

07 August 2018

The Standing Committee on Finance

SACPRIF’S comment on the [2018 Draft Taxation Laws Amendment Bill](https://pmg.org.za/bill/815/) (TLAB)

and the [2018 Draft Tax Administration Laws Amendment Bill](https://pmg.org.za/bill/814/)(TALAB).

1. As we have contended for a decade, all Income Tax and VAT laws conflict with the Constitution, explicitly in sec 25 and implicitely in sec 228.

*Sec 25 (5) The state must take reasonable legislative and other measures, within its available resources, to foster conditions which enable citizens to gain access to land on an equitable basis.*

*Sec 228 (2) The power of a provincial legislature to impose taxes, levies, duties and surcharges ­*

1. *may not be exercised in a way that materially and unreasonably prejudices national economic policies….*

Therefore we again request that Parliament repeals these Taxation and Tax Administration Laws because, in penalising citizens for working, investing and buying things they make access to land, jobs and GDP growth more costly than necessary.

And if this Committee had followed our advice ten years ago to replace hard-earned income taxes and vat with an unearned 100% land tax, a rates and taxes type user-charge, there would now be no (sec 228) expropriation crisis, no involuntary jobless or landless conditions, and GDP in 2018 would be R1.085tr higher

You do not have to accept our judgement, or that of the handful of Nobel Economics Prize Winners which we have mentioned over the years. For the Davis Tax Committee (DTC) came to the same conclusion in their March 2018 report on land taxes in their Wealth Tax analysis (Annexure A hereto).

In reproducing their reasons in full (see below in italics) your committee is reminded that in one way or another each DTC member is vitally interested in the outcome because the tax earning aspects of their profession would disappear if land taxes replace income taxes and vat.

They are therefore all conflicted but nevertheless concluded on pages 62 to 67 that:-

*Theoretically, the benefits of recurrent taxes on immovable property (and particularly a land tax) are attractive for a range of reasons:*

*• A land tax is generally considered to be the least distortive of all taxes and thus the least harmful to economic growth. This is based on the fact that, since the supply of land is fixed, economic efficiency is not reduced by taxing land.*

*Hence a land tax may not deter production or distort the market mechanism or otherwise create a deadweight loss. Hence a land tax discourages unproductive land speculation (by reducing profits from land speculation), thereby promoting the effective use of land.*

*• Ownership of land is generally easy to establish, making it possible to identify who is liable for the tax and it is therefore difficult to evade.*

*• On the basis that it is a “presumptive tax” (i.e. the tax is levied irrespective of whether the owner of the land is in fact extracting the “economic rent” from the land), a land tax promotes and encourages the efficient use of land, and discourages unproductive uses (such as simply leaving land vacant).*

*• Taxing land reduces the likelihood of land price bubbles (and the resulting macroeconomic instability caused by such price bubbles) by stabilising land prices.*

*In summary, recurrent taxation of immovable property is argued to be one of the most efficient forms of taxation from an economic perspective because it does not distort labour supply decisions, has a smaller effect on investment decisions than income tax and is difficult to avoid. The tax system can also be made progressive through rebates and differential tax rates. From a purely theoretical perspective then, the case for taxing land is very strong.*

True to form DTC then goes on to pour cold water on its own conclusions because of administrative difficulties regarding *the transfer duty issue, the effect of double taxation at the local government and at national level, inconsistency that may arise between local government and national governments, complexity regarding business property, farming land and tribal land, basis of valuation and the impact….on Government’s existing policies on land redistribution, particularly the effect upon recipients of a land redistribution programme.*

In attempting to negate the advantages of land taxes what they overlooked is that these problems have been ironed out in both our own Municipal Property Rates Act and in Hong Kong’s land tax regulations.

1. In support of our scepticism of the tax professionals in private and public practice we draw your attention to the fact that in 2017 National Treasury’s Mr Axelson was tasked by your committee to report back to you about land taxes. With Prof Tideman we met with NT in Pretoria a year ago, but no report has yet been forthcoming.
2. Apart from the DTC endorsement, the 2019 Financial and Fiscal Commission report to Parliament was unstinting in what was called the value-capture of land rents. They thought this should be confined to Municipalites but gave no reasons why it should not be adopted by National Treasury.
3. To round off, because in one way or another the expropriation without compensation issue is going to impact on the Minister’s budget, I am obliged to inform you that, de facto, land prices are a state subsidy which can be withdrawn today without compensation.

