the extra costs referred to in (*a*) above, there are also those involved in the preparation and in the casting of the necessary returns to be submitted to the fiscus. We were told by some Rhodesian dealers (with turnovers of between R200,000 and R500,000 per annum) that this occupies about one or two days a month, which amounts to some .05 per cent of turnover. The costs can, however, be higher, because the Rhodesian dealers in question calculated the sales of exempt goods in an indirect way to save on expenses.

(ii) *Farming Requisites, Intermediate Goods and Capital Goods.*

35. In principle the exemption of farming requisites, intermediate goods, and capital goods involves the same difficulties as in the case of food, viz.—

(*a*) problems of definitions that are useful in practice; and
(*b*) accounting problems.

36. Yet a third aspect must, however, be noted here viz. the possibility that concessions will be made only to certain kinds of consumers and/or producers. Only farmers, for example, will not have to pay tax on farming requisites. This entails definition of the various groups. Here follow some general observations on the three aspects we have mentioned:

(*a*) The goods will have to be defined *irrespective of the buyer*.

(*b*) Assuming that there is a definition of each category of goods, which parties shall or shall not have to pay the tax will still have to be determined. It would be possible, for example, to stipulate that those parties whose annual purchases of the goods are less than a certain amount shall not be exempt from tax. Those exempt will then have to apply each year for registration and will have to submit the registration number with each purchase. They will be found in all the branches of production, e.g. farming, mining, the construction industries (building contractors, plumbers, etc.), the service industries (hotels, cafés, drycleaners, hairdressers, etc.), and commerce. As appears from Table 7, the sales of retail dealers to businesses amounted to some R61 million (4 per cent) in 1960/61.

TABLE 7.

Sales of Retail Dealers in South Africa according to Kind of Purchaser, 1960/61.

Kind of purchaser.	Sales.	
	Amount (R'000).	% of total.
Importers abroad (i.e. exports)	894	.06
Government	9,146	.61
Business	61,226	4.13
Other (mainly final consumers)	1,424,338	95.20
Total	1,495,604	100.00

(*c*) With a system of registration there should not be difficult accounting problems, and dealers will only have to keep separate accounts for registered buyers in respect of their purchases, for example in a separate register that can be written up from purchase invoices. Hardware dealers, for example, will have to cast an extra classification in addition to their normal accounts, and where a departmental system is in use, each department will have to have an additional code. The system will, however, place a further burden particularly on general dealers and department stores, since they also sell these goods (see Table 5). In urban areas this will not create many difficulties, since registered persons (including firms) will buy mostly at specialised shops. In rural areas the situation can, however, be quite different. Moreover, those general dealers and department stores that sell to farmers will at times have to bear a heavy burden: not only must they finance the farmer for extended periods, but in respect of certain goods they would have to pay the sales tax as well long before receiving the cash.

37. We may mention that in Rhodesia the system provides for the taxation of capital goods, but the buyer can apply for a refunding of the tax.

38. Finally, Rhodesian experience indicates that evasion does occur in that concerns make use of their registration to make tax-free purchases on behalf of their friends when, in fact, the tax is legally due.

(iii) *Other Exemptions in respect of Goods*

39. It would be feasible to exempt purchases of *medicine on a doctor's prescription* (particularly if farming requisites, including medicines for livestock, are exempt). This exemption will be easy to administer, because chemists in any case already keep a register of such prescriptions.

40. It should further be considered whether Government (central, provincial, and local) purchases from retail dealers should be tax-exempt. As appears from Table 7 the amount involved is not large and did not even represent .1 per cent of total sales in 1960/61. To obviate further accounting problems, one would be inclined to subject these to tax as well.

(iv) *General Conclusion*

41. It would appear that the practical difficulties involved in the exemption of *food in general* are of such a nature that the actual implementation will give rise to numerous complications, will increase administrative costs, and will intensify the manpower shortage. Should one still want to make a concession, say, to consumer groups with low incomes, to keep their cost of living at a minimum, it would appear to be more feasible in practice to limit the list of foodstuffs, as in Rhodesia, to a few items, such as bread, maize, mealie-meal, butter, milk, meat, fish and bread flour. (Even then a problem of definition arises: e.g. when is an article a loaf of bread? Some types of bread contain raisins, and it is questionable whether such types are still to be regarded as bread). In Rhodesia these exemptions are already causing endless difficulties for commerce, and resort is being had to all kinds of short-cut methods to calculate sales of exempt goods. The fiscus there, however, appears to adopt a fairly mild and helpful attitude in this connection and to accept that in the process (well-founded) estimates will have to be made, in which he is prepared to acquiesce.

Accordingly, there are no prescriptions as to *exactly how the sales of exempt goods* are to be calculated, and there is apparently a hope that evasion will not attain such proportions that it will justify an extensive inspection service.

42. As regards exemptions of other goods that are sold to specified parties, the greatest difficulties appear to be related to definition.

43. In a discussion with Mr. V. Pope (Under Secretary, Fiscal Branch) it appeared that he was in favour of exemptions simply because exemption is practical politics particularly with reference to the cost of living of certain groups and to farming and mining. In view of the administrative problems created for the authorities and for commerce, Mr. Pope would in principle prefer not to allow any exemptions at all.

(b) Shifting the tax on to the consumer

44. There are in the main two systems according to which a retail dealer can shift the tax on to his customers:

(1) the add-on system; and

(2) the add-in system.

45. *In the add-on system,* which is at present in use in Rhodesia, the tax is added to the selling price of the goods in question at the time of each sale, and the total amount is recovered from the buyer. This means that a calculation of the tax must be made every time a sale takes place. If both exempt and taxable goods are involved in the same transaction, this system requires that the goods must be identified and separated at the time of the sale, that the total selling price of the taxable goods and the tax on it must be calculated separately, and that the total selling price of the exempt goods must next be taken into account.

