

**REPORT ON**

## **FEASIBILITY OF A WEALTH TAX IN SOUTH AFRICA**

**FOR THE MINISTER OF FINANCE**

Intended use of this document:

*The Davis Tax Committee is advisory in nature and makes recommendations to the Minister of Finance. The Minister will take into account the report and recommendations and will make any appropriate announcements as part of the normal budget and legislative processes.*

*As with all tax policy proposals, these proposals will be subject to the normal consultative processes and Parliamentary oversight once announced by the Minister.*



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**THE DAVIS TAX COMMITTEE**

**March 2018**

## Dear Minister

We, as the Members of the Davis Tax Committee, have the honour and privilege to provide you with this report which has been:

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## Executive Summary

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This report has four main objectives: firstly, to provide an empirical review of the global literature on wealth taxation; secondly, to describe the current state of wealth inequality in South Africa; thirdly, to evaluate the feasibility of increasing the share of wealth taxes in the overall tax mix in South Africa in a way that will achieve the goal of reducing wealth inequality in a way that is economically and administratively efficient and, finally, to examine the potential contribution of wealth taxes to South Africa's revenue streams.

### Chapter 1: Introduction

South Africa has existing wealth taxes in the forms of Transfer Duty, Estate Duty and Donations Tax. These currently raise very small amounts of tax revenue. In previous reports, the Davis Tax Committee has suggested a variety of reforms that would enhance fairness and increase revenue.

Wealth inequality in South Africa is extremely high and poses a threat to social stability and inclusive growth. It is timely for South Africa to consider a range of ways in which wealth inequality can be reduced. It is in this context that the Minister of Finance asked the Committee to consider the feasibility of introducing a net wealth tax.

### Chapter 2: Background

This chapter lays the foundation for a discussion on wealth inequality globally and in South Africa, as well as looking at why the analysis of wealth inequality has recently received significant attention in the academic and public domain. Some of the highlights are:

- The recent work of Thomas Piketty, through developing methods on how to collect wealth data and pioneering statistical techniques on how to analyse the

long run evolution of wealth distribution, has played a vital role in the renewed focus on the study of wealth accumulation and wealth distribution.

- Empirical evidence suggests that in South Africa, wealth inequality (with a Gini coefficient above 0.9) is extremely high and is, in fact, not just higher than income inequality (which has a Gini coefficient of 0.67) but also higher than global wealth inequality.
- The top 10 per cent of the population of South Africa own more than 90 per cent of the total wealth in the country. It therefore comes as no surprise that, when using wealth as a measure of living standards, the so-called ‘middle class’ is a very small group.

### Chapter 3: Economic principles of wealth taxation

This chapter presents a discussion on the criteria used in the literature when considering wealth and wealth transfer taxation from a normative economic perspective. This chapter provides useful criteria for evaluating a wealth tax and, at the same time, discusses certain critical principles that must be considered when designing a well-functioning wealth tax system. Key to this are three main constraints associated with the process of designing a tax:

1. Tax efficiency becomes challenging when the scope of introducing a net wealth tax not only generates distortions of people’s willingness to work, but also impacts choices linked to wealth accumulation and disposal which explicitly affect the tax rate.
2. Administrative costs can be large when designing a system that levies taxes on wealth, in contrast to taxes on wealth transfer. Some forms of wealth are hard to measure and some forms are easy to hide or convert into asset classes that fall outside the defined base.
3. Tax reform and its implementation inevitably produces both winners and losers. Losers may express discontent through capital repatriation or changing assets classes.

This chapter identifies open market valuation and expert valuation as the main techniques for asset valuation. Notably, when a net wealth tax becomes more comprehensive, the challenges of asset valuation become apparent. Lastly, this

chapter concludes with a discussion of the principles of taxation. Key to this are two guiding principles under the equity criterion: the benefit principle and the ability-to-pay principle.

## **Chapter 4: Lessons from international experience**

This chapter provides an overview of the state of wealth taxes and wealth transfer taxes in France, Germany, the Netherlands and India. Importantly, these countries are in different phases of their implementation of wealth taxation. In France, the net wealth tax is currently in existence; in Germany, the creation of a net wealth tax is still under discussion; the Netherlands has recently introduced a presumptive capital tax as part of a wholesale reform; and, just recently, India has abolished their net wealth tax. This chapter highlights some notable lessons from which South Africa can draw experience.

In the last 20 years, several countries have abandoned the taxation of net wealth, including developed countries such as Denmark (1995), Germany (1997), Finland (2006), Sweden (2007), Spain (2008, although it was reintroduced as a temporary measure in 2011) and, more recently, a developing country, India (2015). In most cases, the rising costs of classifying and measuring net assets, structuring the tax collection system, and, above all, accounting for global assets have been the cause of concern.

The international review highlights that high tax rates impose a substantial burden on taxpayers and, in particular, on taxpayers without the means to exploit tax loopholes through expensive tax advice. Recently, India abolished the wealth tax owing to its lack of effectiveness and its negligible contribution to the total tax revenue. The absence of a substantial tax base, accompanied by the difficulties associated with valuation contributed to the abolition of net wealth taxation in India.

Net wealth taxation in France has been affected by tax migration from France to Belgium (driven by lower wealth taxes) and Switzerland (driven by banking secrecy laws). Complexities surrounding tax administration, as well as enforceability, make part of the tax base either highly mobile or easily hidden from tax authorities which would require careful policy consideration.

The Netherlands has introduced a presumptive capital tax as part of a far-reaching suite of reforms to treat capital income more uniformly. Importantly, the tax is considered to be inconsistent with Capital Gains Tax. Exemptions are made for owner-occupied housing and pension assets.