This subsidy exists because in contradiction of sec 228 the state favours taxing citizens for working, investing and consuming rather than land. As soon as this committee stops levying income taxes and vat it will have to increase land rent taxes to 100% as sec 25 insists.

Kind Regards,

Peter Meakin, Registered Professional Valuer

Patron of SACPRIF and Chairman, Management Committee

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Annexure A

**Davis Tax Committee: Wealth Tax Report: March 2018**

Immovable property (including land taxes)

The remaining large asset class is immoveable property. Currently, transfer duty acts as the principal wealth tax in South Africa. However, this does not mean that transfer duty is in itself the correct measure. There are also other taxes on immoveable property.

A land tax is essentially a narrow form of a property tax ; as such, the DTC will discuss these two taxes together. Any discussion of the desirability and feasibility of a recurrent tax on immovable property in South Africa must be conducted with an awareness of and sensitivity to current debates relating to land ownership in the country, as well as concerns regarding the vast disparities in wealth inherent in South African society.

Currently, the following taxes are levied on immoveable property in South Africa:

• Capital Gains Tax (CGT) on the disposal of immovable property (the DTC hastens to emphasise, however, that CGT is not a Wealth Tax but a tax on deferred income);

• Transfer duty or VAT on the purchase of immovable property, payable by the person acquiring the immovable property.

• Municipal property rates, which are levied by local government, generally as a percentage of the value of the immovable property. Municipal property rates are levied in terms of the Local Government: Municipal Property Rates Act, 2004, with South Africa’s Constitution making provision for local government to levy such rates (in addition to any power that National Government might have to levy similar taxes).

Theoretically, the benefits of recurrent taxes on immovable property (and particularly a land tax) are attractive for a range of reasons:

• A land tax is generally considered to be the least distortive of all taxes and thus the least harmful to economic growth. This is based on the fact that, since the supply of land is fixed, economic efficiency is not reduced by taxing land.

Hence a land tax may not deter production or distort the market mechanism or otherwise create a deadweight loss. Hence a land tax discourages unproductive land speculation (by reducing profits from land speculation), thereby promoting the effective use of land.

• Ownership of land is generally easy to establish, making it possible to identify who is liable for the tax and it is therefore difficult to evade.

• On the basis that it is a “presumptive tax” (i.e. the tax is levied irrespective of whether the owner of the land is in fact extracting the “economic rent” from the land), a land tax promotes and encourages the efficient use of land, and discourages unproductive uses (such as simply leaving land vacant).

• Taxing land reduces the likelihood of land price bubbles (and the resulting macroeconomic instability caused by such price bubbles) by stabilising land prices.

In summary, recurrent taxation of immovable property is argued to be one of the most efficient forms of taxation from an economic perspective because it does not distort labour supply decisions, has a smaller effect on investment decisions than income tax and is difficult to avoid. The tax system can also be made progressive through rebates and differential tax rates. From a purely theoretical perspective then, the case for taxing land is very strong.

There are, however, a number of practical and principial considerations that need to be taken into account when considering the recurrent taxation of immovable property.

The first is the concern about liquidity and the ability to pay. It is not generally feasible to sell off a small portion of land or a home in order to meet the tax liability; thus the property/land tax needs to be paid from income. This would pose problems in the case of farmers (who may include previously disadvantaged individuals who have benefitted from land redistribution policies), retired persons with limited incomes and the implications in the case of tribal land ownership are almost impossible to ascertain. While a solution might be to create exemptions for farmers, pensioners and tribal land, this would introduce distortions and would undermine the economic efficiency of the tax.

A further difficulty with a property tax is that it singles out one asset class by only taxing one component of wealth. It would therefore disproportionately affect those who hold relatively more of their wealth in property (as opposed to, for example, listed shares). Thus there is the danger that a property tax would fall disproportionately on middle-income families who tend to hold a greater proportion of their wealth in the form of immovable property than the very wealthy.