46. Since a tax at a relatively low rate on small amounts is usually less than the value of the smallest coin, it is impossible to collect a tax at the prescribed rate on such small purchases. Moreover, since the application of the rate to amounts that are not multiples of the rate results in tax made up of fractions of the smallest coin, it is impossible to collect the exact prescribed tax on each sale. To prevent these difficulties and to limit both confusion and arguments at selling points to a minimum, it is desirable that the settling of taxes on individual transactions should occur in accordance with a standard procedure. In Rhodesia, the following scale is prescribed by law for the levying of the tax:

Tax rate: 3⅓ per cent

Rate at which the tax is levied

(*a*) Selling price below £1:

	Selling price			*Tax*
More than	1/2	but less than	2/6	1d.
	2/6		5/–	2d.
	5/–		7/6	3d.
	7/6		10/–	4d.
	10/–		12/6	5d.
	12/6		15/–	6d.
	15/–		17/6	7d.
	17/6			8d.

(*b*) In respect of each full £1 8d.

47. The use of a block rate as above causes the tax rate on amounts at the lower level of each block to be higher than the prescribed rate. In this way an attempt is also made to recoup the tax on articles with a selling price below the minimum amount in the scale.

48. In practice it does happen that, when such a large part of a retail dealer's sales consists of items with a selling price below the smallest amount on which the tax can be levied, the tax does not produce the due amount of revenue. This is particularly true of the Bantu trade, as is indeed demonstrated by what has been experienced in Rhodesia. For example, there are dealers who have a very large turnover in buns that are sold one by one to Bantu at sixpence a piece.

49. The application of the add-on system is time-consuming. The separation of taxable and tax-exempt items in a typical supermarket transaction delays the completion of the transaction by about one-half to one minute, according to the estimate of a supermarket owner in Rhodesia. This delay can affect the net profit of a smaller supermarket by as much as 10 per cent.

50. Because the add-on system necessitates such a large number of calculations by sales assistants, it is also inevitably accompanied by a high percentage of calculating errors. In most cases it is impossible, or out of the question to check or to correct such errors.

51. In Rhodesia it has also been found that the add-on tax system causes sales resistance, particularly in the Bantu trade, apparently because the system brings the tax to the fore at each sales transaction. (Retail dealers are compelled by law in Rhodesia to make the amount of tax in question known to the buyer with each sales transaction, and this is done either orally or by way of a separate item on an invoice or cash slip).

52. The add-on tax system further gives rise to a whole series of troublesome administrative complications, among which the treatment of empty containers is but one example. In terms of the system a bottle store must calculate the sales value of the beverage separately from the deposit on containers, to determine the tax thereon. A typical invoice of a bottle store may appear as follows:

12 brandy	£14.12. 0
2 doz. beer pts. (contents only)	1.12. 6
1 vermouth	1. 4. 4
6 cases soft drinks (contents	0. 3. 0
	£17.11.10
Discount	0.10. 0
	£17. 1.10
Tax	0.11. 5
Deposit on bottles	0.11. 0
Deposit on cases	0. 8. 0
Cigarettes (tax-exempt)	0.16. 1
	£19. 8. 4

53. In the *add-in tax system* the tax is absorbed in the selling price, in the same way as increased railage would be. This system is much simpler to administer than the add-on tax system: it eliminates the identification of taxable and exempt items at the sales point as well as the repeated calculation of the tax, the use of tables, and the waste of time and expenses accompanying it. Each taxable article can in this system be marked at its total selling price (inclusive of tax), or, if so preferred, at the selling price and the tax separately. The system enables a retail dealer to recoup the tax in the way that best suits the particular conditions in his firm. In particular, it is more flexible when a large volume of sales takes place at selling prices below the minimum on which the tax can be paid in the smallest coin.

54. In the add-in tax system it is desirable that the tax rate should remain unchanged for a relatively long period. When the rate changes, the result is that all selling prices must be recalculated and the new price cards must be made out at short notice for a tremendously large number of items.

55. The add-in tax system had previously been in use in Rhodesia, but was replaced by the add-on tax system, apparently mainly because of undesirable competitive practices. Certain firms published the fact that they themselves absorbed the tax and did not shift it on to the consumer, whereas in some cases this was not true. This, and the problems arising from an increase in the rate, induced the authorities to decide on the add-on tax system. At present, however, the general feeling in Rhodesia is that the original add-in system is the more practical and desirable system. (In the add-on tax system the dealer can still exempt the buyer from the tax by granting discounts).

56. The add-in tax system may cause difficulties in connection with resale price maintenance. Should this practice remain in force, it may be necessary for the suppliers in question to make price adjustments, but this need not create problems or lead to injustices.

57. In both cases (add-on and add-in tax), tax will be levied on tax. The retail dealer will most probably be assessed on his gross sales, which include already collected taxes. To allow for this, a dealer should be allowed to load his net selling prices with a slightly higher rate than the current tax rate.

Conclusion

58. To us it would appear that the add-in tax system is, on balance, to be preferred to the other, mainly because it will lessen the administrative difficulties.

(c) Credit Sales, Hire-purchase Transactions and Instalment Sales

59. According to the retail distributive trade census of 1960/61 (which excludes the motor trade), cash sales in the retail trade amounted to some 58 per cent, sales on open account some 37 per cent, and hire-purchase sales some 5 per cent. Hire-purchase transactions are undertaken particularly by furniture stores (63 per cent), dealers in domestic electrical appliances (24 per cent), department stores (5 per cent), and general dealers (2 per cent). The Bureau of Statistics also periodically publishes

data in connection with cash, credit, and hire-purchase sales in the retail trade, but unfortunately the figures are not available for all kinds of business and for the retail trade as a whole. For furniture dealers and dealers in domestic electrical appliances data are nevertheless available, and the most recent figures in this respect compare as follows with those of the 1960/61 census (percentages):

Kind of Business.	Cash Sales.		Sales on Open Account.		Hire-purchase Sales.	
	1960/61.	March 1968.	1960/61.	March 1968.	1960/61.	March 1968.
Furniture Dealers	9·6	7·3	27·2	36·0	63·2	56·7
Dealers in Domestic Electrical Appliances.. ..	19·1	13·5	34·1	26·8	46·8	59·7

60. A turnover tax on credit sales, whatever its nature, will have the effect of making the dealer liable for tax that he has not yet recovered. This principle, however, is not novel in South African income tax legislation, and normal income tax is calculated on the same principles.