While most, if not all, taxable assets require valuation, different valuation methodologies across countries yield different administrative costs and burdens. Often, this brings the impartiality of the tax system into question. This highlights the fact that some taxes may not be efficient but rather symbolic, given the amount of revenue that they collect after factoring in all costs.

## **Chapter 5: The South African case**

Inequality in South Africa is unacceptably high. Persistent high wealth inequality has the potential to undermine social, economic and democratic values. A compromise of such values has long-term implications not only for economic growth, but also for the developmental welfare of South African citizens.

A wealth tax is not, however, the only available instrument to address the inequities of income and wealth. Other methods of redress include land reform and programmes on the expenditure side of the fiscal budget such as increased access to quality health and education and the provision of infrastructure as well as effective government leading to growth and employment. Wealth taxes are merely one tool, amongst many, with which to address the pressing problem of inequality.

There are many misconceptions that exist with regard to wealth taxes in South Africa. Not only do wealth taxes already exist but there are also tremendous difficulties and unintended consequences that would need to be addressed prior to implementing further wealth taxes.

The DTC argues that Transfer Duty is second best to a properly functioning national property tax. At the same time, we recognize that systems are not in place to roll out a national property tax. While some municipalities have up-to-date and reasonably uncontested Municipal Valuation Rolls, this is not the case for all parts of the country. In addition, different municipalities take different approaches to valuation, which would pose coordination problems if one wishes to implement a single rate



system country-wide. In the immediate future, it seems pragmatic to accept that Transfer Duty will not be repealed, given the substantial revenue that it raises.

## **Chapter 6: Conclusion and recommendations**

The DTC recognises that while a recurrent net wealth tax may be an admirable and desirable form of wealth tax, more work is needed to ensure that the tax is well-designed and will yield more revenue than it costs to administer. As a first step, the DTC proposes that all personal income taxpayers above the filing threshold be required to submit a statement of all assets and liabilities from the 2020 tax year onwards. This will not be used (at this stage) to calculate a liability for a wealth tax but will provide much needed information to inform a future decision about a wealth tax and allow SARS and National Treasury the opportunity to iron out definitional issues with regard to the proposed tax base. Importantly, this information on assets and liabilities will also provide useful information which SARS can use in verifying declared income under the Personal Income Tax system.

While the design and implementation of a Wealth Tax will take some time, as an immediate action the DTC strongly encourages government to heed the recommendations of the First and Second Estate Duty Reports.

The Davis Tax Committee's sincere appreciation goes to Samson Mbewe for his excellent research assistance.

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## Chapter 1: Introduction

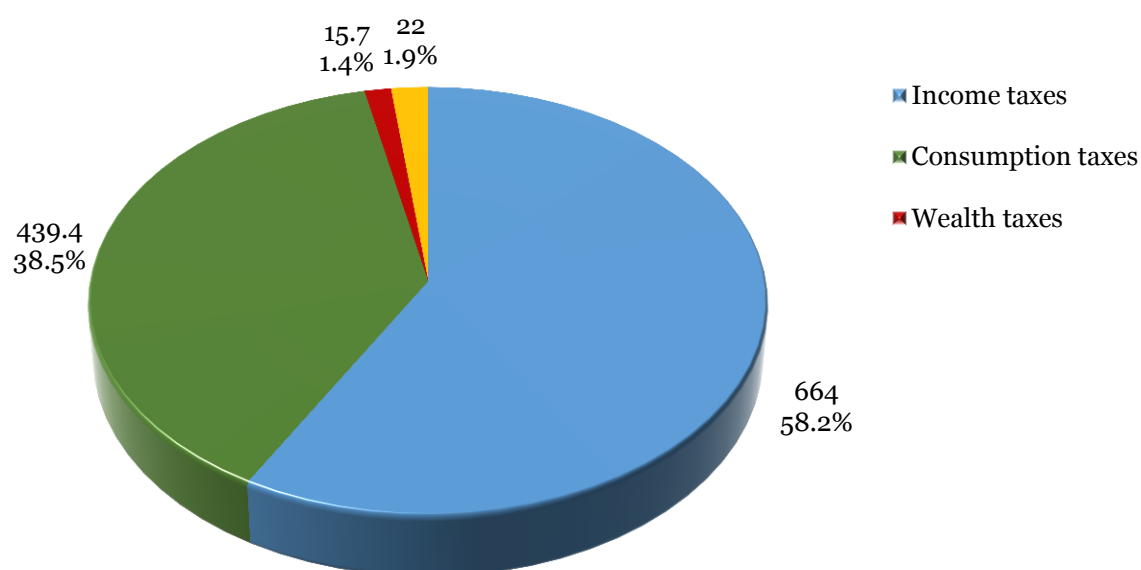
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The Davis Tax Committee (DTC) was mandated in 2013 by the Minister of Finance to inquire, *inter alia*, into ‘the progressivity of the tax system and the role and continued relevance of estate duty to support a more equitable and progressive tax system’. In 2016, the Minister of Finance expanded the mandate of the DTC and requested the Committee to look into the feasibility of additional taxes on wealth.

It is important to emphasise at the outset that a tax on wealth is not the same thing as a tax on the wealthy. This point was not well understood by the vast majority of individuals and organizations that made written and oral submissions to the DTC. The income stream *generated* by wealth is taxed through the income tax system. Wealth bestows certain benefits over and above the rate of return that it generates; as such, wealth is a tax base in its own right.