While Municipal Valuation Rolls exist, the valuation problems involved in introducing a national land or property should not be underestimated. Different municipalities use inconsistent approaches to determining property values. In addition, while some municipalities have the capacity to ensure that the valuation roll is up-to-date and reasonably comprehensive, this is by no means true for all.

Given the difficulties that municipalities face in terms of collecting municipal rates and the extent of corruption within some municipalities, it is not clear that a national system will easily succeed. As the OECD has recommended (OECD, 2015), “as a first step, problems at the local level should be addressed through capacity building and law enforcement.” The administration of the current system would need to be improved before a new national tax could be introduced. Further technical support from the national government may be required in improving capacity, for example in updating valuation registers and establishing a methodology for future updates.

Notwithstanding the need to address these administrative challenges, there are still good reasons to favour a national recurrent property tax as an alternative to the existing system of Transfer Duty. Transfer duty is particularly distortionary because it hinders the efficient functioning of the property market. Transfer duty is a significant impediment to buying and selling, thereby causing property owners to ‘hang on’ to a property that no longer best serves their needs, rather than sell and buy a different property. In addition, by limiting the movement of households, employment and growth are negatively affected.

The DTC has not examined the issues surrounding transfer duty, being a transactional wealth tax. The National Treasury has, in recent years, substantially increased the transfer duty rates applicable to high value transactions of predominantly residential immovable property.

An 11% top rate band (applied to considerations exceeding R2.25 million) was added to the Transfer Duty table with effect from 1 April 2015. A 13% top rate band (applied to considerations exceeding R10 million) was added to the transfer duty table with effect from 1 April 2016. The above increases have substantially increased the proportion of transfer duty paid by the wealthy taxpayer.

These Transfer Duty collections exclude CGT collections that are paid on the disposal of fixed property. As indicated above, the CGT inclusion rate for individual taxpayers has been increased to 40% (effective 2016 year of assessment). If this is coupled with the top marginal PIT rate (45%) the maximum effective tax rate on the taxable portion of a capital gain has now reached 18%.

Chapter 5: The South African case

Thus, the total tax take on the gain arising on the transfer of high-end residential property can be as much as 31% if transfer duty and CGT are combined. This excludes other transaction costs associated with the disposal and acquisition of highend residential properties.

This must surely create the concern with regard to the effects of all taxes and transaction costs. All combined they can cause stagnation within the residential property market thus reducing related capital and revenue income tax collections.

During the tax year ended 31 March 2017 there were 105 977 transfer duty leviable transactions in South Africa yielding total transfer duty receipts of R8.7 billion. Transactions of more than R2.25 million totalled 23 441 yielding transfer duty receipts of R6,96 billion. (79% of the total).‘Stamp duties on the transfer of both property and equities raise significant revenue, but distort people’s behaviour in an economically costly way, discouraging mutually beneficial transactions and thereby hindering the efficient allocation of assets.’ (Mirrlees (2011) p. 737).

Given the current state of South Africa’s tax collections it is unrealistic to propose the unilateral or immediate withdrawal of transfer duty. Equally, it would be unwise to propose further taxation of residential property through a wealth tax, at least until such time as the adverse impact of the transfer duty rate can be reduced.

Rates and taxes on land and improvements

As indicated, there is technically an argument for a wealth tax to be imposed on land and buildings. This would have the advantage of collecting tax on a monthly or annual basis over the holding period of the property as opposed to delaying taxation until sale or transfer through the transfer duty system.

The Eighth report of the Katz Commission of Inquiry conducted a substantial investigation into the taxation of land in South Africa. The report concluded that land taxation should be the prerogative of local government policy. This was implemented through the Municipal Property Rights Act, 2004.

The issue to be addressed is thus ‘can a further wealth taxation on property be justified at national level?’

If further wealth taxes are to be proposed on land and improvements, the following issues must be addressed

• The transfer duty issue,

• The effect of double taxation at the local government and at national level.

• Inconsistency that may arise between local government rating policies versus wealth taxation at national level

• Complexity with regard to Business property, farming land and tribal land.

• Basis of valuation.

• The impact of the above on Government’s existing policies on land redistribution, particularly the effect upon recipients of a land redistribution programme.