61. The tax burden during the first cycle of the credit period will exceed the amount recovered from customers. This difference between the tax paid each month and the tax recovered during the relevant month will decrease more and more with a constant turnover until it disappears at the end of the credit period. The firm itself, however, will have to permanently finance the total difference between tax paid and tax recovered during the first credit period and so too any difference arising from increasing sales. This also occurs at present, however, in respect of the calculation of normal tax on profits arising from short-term credit sales. With a turnover tax the amounts involved and, consequently, also the extent to which the firm will have to finance the "pre-paid" tax will probably be higher than in the case of normal tax.

62. In Ireland this difficulty associated with hire-purchase transactions was obviated by levying the tax only on receipts in respect of hire-purchase accounts. In South Africa, the same concessions existing in respect of normal tax can also be granted in respect of a sales tax.

63. In Rhodesia the finance charges on hire-purchase transactions are exempt from sales tax, whereas in Ireland they are apparently included. To us it would appear that the inclusion of such charges can give rise to numerous troublesome problems; for example, one would have to be able to distinguish between interest and rent and, furthermore, would have to make special arrangements in respect of dealers who finance their own hire-purchase sales and those who do so with the assistance of a hire-purchase financing house. Will this be worth the trouble?

(d) Returns, discounts, bad debts

64. A sales tax should be levied only on net sales, i.e. sales after deduction of returned goods and discounts. Legislation in Rhodesia makes no provision for the adjustment of taxes on sales in respect of which bad debts eventually arise. It does not, however, seem either unreasonable or administratively impossible to bring bad debts into account in the calculation of the turnover tax.

(e) Letting of Motor Vehicles, Equipment, and other Capital Goods

65. A turnover tax will have to be levied on the gross income derived from the letting of motor vehicles, equipment, and other capital goods. The same exemptions that are in force in respect of sales of such goods will also have to apply to the letting of the goods. The administration of this should not create great difficulties.

(f) Exemption of Goods and Services taken from the Business for the Owner's Personal Use

66. Goods and services that the owner draws from his firm for personal use should not be taxable. Their exclusion can be handled fairly easily in the accounts.

(g) Sales by Wholesalers and Manufacturers directly to Consumers

67. In the proposed system of registration sales by manufacturers (e.g. jewellers, bespoke tailors, and ice-cream makers) and wholesalers to registered concerns will be tax-exempt. Any sales directly to a final consumer who is not registered will, however, be taxable. It will be necessary for wholesalers and manufacturers to keep records of such sales. No difficult administrative problems should arise here.

(h) Second-hand Goods and Auctioneers

68. Second-hand goods sold by the trade should in all cases receive the same treatment as new goods. Similarly, sales of all taxable goods, whether new or second-hand, at auctions should be taxable in the same way as when sold by dealers. (In Ireland auctioneers are not liable for sales tax. Such exemption may, however, encourage malpractices).

(i) Exports

69. Exports should be exempt from sales tax. In the same way in which firms will have to keep account of sales to exempt concerns, retail dealers will also have to keep record of exports.

(j) Service Industries and the Professions

70. The question as to how far the service industries and the professions should be subjected to a sales tax, can now be considered. Definitions of the two concepts are difficult to frame, but we have in mind hotels, motels, holiday farms, restaurants, Bantu eating-houses, various kinds of agents, dry-cleaners and laundries, plumbing establishments, electricians who work for their own account, places of entertainment, garages, clubs, doctors, dentists, accountants, barristers, etc. The distinction made below is, therefore, on a rather arbitrary basis and purely for purposes of discussion.

(i) *Service Industries*

71. The available census data in respect of numbers and sales are given in Table 8. On the assumption that all figures relate to 1960/61, we have here 15,300 establishments with a total gross income of R573 million. The table is, of course, not complete and also contains classifications that are disputable. It nevertheless reflects the nature of the activities that qualify for a sales tax.

TABLE 8

Available data in respect of numbers and sales of service industries in South Africa, as revealed in different censuses.

Kind of business/ type of establishment	Number of establishments	Gross income (R'000)
Catering services (1964/65)		
Bantu eating-houses	244	3,195
Bars	109	3,546
Cafés, restuarants and tearooms: *a*		
With liquor licence	64	5,261
Without liquor licence	1,264	39,242
Cafés and tearooms that also deal in groceries *a*	1,056	39,707
Fish and chips shops	372	8,942
Milk and coffee parlours	35	1,036
Sandwich services and delicatessen	75	1,954
Other catering services	17	895
SUB-TOTAL	3,236	103,779
Toilet and beautifying services (1961/62)		
Hairdressers for Whites	2,120	11,620 (Services)
Hairdressers for Non-Whites	211	305 (Services)
Beauty parlours	50	185
Goods sold	—	2,178
SUB-TOTAL	2,381	14,288
Agents (1960/61)		
Auctioneers	180	7,330
Market-masters	124	2,689
Factory representatives	1,036	15,679
Indent agents	568	11,319
Hides and skins	79	3,143
Wool	119	10,350
Other	176	1,124
SUB-TOTAL	2,282	51,634
Business services (1958/59)		
Advertising agents	77	9,869
Market research and credit reporting	11	315
Signwriting and commercial artistry	134	2,420
Engraving	17	133
Buying associations	15	1,552
Debt collecting	5	74
Fumigating..	18	334
Night watch patrol	19	822
Office cleaning services	13	416
Typing, etc.	61	841
Employments bureaux	12	95
Private detective work, etc.	10	36
SUB-TOTAL	392	16,906
Automotive service stations (*census* 1960/61)	3,055	186,987
Bespoke Tailoring (1961/62)	598	5,799
Shoe repairs (1961/62)	449	3,146
Re-treading (1961/62)	152	12,041
Engineering workshops (1961/62)	128	8,908
Automotive electricians (1961/62)	48	1,477
Panel-beaters and spray painters (1961/62)	201	8,129
Smithies (1961/62)	128	1,369
Laundries (1961/62)	586	20,574
Electro-technical contracting (1962/63)	608	29,317
Plumbers (1961/62)	499	15,194
Painting and decorating (1961/62)	257	8,190
Bioscope, café-bioscopes and drive-in theatres (1964/65)	482	25,653