South Africa’s revenue streams can be summarised into three broad categories based on the tax base onto which they fall:

- income taxes – Personal Income Tax (PIT), Capital Gains Tax (CGT) and Corporate Income Tax (CIT);
- consumption/transaction taxes – Value Added Tax (VAT), customs and excise taxes, fuel levy, electricity levy, international air passenger departure tax, plastic bag levy, incandescent light bulb levy, CO<sub>2</sub> tax on motor vehicle emissions; and
- wealth taxes – Estate duty (ED), Donations Tax (DT), Securities Transfer Tax (STT) and Transfer Duties (TD).
- other taxes – including payroll taxes (Skills Development Levy (SDL)



**Figure 1:** 2016/17 revenue collected in South Africa (R billions) (National Treasury & SARS, 2017)

It is evident that the share of wealth taxes in the overall tax mix is currently very small. It is important to note that South Africa is not unusual in terms of the small contribution made by wealth taxes. Even in OECD countries, which are more reliant on wealth taxes than developing countries, only 5.5% of tax revenue on average derives from wealth taxes (broadly defined) with more than half of this coming from property taxes (OECD, 2017).

Estate duty and donations tax collections have declined, both in real terms and in terms of their overall contribution to National Revenue to the extent that today this represents a mere 0.17% of all revenue collected. The DTC has argued in its two reports on Estate Duty that South Africa has significantly underperformed in terms of revenue collections in respect of estate duty and donations tax; hence there is scope to increase performance in this regard. Given the massive wealth disparity in South Africa, it is clear that reform is needed in order to enhance the effectiveness of these taxes. The DTC has recommended that, with some modification, the estate duty

and donations tax regimes could better achieve the objective of reducing wealth inequality without necessarily implementing new forms of wealth taxation.<sup>1</sup>

Collections from Transfer Duty have increased steadily over time and now represent 0.6% of total tax collections. The DTC has not been specifically mandated to examine the Transfer Duty. Aspects of Transfer Duty are, however, addressed in this report as Transfer Duty is classified as a wealth tax on non-VAT leviable land and improvement transactions.

It should be noted at the outset that taxation does not form the only viable instrument to address the inequities of income and wealth. Other methods of redress include land reform and programmes on the expenditure side of the fiscal budget, for example, through health, infrastructure, education. The authors of the World Inequality Report - 2018 argue that ‘tackling global income and wealth inequality requires important shifts in national and global tax policies. Educational policies, corporate governance and wage setting policies need to be reassessed in many countries. Data transparency is also key.’ (Alvaredo, et al., 2017). Manifestly all of these issues require urgent action in South Africa. If the disturbing patterns of inequality overlaid by race are to be meaningfully addressed. These mechanisms, however, lie outside the scope of the terms of reference of the DTC and we focus in this report only on whether a wealth tax could play a meaningful role in helping to address the problem.

Internationally, the interest in wealth taxes has waxed and waned over time. There are now only four OECD countries that have net wealth taxes, down from 12 in 1990 (OECD, 2017), with the decisions to repeal net wealth taxes having been motivated by efficiency and administrative concerns as well as by the observation that net wealth taxes often failed to meet their redistributive goals.<sup>2</sup> More recently, however, pressure on government revenue combined with Piketty’s seminal work on the extent of wealth inequality, have resuscitated discussions around wealth taxation.

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<sup>1</sup> First and Second DTC reports on Estate Duty and Donations Tax

<sup>2</sup> For example, Healey (1989) reflected: ‘you should never commit yourself in Opposition to new taxes unless you have a very good idea how they will operate in practice. We had committed ourselves to a Wealth Tax; but in five years I found it impossible to draft one which would yield enough revenue to be worth the administrative cost and the political hassle.’

Significant improvements in international cooperation and tax administration have also raised the prospect of taxing wealth more effectively.

The DTC invited public submissions and held extensive public hearings to solicit views on wealth taxation. The enormous feedback received was overwhelmingly negative, although it is readily acknowledged that the submissions were primarily made by individuals and organizations representing the interests of the wealthy. A list of all the submissions made may be found in the Submissions Received section on p. 85. A key point that was made repeatedly was that new wealth taxes might inhibit investment and were unlikely to generate much revenue. This point was supported by Orthofer (2015) that *'given that the wealth-income ratio is so much lower in South Africa than it is in rich countries, capital-related taxes not only have much lower revenue potential than elsewhere, but might also undermine the country's simultaneous efforts of encouraging capital formation and lowering the dependency on foreign capital inflows.'*

Despite these concerns, the DTC maintains that South Africa's levels of wealth inequality are a threat to social stability and shared prosperity. Reducing wealth inequality is a key aspect of ensuring South Africa's economic success. Wealth taxation presents one possible means of reducing the extreme concentration of wealth and requires serious investigation. The DTC cannot simply dismiss the idea based on the experiences of other countries.

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## Chapter 2: Background

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Wealth refers to all forms of accumulated marketable assets by individuals (or households) through savings or the preservation of inherited wealth (Trotman-Dickenson, 1996). Net wealth, synonymously termed as ‘wealth’ in the literature, is the difference between gross wealth and total debt.

Over the last three decades, tax systems around the world have gradually become less progressive (IMF, 2013). Living in the age of increasing financial globalization, the process of effectively taxing capital and investment returns has become a challenge owing to the rise in both legal and illegal international capital mobility (Profeta, et al., 2014). Although, from a taxpayer’s perspective, capital mobility offers the opportunity to move capital to financial institutions with relatively favourable tax rates and higher returns on capital, a notable shortcoming is the continued deterioration of revenue from taxes on capital income globally.

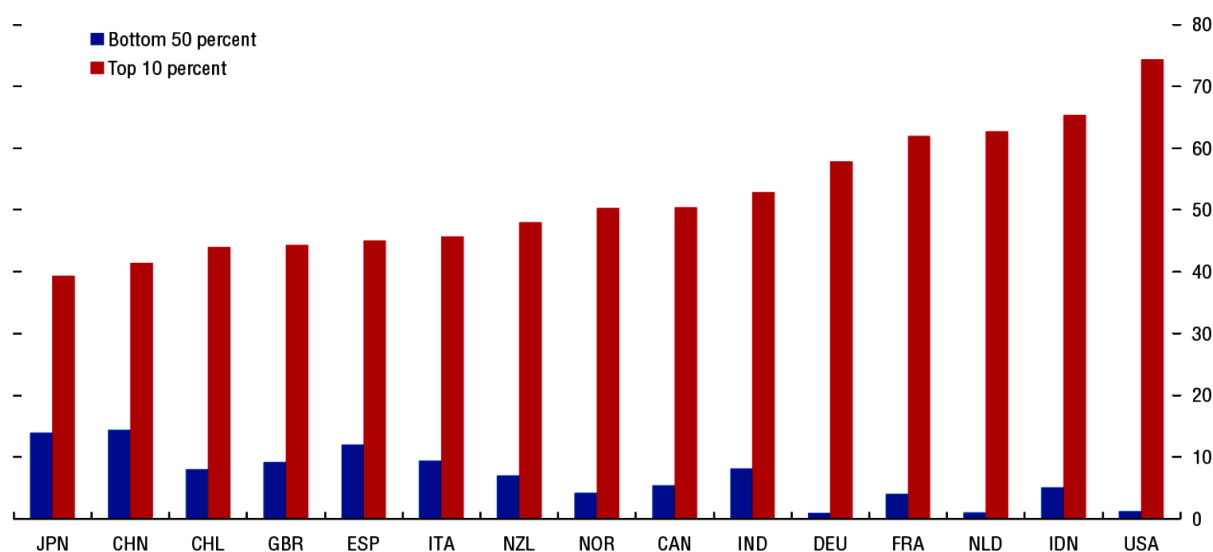
A product of this conundrum is that it has resulted in a shift of the tax burden from capital income to labour income (Ndikumana, 2015). As a result, global income inequality has deepened as indicated by the rising shares of the top one per cent in various Anglo-Saxon countries (Piketty & Saez, 2006; Atkinson, et al., 2011). Inequality – though its causes, consequences and remedies remain the subject of a highly contentious debate – undoubtedly forms a challenge that requires redress (OECD, 2014).

Furthermore, studies show that wealth-to-income<sup>3</sup> ratios have also been on the rise (IMF, 2013) and, in fact, global wealth distribution has become highly unequal since the 1970s, with the ratio of private wealth to national income reported to have doubled (Piketty & Zucman, 2014).

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<sup>3</sup> A wealth-to-income ratio is the ratio of wealth and national income (Gross Domestic Product).

Rising inequality has not only been associated with declining economic growth but also rising capital-to-income ratios<sup>4</sup> which has led to increasing inequality. This is the current experience in developed countries, where the top ten per cent own more than half of the wealth (with about 75 per cent in the USA)<sup>5</sup> as illustrated in Figure 2 (IMF, 2013). This reinforces the theoretical underpinning that the distribution of wealth is often more unequal than the distribution of income.



Source: IMF (2013).

Note: See abbreviations in Country Abbreviations section on p. 83.

**Figure 2:** Country net wealth shares held by the top 10% and bottom 50% (2013)

Such high levels of wealth inequality are of concern and require some form of policy response. The introduction of a wealth tax as a form of redress has sparked highly contentious debates<sup>6</sup> and has received increasing attention among policy makers, academics and the public for several reasons. First, large fiscal deficits after the financial crisis have created significant fiscal imbalances in various countries, especially those in Europe. Policy makers have therefore initiated discussions on the

<sup>4</sup> The capital-to-income ratio is the ratio of capital and national income. A high ratio indicates that most of national income goes to individuals that possess assets that yield income.

<sup>5</sup> See IMF (2013) for more details.

<sup>6</sup> The debate on wealth taxation is not new to the discourse of economic inequality, and in fact, traces back to the 19th century. See IMF (2013) for further details.

possibility of (re-)creating a net wealth tax with the aim of financing these countries' large fiscal deficits (Princen & Mourre, 2013; Bach, et al., 2014) What makes wealth taxation very attractive to policy makers is its large potential tax base which typically should be a multiple of the tax base on capital income (Schnellenbach, 2012).

Second, Thomas Piketty<sup>7</sup> and his recent works on wealth accumulation in advanced economies have sparked contentious debates, both in the academic and public space, regarding rising global wealth inequality and the threat this poses towards social, economic and political processes. Piketty's work posits that the state of wealth inequality is worsening and requires intervention by the state through using a net wealth tax to achieve redistribution objectives and to create wealth for the 'patrimonial middle class'<sup>8</sup>.

Although Piketty's works have focused more on the inequalities of wealth and income in advanced economies, his findings and conclusions have also echoed and stirred pragmatic debates in developing countries regarding the pervasive nature of wealth inequality.

Particularly in South Africa – a country well-known to be among the most unequal in the world (when measured on income) with a Gini coefficient of 0.70<sup>9</sup> – recent evidence (Orthofer, 2015; Orthofer, 2016; Mbewe & Woolard, 2016) suggests that wealth inequality is in fact much higher than income inequality with a Gini coefficient above 0.9. In light of this, there is an ongoing debate on the feasibility and practicality of introducing a net wealth tax in South Africa.