a See also point (e), par. 2. Many cafés were, therefore, covered in the retail distributive trade census.

72. The transactions of many service industries consist in part of sales of merchandise and, for the rest, of the selling of labour. As a general principle, the merchandise part is taxed in Rhodesia, but not the labour, although many of the service industries are excluded (e.g. hairdressers and plumbers). In Ireland it would appear that goods and labour are taxed in so far as the kind of service in question is subject to sales tax.

73. The Rhodesian practice saddles the authorities as well as business with many difficulties. Separate accounting is necessary, and in firms that provide their own services (e.g. staff cafeterias) the problem is worse. Because petrol as well as labour is excluded in Rhodesia, garages often have a difficult accounting task.

74. We wish to suggest that in so far as service industries are included the tax should be on the sale of merchandise as well as of labour. There are no real reasons for excluding the labour portion, and in any case exclusion will only create difficult administrative problems for the fiscus and for business. Purchases of required stocks and services by all business concerns should be exempt; and this can be accomplished by means of a system of registration, which would naturally call for definitions.

75. Should food be excluded, businesses such as hotels, restaurants, bars and cafés will have additional administrative difficulties. Thus a hotel would have to separate the residential from the table tariffs and for this a simple solution is not to be found.

76. We must also point out that many service industries are small concerns, with a minimum of accounting and a minimum ability to effect exclusions properly. In 1961/62, for example, 210 of the 499 plumbing establishments had a gross output of less than R20,000.

Conclusion

77. In our opinion, it would be most practical to present a list of service industries which would be liable to a sales tax. The whole turnover must be taxable, and even the smallest concerns should have no difficulties with this arrangement. With regard to cafés and similar businesses, arrangements similar to those obtaining in the case of certain exempt goods (see (*a*) above) will have to be made.

(ii) *Professions*

78. We do not wish to comment at all on the inclusion or not of the professions: this is a matter of policy. We wish, nevertheless, to point out that difficult problems of definitions can arise here too.

(*k*) *The Valuation Problem*

79. The value on which the tax is to be levied should give rise to many difficulties. In respect of sales to the *final consumer* the value can be based on the actual sale (before tax and after deduction of discounts). The same applies to all the exempt goods delivered to exempted concerns.

(l) Imports

80. Normally, sales of imported articles will be taxed at the final selling point. The problem of gifts and of direct imports by final consumers remains, however. As regards the former, imports of gifts up to, say R50 can be exempt from the tax. No other concessions should, however, be made.

General Conclusion

81. We foresee a wide range of difficulties arising from a sales tax that excludes food, intermediate products, and capital goods, unless the fiscus is prepared, as in Rhodesia, to adopt an accommodating and helpful attitude.

THE TAXATION OF CAPITAL GAINS IN CERTAIN COUNTRIES

ENGLAND (1966)

Short-term Capital Gains

Short-term capital gains are taxed as part of normal taxable income. Profit on the disposal of all forms of property, immovable and movable, including options, debts, etc., is taken into account. Initially the holding period was 3 years for real property and 6 months for other property. As from 1965, the period has been 1 year for all property acquired after 6th April, 1965.

Long-term Capital Gains (Capital Gains Tax)

Capital gains falling outside the short-term period are subject to a capital gains tax calculated at a fixed rate of 30 per cent. In two cases the tax is not calculated at the fixed rate of 30 per cent, viz.—

(1) in specified circumstances the capital gain accruing to an individual is taxed as part of his normal taxable income; and

(2) a capital gain which accrues to a company is subject to corporation tax and not to the capital gains tax.

Capital Losses

Short-term

Capital losses are set off against capital profits of the same and subsequent years, but may not be set off against income from other sources and long-term capital gains.

Long-term

Capital losses are set off against long-term capital gains of the same and subsequent years.

UNITED STATES (1967)

Capital gains are not taxed separately but are included in gross income with the following concessions:

Individuals: A special deduction of 50 per cent of the net capital gain or, alternatively, a special tax rate of 25 per cent on the net capital gain, whichever may be the more beneficial to the taxpayer.

Companies: A special tax rate of 25 per cent on the net capital gain is applicable.

Capital losses

Individuals: Capital losses may be set off in full against capital gains and up to $1,000 against other income. Capital losses may be carried forward without any limitation.

Companies: Capital losses may be set off against capital gains only with a 5 year carry-over.

France (1966)

French tax law distinguishes clearly between—

(1) gains realised by an individual on the sale of private capital assets, and

(2) gains realised by a business enterprise (individual or company) on capital assets.

Gains realised by an individual on the sale of private capital assets (other than real property) are generally exempt from taxation. Capital gains realised by a business enterprise are included in normal taxable income.

If, however, the proceeds are invested in other capital assets, the gain is excluded from the taxable income, but for purposes of depreciation it is also excluded from the cost basis of the asset. In order to discourage speculation in unimproved land, the gain on unimproved land suitable for the erection of residences is included in the normal taxable income of an individual as from 1964. The same rule also applies in respect of a gain on the sale of shares in a property company. Gain on share transactions outside the normal course of trading is as a general rule not taxable. If transactions occur frequently, they are regarded as trading, and the gains are taxable.