It is, however, important to note that taxes are but one form of redistribution and therefore not the only existing instrument to address the inequities of income and wealth. Other approaches to redress and restitution, such as land reform and effective expenditure-side initiatives to increase human, social and community capital through health, infrastructure, education and the like are also important in

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<sup>7</sup> Thomas Piketty is Professor of Economics at the Paris School of Economics and at the École des Hautes Études en Sciences Sociales (EHESS, School for Advanced Studies in the Social Sciences) in Paris. For the past 15 years, his works have focused on understanding the accumulation and distribution of global income and wealth.

<sup>8</sup> This is the share of individuals or households above the bottom 50 per cent of the population but below the top 10 per cent.

<sup>9</sup> See Finn & Leibbrandt (2013) for more detail.



addressing inequality. These mechanisms, however, lie outside the mandate of the DTC. The DTC focuses here on wealth taxation as a redistributive tool to curb rising wealth inequality. Furthermore, although this report will provide some discussion on taxing the *transfer* of personal wealth, these issues have already been dealt with in the First and Second DTC reports on Estate Duty and Donations Tax; thus the major focus of this report is to provide a more comprehensive discussion on taxing personal wealth, and particularly personal *net* wealth.

## Rethinking wealth taxation – the Piketty argument

In his seminal book *Capital in the Twenty-First Century*, Thomas Piketty shifts the focus of the debate from the overall size of wealth to how wealth is distributed. Part of his analysis points to the fact that the distribution of income and wealth has become more unequal over the past two decades, especially with the marked rise of the share accruing to the ‘top one per cent’ (Piketty, 2014). He argues that the high levels of income inequality experienced in the 19<sup>th</sup> century<sup>10</sup> are re-emerging and are, by no means, an accident but rather a product of patrimonial capitalism<sup>11</sup>, with a chance of reversing this only through government intervention (Piketty, 2014).

One of Piketty’s fundamental contributions to the existing literature on wealth inequality rests on the relationship between the rate of return on capital ( $r$ ) and the rate of economic growth ( $g$ ). He argues that, in the long run there is a tendency for the rate of return on capital ( $r$ ) to significantly exceed the rate of economic growth ( $g$ ) which suggests that inherited wealth is likely to grow much faster than output and income. He supports this assertion by arguing that individuals with inherited wealth need only save a portion of their income from capital to see that capital grows more quickly than the economy as a whole (Piketty, 2014). For example, if  $r$  is 5% and  $g$  is 1%, wealth holders only need to invest one-fifth of their capital income to ensure that their wealth grows as fast as the size of the economy. This was evident during the Belle Époque Europe when owners of capital could expect to earn 4 to 5%

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<sup>10</sup> where 90 per cent of the wealth belonged to the top 10 per cent as compared to now where about 60 to 70 per cent is owned by the top 10 per cent.

<sup>11</sup> A reference made to the elite who have largely inherited their wealth rather than created wealth through innovation or entrepreneurship.

on their investments with minimal taxation while economic growth was only around 1% (Piketty, 2014). Wealthy individuals could easily reinvest enough of their income to ensure that their wealth, and hence their incomes, were growing faster than the economy — thereby reinforcing their economic dominance.

It follows that a higher gap between  $r$  and  $g$  is likely to lead to convergence of higher levels of wealth concentration in certain groups of society. Under such conditions, Piketty argues that inherited wealth will dominate (by a wide margin) the wealth accumulated from a lifetime's labour and the concentration of capital will attain extremely high levels — levels potentially threatening extreme inequalities that stir discontent and weaken democratic standards.

Until very recently, no empirical evidence existed on the long-run evolution of aggregate wealth-income and wealth-output ratios. In fact, most of the wealth data collected globally represented wealth as a flow of assets (which is the case with income and expenditure), rather than an accumulated stock of assets. However, the works of Piketty and the works of Anthony Atkinson<sup>12</sup> and Emmanuel Saez<sup>13</sup> have introduced a paradigm shift in the discourse through pioneering data collection and statistical techniques that make it possible to track the concentration of income and wealth back to the early 20<sup>th</sup> century. This has been undertaken for the USA and UK and for France until the late 18<sup>th</sup> century (Piketty, 2014). They construct a wealth dataset<sup>14</sup>, including the elite (who have generally not been accounted for in previous wealth surveys), by merging tax records and annual national wealth publications, together with other sources as shown in Tables A1, A.2 and A.3 in Appendix A.

Piketty demonstrates the theoretical construct of how inequalities from capital tend to be greater than inequalities from labour (compare Tables A.1 and A.2 in Appendix A. He contends, however, that disregarding inequalities from labour would be unjust, not only because labour tends to account for about 60 to 75 per cent of national income but also because the distribution of labour income tends to be dissimilar across countries. This implies that public policy and national differences may have

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<sup>12</sup> The late Anthony Atkinson was Professor of Economics at Oxford University.

<sup>13</sup> Emmanuel Saez is Professor of Economics at the University of California, Berkeley.

<sup>14</sup> These data can be found in the World Wealth and Income Database : <http://www.wid.world/>.

major consequences for these inequalities and for the living conditions of a large number of people. Piketty notes further that the joint level of income and wealth inequality, as shown in Table A.3, is a lot higher than inequalities emanating from labour income alone.

Contrary to Piketty's argument, some practitioners and researchers view income inequality as moderate and less conflicting, making it unlikely to raise social unrest. This view has gained popularity because, when comparing the distribution of labour income to capital ownership, one finds it to be less egalitarian everywhere (see Table A.2 in Appendix A) (Piketty, 2014). Even in societies that were considered to be highly egalitarian - such as the Scandinavian countries in the 1970s and 80s – more than half of national wealth was typically owned by the richest 10 per cent (Piketty, 2014). This is still the case in Europe (and in particular, France, Germany, the United Kingdom and Italy) where the richest 10 per cent own approximately 60 per cent of national wealth (Astarita, 2015). What is distinctive about these societies is that the poorest 50 per cent own less than 10 per cent of national wealth, and typically less than 5 per cent (Piketty, 2014).

In modern society, although less important than they were in the Belle Époque, inherited wealth and capital income are both still dominant drivers of inequality and their importance is growing. The risk to society is that  $r$  is growing by more than  $g$ , *i.e.*, if the return on capital is greater than the rate of growth, wealth will concentrate among the rich and the inequality gap will widen. Therefore the argument that the obvious way to reduce inequality is to encourage growth is not necessarily correct. As such, a core focus rests on the argument that current wealth tax systems place too little emphasis on the role of inheritance inequality (Piketty & Saez, 2013).

Piketty further contends that the reason why inherited wealth still plays such a small part in today's public discourse and is not yet a central political issue is due to the fact that 'wealth is so concentrated that a large segment of society is virtually unaware of its existence' (Piketty, 2014). Furthermore, Piketty emphasises that the balance between  $r$  and  $g$  is complex because it depends on a set of factors that are difficult to predict: technology, savings behaviour and the like.

In light of such high global wealth inequality, Piketty recommends that the world's governments should cooperate and introduce a global wealth tax. This will curb most

problems associated with tax migration and relax any tax secrecy laws. Furthermore, during his visit to South Africa in 2015, Piketty recommended that South Africa should create an annual net wealth tax initially at a low rate to establish some level of transparency and identify what people own and, more importantly, who owns what (Piketty, 2015)

## **Current wealth inequality in South Africa**

A major challenge with estimating the long-run evolution of wealth accumulation and distribution of any one country (as noted in Piketty's work) has been the lack of reliable balance sheet data. Even with the emergence of Piketty's dataset for advanced economies, the collection and recording of reliable balance sheet data is still an ongoing process in some developed countries. Moreover, this problem is much more pervasive in developing countries which often face the challenge of capturing reliable data in official statistics.

### *Long run evolution of private wealth*

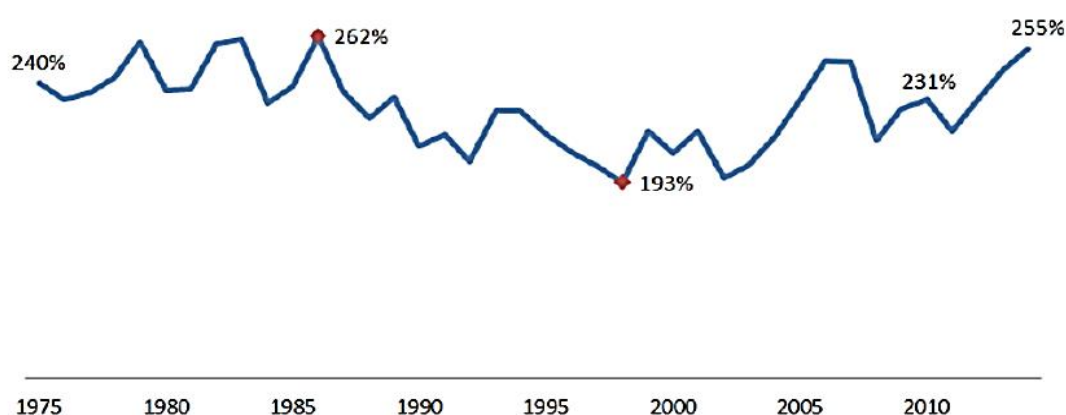
Recently, South Africa became the first developing country to publish official balance sheet data which dates back to 1975. Using this data, Anna Orthofer attempted to recreate Piketty's analyses for South Africa, making her study the first ever to analyse the long run evolution of private wealth in South Africa (Orthofer, 2015).

Her findings revealed that South Africa's wealth-to-income ratio was 240 per cent of national income in 1975 while, in 2014, the ratio was estimated to be 255 per cent of national income. In comparison with wealth-to-income ratios in advanced economies (which were in the range of 200-300 in 1975 and 400-700 in 2010) she contends that the small difference between South Africa's wealth-to-income ratio between 1975 and 2014 is largely due to the low rate of private savings experienced over the period and the rise in prices of financial assets (Orthofer, 2015). Furthermore, she associated the high wealth-to-income ratio of South Africa (despite it being a developing country and being a less capital-intensively driven economy) with extraordinary wealth in luxurious real estate (largely in the Western Cape Province), platinum mining and industrial farming (Orthofer, 2015). Orthofer also found that South Africa's wealth-to-income ratio had declined in the 1970s from just above 260 per cent of national

income, to 190 per cent of national income in the early 1990s (see **Figure 3**). Furthermore, **Figure 3** shows that the wealth-to-income ratio begins to rise in the late 1990s illustrating a U-shaped evolution of the dynamics of private wealth in South Africa (Orthofer, 2015).

Orthofer's work also added to the South African wealth literature by analysing the composition of private wealth as shown in

**Table 1.** In most countries and, for most individuals, housing assets constitute the bulk of their wealth (OECD, 2015) but this is not true for South Africa where only about a quarter of total private assets in South Africa are in the form of housing assets (Orthofer, 2015). Three quarters of household assets in South Africa are financial, with interests in pension funds and long-term insurers constituting the single largest category. The importance of pension assets for South African households is unsurprising when one considers that the domestic pension system is almost entirely capitalized and privately administered. By contrast, most developed countries have pay-as-you-go social security schemes which obviate the need for households to participate in privately-run retirement schemes.



Source: Orthofer (2015).

Note: household private wealth as percentage of national income.