Germany (1963)

Kapitalgesellschaften (i.e. the corporation, the limited liability company, the partnership limited by shares, and a mining company with independent legal existence): These entities are traders with respect to all their activities, and every transaction, whatever its nature, is regarded as a business transaction which may give rise to a taxable gain. All income, therefore, whatever its source may be, is taxable business income. Consequently there is no distinction between capital gains and other gains.

Other Taxpayers: A distinction is made between business and private assets in the case of taxpayers other than *Kapitalgesellschaften*. Capital gains arise only from so-called speculative transactions, and speculative transactions can be carried not only in respect of non-business or private assets. Therefore, any property of an entity not engaged in business may be the object of a speculative transaction, as may be the private property of an individual trader. The following are speculative transactions:

(1) The disposal of real property or rights thereto if held for less than 2 years.

(2) The disposal of movable property, particularly securities, if held for less than 6 months.

Speculative gains are aggregated with other income and thus form part of normal taxable income.

Sweden (1968)

Real Property

If real property is sold within less than 2 years after acquisition, the whole profit is taxable as ordinary income. If the property is sold after being held 2 years or more, 75 per cent of the profit is taxable income.

Property acquired by gift or inheritance is considered to have been acquired as at the date when it was purchased by the donor or the deceased. The acquisition price can be adjusted according to a price-index. If the property sold includes a residence, a deduction of 3,000 Swedish Crowns per year is allowed. Losses are deductible from capital gains during the same and the following six years.

Shares and other Securities

(1) If held for less than 2 years—taxable profit 100 per cent.
If held for 2 but less than 3 years—taxable profit 75 per cent.
If held for 3 but less than 4 years—taxable profit 50 per cent.
If held for 4 but less than 5 years—taxable profit 25 per cent.

(2) If sold when held 5 years or more, taxable profit is 10 *per cent of selling price* minus costs, unless the seller can prove that there is no profit or a profit less than 5 per cent of the selling price.

A general deduction of 500 Swedish Crowns is allowed from the profit under (2) above.

Losses are deductible only if the shares are sold within 5 years and are adjusted in accordance with the schedule set out in (1) above. The losses are deductible only from capital gains. Capital gains under (2) can be exempted from tax if the Government considers the taxation of such gains to be against the public interest.

Capital gains arising from share transfers within a group of companies are exempted from tax if the shares constitute inter-company holdings.

For the acquisition of shares by gift, inheritance, etc., the same rules as for real property apply.

Property other than real Property and Shares

If held for less than 2 years—taxable profit 100 per cent.
If held for 2 but less than 3 years—taxable profit 75 per cent.
If held for 3 but less than 4 years—taxable profit 50 per cent.
If held for 4 but less than 5 years—taxable profit 25 per cent.
If held for 5 years or more—no tax.

If the property is sold within 5 years, the profit is taxable only if the property has been acquired by purchase, exchange, etc. Consequently the profit is not taxable if the property has been acquired by gift or inheritance.

THE DISTINCTION BETWEEN CAPITAL AND REVENUE IN CASE LAW

From a study of a number of important cases it appears that the following principles and tests are at present applied:

The Nature of the Transaction

The nature of every transaction must be carefully analysed to determine whether it is a capital receipt or not. Watermeyer, C.J., stated in New States Area Ltd. v. C.I.R. (1946 A.D. 610; S.A.T.C. (14) 155):

> "The conclusion to be drawn from all these cases seems to be that the true nature of each transaction must be enquired into in order to determine whether the expenditure attached to it is capital or revenue expenditure."

Referring to these words, Hathorn, J.P., stated quite correctly, in C.I.R. v. Illovo Sugar Estates Ltd. (1951 (1) S.A. 306 (N); S.A.T.C. (17) 387):

> "In my opinion, that passage applies *mutatis mutandis*, to receipts."

In determining the true nature of a transaction, regard must be had to its content and not its form (New States Areas Ltd. v. C.I.R. (*Supra*)). In each case the correct inference must be drawn from all the circumstances (de Villiers v. C.I.R., 1929 A.D. 227; S.A.T.C. (4) 86).

It is generally accepted that the intention of the taxpayer is the most important factor in determining the nature of a transaction. In C.I.R. v. Stott (1928 A.D. 252; S.A.T.C. (3) 253) Wessels, C.J., stated:

> "The gain must be acquired by an operation of business in carrying out a scheme of profit-making . . . It is not necessary to go so far as to say that the intention with which an article or land is bought is conclusive as to whether the proceeds derived from a sale are taxable or not. It is sufficient to say that the intention is an important factor, and unless some other factor intervenes to show that when an article was sold it was sold in pursuance of a scheme of profit-making, it is conclusive in determining whether it is capital or gross income."

This was also the approach of Maritz, J., in C.I.R. v. Visser (1937 T.P.D. 77; S.A.T.C. (8) 271). He stated:

> "The intention, therefore, of a taxpayer in regard to any particular transaction, although not necessarily conclusive, is always of the utmost importance in deciding whether the profit made on the sale of an asset is income or merely the enhanced value of a capital asset."

Intention of the Taxpayer

The intention of the taxpayer must be established from all the circumstances of the case. Here the following may be of particular interest: the operation of business in the execution of a profit-making scheme, the manner in which an asset is acquired and sold, the period for which the asset is held, the continuity of activities, the nature of the taxpayer's work or profession, and the manner of financing the transaction, etc.

(*a*) *The Operation of Business in carrying out a Scheme of Profit-making*

Here the relevant test is whether the accruals or receipts are not fortuitous in nature but are designedly sought for.