**Figure 3:** Private wealth to income ratio for South Africa, 1975–2014

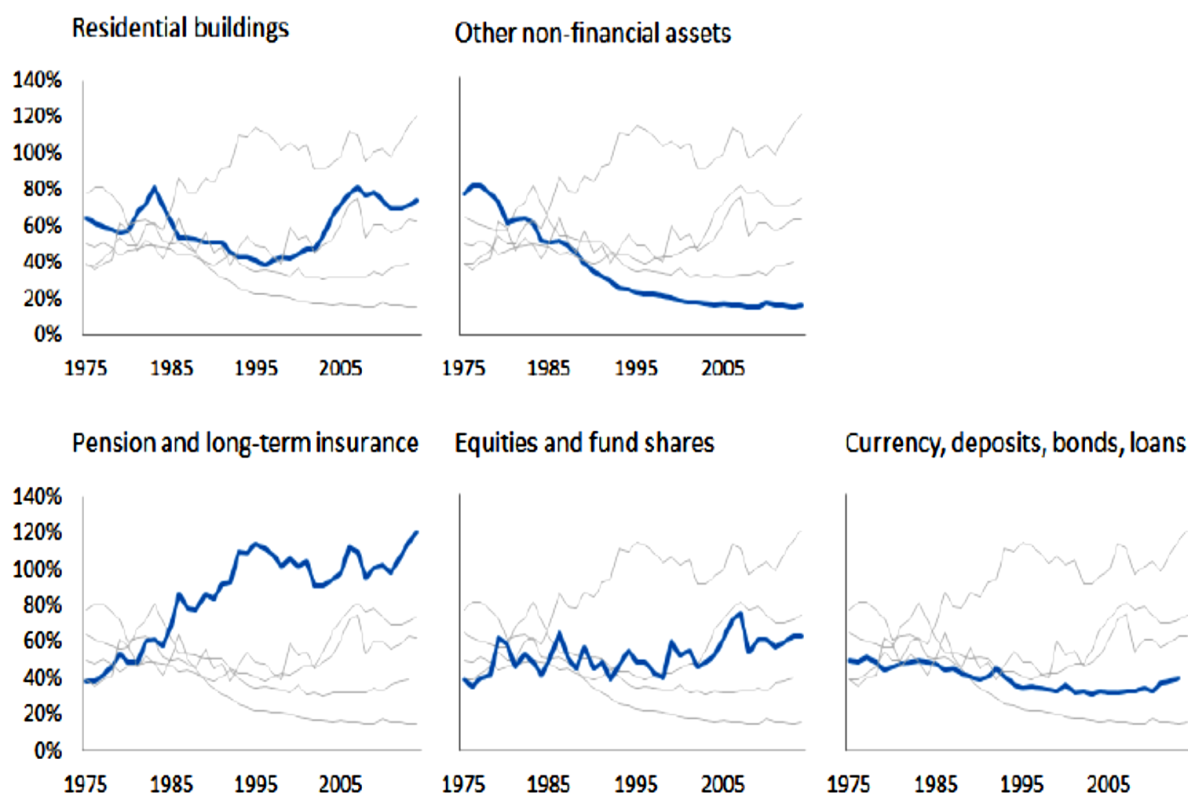
**Table 1:** Portfolio composition of private wealth in South Africa, 2010

Residential buildings	74
Other non-financial assets	18
<i>Total non-financial assets</i>	<i>91</i>
Pension funds and life insurance	103
Equities and fund shares	61
Currency, deposits, bonds and loans	34
<i>Total financial assets</i>	<i>198</i>
<b>Total assets</b>	<b>289</b>
Mortgage advances	33
Other liabilities	25
<b>Total liabilities</b>	<b>58</b>
<b>Net wealth</b>	<b>231</b>

Source: Orthofer (2015).

Note: as a percentage of national income (as percentage of total assets).

The rapid move away from defined benefit to defined contribution schemes in South Africa since the 1980s can be seen in Figure 4 where pension funds and long-term life insurance have exhibited an upward trend between 1975 and 2014.



Source: Orthofer (2015).

Note: presented as a percentage of national income.

**Figure 4:** Private wealth to income ratio by asset class for South Africa, 1975–2014

### *Household wealth distribution*

In the previous sub-section, the work of Orthofer (2015) provided insight into the long run evolution of private wealth in South Africa but a lack of data inhibited further analysis into the long run dynamics of the distribution of wealth among households or individuals. South Africa became one of the first countries to publish a household wealth survey in 2012<sup>15</sup> but this dataset had initially received very little attention, with most studies of inequality (Leibbrandt, et al., 2010; Finn & Leibbrandt, 2013) continuing to focus exclusively on income inequality.

It is reasonable to note that the lack of sufficient research into wealth distribution and wealth inequality in South Africa had previously been affected by the availability

<sup>15</sup> National Income Dynamics Study (NIDS) – the first ever panel study of income in South Africa. It is a large household survey implemented by the Southern Africa Labour and Development Research Unit (SALDRU). NIDS incorporates wealth questions in every second wave. See SALDRU (2015) for more detail.



of data. The effect of having reliable household data becomes apparent in the process of designing effective tax policy. Recent efforts have been made to collect wealth data as seen in the National Income Dynamics Study (NIDS) which incorporates various wealth related questions into the household and individual survey questionnaires.