In Marshall Industrials v. C.I.R. (1951 (3) S.A. 581 (A); S.A.T.C. (17) 378) the appellant bought a number of shares in another company with a view to selling some of them at a profit and retaining the balance as controlling shares in the other company. The court found that the profit constituted revenue. Schreiner, C.J., stated:

> "In dealing with the question when a gain following from a purchase and a resale at an enhanced figure is taxable as income and when it is a gain of a capital nature, the President of the special court referred to the factor of intention with which a purchase and resale were undertaken and to the relation of the intention to such accepted expressions as 'an operation of business in carrying out a scheme for profit-making'. It is unnecessary to pursue this inquiry, which is not a new one."

In S.A. Marine Corporation Ltd. v. C.I.R. (1955 (1) S.A. 654 (K); S.A.T.C. (20) 15) it was held that an incidental exchange profit does not constitute a capital profit. The judge justified his finding as follows:

> "In my judgment the correct view is that the transmission of moneys to and from America is not not merely part of appellant's trading structure but is an integral part of appellant's business operation in carrying out a scheme of profit making: in my judgment such transmissions of money to and from America constitute transactions on revenue account and exchange profits or losses attendant upon such transmissions have a revenue character."

In Overseas Trust Corporation Ltd. v. C.I.R. (1926 A.D. 444; S.A.T.C. (2) 71) the appellant was a finance and investment company whose business included the buying and selling of shares. The court found that the interest concerned was acquired with a view to making a profit, and that the proceeds were therefore not of a capital nature. Innes, C.J., stated:

> "It was pointed out in Commissioner of Taxes v. Booysen's Estate (1918 A.D. 576) that the profit resulting from the sale of an asset might be either capital or income, according to circumstances. If the transaction were a mere realisation of capital at an enhanced value, the entire proceeds would remain capital; but if it were an act done in the ordinary course of the vendor's business, then the resulting gain would be income. The reason for the distinction is clear. Where an asset is realised at a profit as a mere change of investment there is no difference in character between the amount of enhancement and the balance of the proceeds. But where the profit is, in the words of an eminent Scotch Judge, see Californian Copper Syndicate v. Inland Revenue (41 Sec. L.R. p. 694), 'a gain made by an operation of business in carrying out a scheme of profit making' then it is revenue derived from capital productively employed, and must be income . . . This was no fortuitous and unforeseen

enhancement. It followed from the facts which were within the knowledge of the contracting parties, and the resulting benefits must have been within their c ntemplation and intention."

(*b*) *Mode of Acquisition or Sale of an Asset*

The way in which an asset is obtained is sometimes important in determining intention, but it is not decisive. Assets acquired by means of donation, or inheritance are usually not held with the intention of realising them at a profit. This need not always be the case. In C.I.R. v. Strathmore Exploration and Management Ltd. (1956 (1) S.A. 591 (A); S.A.T.C. (20) 375), for example, it was held that the proceeds of an asset inherited by the company are not of a capital nature. After the court had examined and considered all the circumstances, it concluded that the asset had been bequeathed to the company so that the asset could be profitably sold in the ordinary course of the company's business. The way in which an asset is sold may also be of importance in determining intention. Thus an incidental offer to buy or the expropriation of property may be an indication that an asset has been acquired with the intention to hold it as an investment, while active efforts to sell an asset, especially if it has been held for only a short period, may be an indication that it was acquired with a view to reselling at a profit. (See for example: Yates Investments (Pty.) Ltd. v. C.I.R., 1956 (1) S.A. 612 (A); S.A.T.C. (20) 368). The way in which the purchase of an asset has been financed may also be an indication of the intention with which an asset has been acquired. When money is lent for the purchase of an asset and is repayable over a short term, the inference that it has been obtained for purposes of speculation will be more readily drawn than when it has been acquired with the taxpayer's own surplus funds. Take note, for example, of the arguments of Beyers, J.A., in Strathmore Holdings (Pty.) Ltd. v. C.I.R. (1959 (1) S.A. 460 (A); S.A.T.C. (22) 203):

> "The appellant was handicapped by a lack of capital from the outset. The fact that it had to resort to large-scale borrowing of money might not have been a vital consideration if the appellant had possessed revenue-producing assets out of which to pay the interest on its loans. The fact that it had no revenue-producing assets might not have been important either if it had not had to pay a substantial amount of interest annually. Taken in conjunction, however, these two factors alone are sufficient to warrant the inference that the appellant acquired the New Pioneer and Stilfontein shares with a view to a profitable resale and not with the object of holding them as an investment."

(*c*) *The Period for which an Asset has been held*

The period may be of importance when the intention with which an asset has been acquired has to be determined. If an asset has been held for a long time, this may serve to confirm an intention to hold it as an investment, while a short holding period may indicate the opposite. (I.T.C. 874, S.A.T.C. (23) 96). Time can be a factor which must be considered only together with other factors and need not necessarily be decisive. So, for example, it was held, after all the circumstances had been taken into account, that the proceeds of property which had been held for 18 years (Durban North Traders Ltd. v. C.I.R. 1956 (4) S.A. 594 (A); S.A.T.C. (21) 85) or even for more than 50 years (I.T.C. 862, S.A.T.C. (22) 301), were taxable.

(*d*) *Continuity*

The frequency and repetition of transactions may also be important in determining the intention of the taxpayer. Continuity is also only one of the factors to be considered. It appears from *obiter dicta* in Appellate Division judgments that a distinction is drawn between companies and individuals as regards the part played by continuity. This was the view taken both in Platt v. C.I.R. (1922 A.D. 42) and in C.I.R. v. Stott (1928 A.D. 252; S.A.T.C. (3) 253). In the latter case Wessels, J.A. stated:

> "If you are dealing with a company one of whose objects is to buy and sell land, then the company might well be considered to be doing the business of selling and buying land even though it carries out only a single transaction, but when an individual like a surveyor who is not professedly carrying on the occupation of a landjobber buys and sells one or more plots of land, he cannot be said *prima facie* to be doing the business of a landjobber. Before it can be said that an individual is carrying on a business, there must be some proof of continuity."

In C.I.R. v. Lydenburg Platinum Ltd. (1929 A.D. 137; S.A.T.C. (4) 118), it was stated:

> "So that 'continuity' (as it has been called) is a necessary element in the carrying on of a business in the case of an individual, but not of a company."

In C.I.R. v. Paul (1956 (3) S.A. 335 (A); S.A.T.C. (21) 1), Centlivres, C.J. said that a company

> "may carry out an isolated transaction as a profit making scheme whereas it may not be so in the case of an individual."

It would appear from the cases quoted that a distinction is drawn between an individual and a company because, in the case of a company, its objects are contained in its memorandum, and in determining the intention of the company regard is to be had to these objects.

Mixed Intentions

It may often happen that more than one consideration applies in the purchase of an asset, as was the case in C.o.T. v. Levy (1952 (2) S.A. 413 (A), S.A.T.C. (18) 127). When Levy bought the shares, his main intention was to hold them as an investment, although he also considered the possibility that the shares could increase in value and that he could resell them at a profit. Schreiner, J.A. proposed the following test:

> "But unless one were to hold, what the legislature could not have intended, that the taxpayer must exclude the slightest contemplation of a profitable resale of the property, it seems to me that the only test to apply is that of the main or dominant purpose."

In casu it was found that Levy's dominant intention was to hold the shares as an investment and that the profit on the sale of the shares was of a capital nature.

When the taxpayer has a double intention, there can of course be no dominant intention. In Durban North Traders Ltd. v. C.I.R. (supra) the company bought land and erected buildings with the object of letting them for as long as was profitable and to sell them if a good profit could be made. The court found that the profit was not of a capital nature, Schreiner, J.A. stating:

> ". . . the policy throughout in respect of both properties was twofold—to let while that was the most profitable course and to sell when circumstances pointed to that as the best method of making a profit. They were alternative ways of carrying on the company's business which was a single business of turning land to account."

Change of Intention

The intention with which an asset is acquired need not necessarily be decisive. The intention with which an asset is held may change. For example, the intention to hold an asset as an investment may change so that the asset is then held as a current asset.

It is obviously very difficult to prove a change of intention. In C.I.R. v. Richmond Estates Ltd. (1956 (1) S.A. 602 (A), S.A.T.C. (20) 355) Centlivres, C.J. quoted as follows from Gunn's Commonwealth Income Tax:

> "It is possible for a company or any other taxpayer to change from a trader to an investor and vice versa, but with reverence, it is as difficult to make the change for taxation purposes as it is for a rope to pass through the eye of a needle."

In this case the company bought properties with the object of selling them at a profit. It was subsequently decided to hold 14 of the properties for letting purposes. As a result of the effect which the Group Areas Act was expected to have on the properties, it was decided to sell. The court held that the profit was of a capital nature. Although the properties originally formed part of the working assets (trading stock), their nature changed with the change of intention and they became fixed or capital assets. In the case of Yates Investments (Pty.) Ltd. v. C.I.R. (supra), however, appellant did not succeed in convincing the court that there had been a change of intention, and the profit on the sale of the properties was declared taxable. In C.I.R. v. Lydenburg Platinum Ltd. (supra) the same thing happened. The judge stated:

> ". . . even though it be assumed that these properties were originally acquired for the purpose of carrying on the business of mining, the subsequent events to which I have referred point to a clear change of policy in regard to the use to which they were put . . . In the present case, a new factor did intervene of a decisive character, namely the deliberate adoption of the policy of selling the company's properties to make profits."

Intention in the case of a Company

Apart from what has been said above about intention in general, there are specific considerations that apply in the case of a company.

In Lace Proprietory Mines Ltd. v. C.I.R. (1938 A.D. 267, S.A.T.C. (9) 349) it was stated:

> "It was submitted that to determine whether this sale was effected in pursuance of a pre-existing scheme of profit making, it was permissible to consider the following matters: (1) the name of the company; (2) its objects; (3) its activities; (4) its policy; (5) the circumstances of acquisition of the assets in question; and (6) the cir-

cumstances of its realisation. No objection can be made to the relevance of an enquiry on those lines."

The objects of a company are usually very widely stated in order to avoid *ultra vires* acts, and although the objects of a company are often referred to in judgment, it is doubtful whether they have any value in determining intention. In C.I.R. v. Strathmore Exploration and Management Ltd. (supra) the judge quoted as follows from Ruhamah Property Company Ltd. v. Federal Commissioner of Taxes (41 C.L.R. 148):

> "In our opinion the authorities show that the objects and powers of the company contained in its memorandum . . . are not decisive of the question whether the sale was an operation in carrying out a scheme of profit making, but that a consideration of all matters advanced by the company was relevant to a determination of that question."

The intention of the company is determined with reference to the intention of directors (C.I.R. v. Richmond Estates (Pty.) Ltd. (supra)) or of those who control the company. (I.T.C. 944, S.A.T.C. (24) 451). Regard may also be had to the intention of the promotors, (C. Ltd. v. C.o.T. 1961 (2) S.A. 444 (S.R.), S.A.T.C. (24) 148) and the circumstances and events preceding incorporation. (Realisation Company v. C.o.T. 1951 (1) S.A. 177 (S.R.), S.A.T.C. (17) 139). Formal acts, and minutes in particular, are also most important. (Wilson v. C.I.R. 1926 C.P.D. 63, S.A.T.C. (2) 12).

LIST OF ORGANISATIONS AND INDIVIDUALS WHO MADE SUBMISSIONS TO THE COMMISSION

Abrahamse, H. L.
Abrahamson, D. A.
Adams, K. A. H.
Adcock, E. J. Limited
African Cement Producers Association
African Hide Trading Corporation (Pty.) Ltd.
Afrikaanse Handelsinstituut
Afrikaanse Christelike Vroueveréniging
Afrikaanse Sakekamer, Pretoria
Aiken, A.
Airways Pilots' Association
Arnold, W. V.
Association of Chambers of Commerce of South Africa
Association of Law Societies of the Republic of South Africa
Association of Pension and Provident Funds of South Africa
Association of Railways and Harbour Pensioners
Association of Trust Companies in South Africa

Badenhorst, C. H.
Bam, J. H.
Bantu Administration and Development, Department of
Baptist Union of South Africa
Beattie, W. E.
Boden, M. B.
Boland Agricultural Union
Bond, W. L. C.
Booysen, C. M.
Borkum, M. M.
Brewers' Institute
Brink, W.
Building Industries Federation (S.A.)

Celliers, J. A.
Celliers, J. M.
Central Board of Land Surveyors of South Africa
Central Co-op Tobacco Co. of South Africa Ltd.
Chamber of Mines of South Africa
Christian Council of South Africa
Cilliers, A. C.
Clarke, R. G.
Cliffe, Dekker and Todd
Coca-Cola Bottlers Association Ltd.
Committee of University Principals
Community Chest of the Western Cape
Convocation of the University of the Witwatersrand
Cook, G. W.
Croft, R. B. E.
Customs and Excise, Department of

De Beers Consolidated Mines Ltd.
Deetlefs, J. J.
de Kock, M. H.
Delwers-Adviserende Raad van Barkly-Wes
Denis Lowe, Venn & Co.
Dental Association of South Africa
de Vries, J. van W.
Dickman, A. B.
Drake, P. A. I.
Drum, C. P.
Duncan, J. M.
du Plessis, P. J.
du Preez, D. J.

Eastern Province Coastal Agricultural Union
Edgars Stores Ltd.

Federale Groep
Finance Houses Association of South Africa
Firman, S. T.
Fiske, J. (Mrs.)
Foulous, H. G.
Friedman, C.
Furniture Traders' Association of South Africa

Geldenhuis, E. J. S. (Mrs.)
Gillie, N. C.
Glasse, J. (Miss)
Gordon, D.
Greyling, D. J.

Haacke, Sher en Aab
Halliday, G. H.
Hare, H. A.
Hartzenberg, J. S.
Haynes, R.
Hitge, T. W.
Hoek, P. W.
Holsboer, B. H.
Hurter, J. A.

Industries, Department of
Industrial Development Corporation of South Africa, Ltd.
Inland Revenue, Department of
Institute of Social Research—University of Natal
Institute of South African Architects
Insurance Associations (Short Term Insurers)

James, D. A.
Johannesburg Stock Exchange

Kaapstadse Afrikaanse Junior Sakekamer
Kellermann, D. O. K. A.
Kidson, C. C.
King, M. H. M.
Ko-operatieve Wijnbouwers Vereniging van Zuid-Afrika, Bpk.

La Rocca, E. V.
Larsen, O.
Lex Poole Agencies (Pty.) Ltd.
Lichtenburgse Afrikaanse Sakekamer
Liebenberg, F. W. R.
Life Offices' Association of Southern Africa
Logie, M.
Londal, E. A.
Louw, J. G.
Lurie, R.

MacPherson, I. G.
Marais, H. B.
Marais, H. S.
Marais, M. D.
Marais & Du Preez
Maré, W. J.
Martin, V. T. H.
McDonald, C. A.
Medical Association of South Africa
Metro-Goldwyn-Mayer Films
Merchant Bankers' Association
Moore, P. H.
Munro, D. G. N.
Murray, M. A. (Miss)

National Council for the Care of Cripples in South Africa
National Council of Chartered Accountants (S.A.)
National Council of Social Services Association of South Africa
National Council of Women of South Africa
National Federation of Hotel Associations (Non-Liquor) of S.A.
National Party: Fosfaat Branch
National Party Office—Wolmaransstad
Northern Transvaal Chamber of Industries
National Welfare Organisation

Ollemans, P. H.

Parsons, R. (Mrs.)
Pearson, P.
Permanent Force Pensioners
Pierson, H. N.
Pistorius, C. W. I.
Pottinger, W. H.

Raath, C. J.
Railway Pilots' Association
Rasmussen, A. J.
Reid, E. S.
Reynders, H. J. J.
Roberts, T.
Rosenthal, E.
Rossouw, G. P.
Roy, E. J. G.

Salomon, G.
Sevenbergen, A. P.

Shrand, D.
Simpson, A. (Miss)
Sinclair-Black, R. B.
Society of Advocates of South Africa (Witwatersrand Division)
South African Agricultural Union
South African Association of Consulting Engineers
South African Confederation of Labour
South African Federated Chamber of Industries
South African Federation of Business and Professional Women
South African Institute for Medical Research
South African Iron, Steel and Allied Industries Union
South African Mutual Life Assurance Society
South African National Council for the Blind
South African National Council for the Welfare of the Aged
South African Nursing Association
South African National Council for Child Welfare
South African Timber Growers' Association
Staff Association, University of Cape Town
Staff Association, University of Natal
Staff Association, University of Pretoria
Staff Association, University of Rhodes
Steel and Engineering Industries Federation of South Africa
Ster Teaters (Pty.) Ltd.
Stuart-Rogers, V. A.
Swartz, E. T.

The Association of Building Societies of South Africa
The Cape Distilling Merchants' Association
Tobacco Industry Control Board
Trade, Department of
Trade Union Council of South Africa
Transvaalse Onderwysersvereniging
Twentieth Century-Fox Organisation
Trollip, A. E. G.
Twycross, H. C.

University of Natal
University Teachers Association of South Africa

van den Heever, D. J. G.
van Deventer, J. H. A.
van Eeden, H. S.
van Rensburg, D. G. J.
van Rooyen, A. J.
van Waasdijk, T. J.
van Zyl, Schutte en Kie. (Edms.) Bpk.
van Zyl, T. L.
Venn, G. S.
Vermooten, J. J.
Volkskas Ltd., Estate Department

Webster, G. C. S.
Wells, F. J.
Werksman, N.
Worcester Board of Executors Ltd.

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