### *Evidence from wealth survey and tax data*

A recent study by Orthofer (2016) investigated the South African wealth distribution using Wave 2 of the National Income Dynamic Study (NIDS) for 36,000 South Africans (collected between 2010 and 2011) and (a 20% random) sample of 1.2 million Personal Income Tax (PIT) records for the 2011 tax year<sup>16</sup>. Part of her goal was to consider the distribution of wealth in NIDS and to see if she could reconcile this with the income streams from capital assets that are reported through the PIT system. Orthofer's motivation for making this comparison was that, very often in voluntary wealth surveys, top wealth holders are reluctant to disclose their actual net worth and as such, top wealth holders are mostly under-represented in such surveys yet their wealth is a highly significant factor in the analysis of wealth inequality. In the case of PIT, however, tax filing is obligatory for persons earning an income above a certain legally stipulated threshold. The biases associated with voluntary survey data are therefore limited in PIT records<sup>17</sup>.

Orthofer's main findings revealed that wealth inequality is high in South Africa with a wealth Gini coefficient of 0.95, in comparison to an income Gini coefficient of 0.67. If these results are indeed correct, she argued that this would imply that based on global wealth inequality estimates from Davies *et al.* (2016), wealth inequality in South Africa is higher than the global estimate (Orthofer, 2016). She provided additional evidence of the higher wealth inequality by showing the highly uneven distribution of wealth by focusing on the wealth shares of the top 1 per cent and the top 10 per cent of the population. She found that the top 10 per cent owns more than 90 per cent of total wealth in the country and more than 80 per cent of the

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<sup>16</sup> For more details on the methodology and data treatment of NIDS and PIT, see Orthofer (2016).

<sup>17</sup> Of course, tax avoidance and tax evasion result in other biases within the PIT data which cannot be addressed in Orthofer's work.

population holds no wealth; highlighting the virtual non-existence of the so-called ‘middle class’.

Orthofer further compares her results to ‘rich lists’ compiled by publishing companies such as New World Wealth<sup>18</sup> and Forbes<sup>19</sup>. In 2014, New World Wealth estimated that South Africa had approximately 46 800 high net worth individuals with collective wealth amounting to USD\$ 184 billion (equivalent to R2 140 billion). By comparing the collective net worth of these individuals with aggregated data from the household balance sheets, Orthofer finds that the richest 0.1 per cent of South Africa’s population owns a quarter of overall household wealth. In 2015, the *Forbes Africa’s 50 Richest* list included 10 South Africans who had a collective net worth of USD\$ 25 billion, constituting approximately 5 per cent of South Africa’s total wealth.

### *Evidence from the cross-sectional features of wealth distribution*

A more recent study by Mbewe and Woolard (2016) examined the cross-sectional features of wealth distribution in South Africa using survey data from Wave 2<sup>20</sup> (2010-2011) and Wave 4<sup>21</sup> (2014-2015) of the National Income Dynamics Study (NIDS). This study compared the distribution of wealth between the two Waves. Given the racialized history of South Africa, the study began by looking at the racial pattern of wealth inequality.

Mbewe and Woolard (2016) found that overall, wealth inequality in South Africa is high with Gini coefficients above 0.9 in both Waves<sup>22</sup>. Furthermore, they estimated the racial wealth gaps in Waves 2 and 4 as seen in Figure 5 and Figure 6. They defined the racial wealth gap as the difference between the wealth held by an average African household relative to a White household. Notwithstanding the limitation of self-reported data and that there is undoubtedly measurement error in the data, they find that there remains a massive gap between the average wealth of an African household and that of a White household. The average wealth of an African

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<sup>18</sup> ‘New World Wealth’ is a global wealth intelligence and market research consulting company.

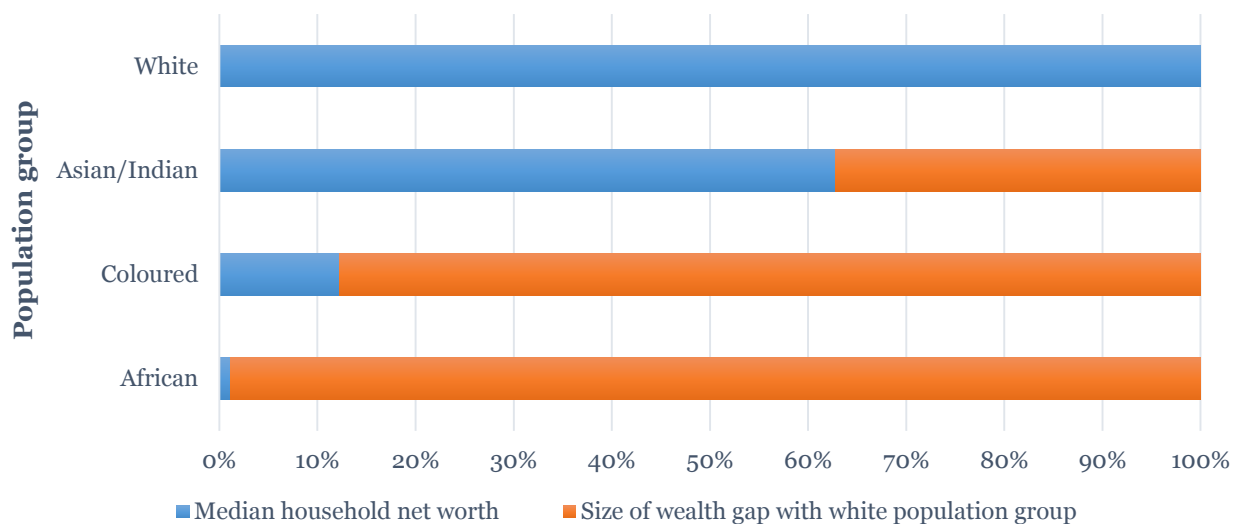
<sup>19</sup> Forbes is an American media and publishing company.

<sup>20</sup> NIDS Wave 2 survey was officially released in 2012.

<sup>21</sup> NIDS Wave 4 survey was officially released in 2016.

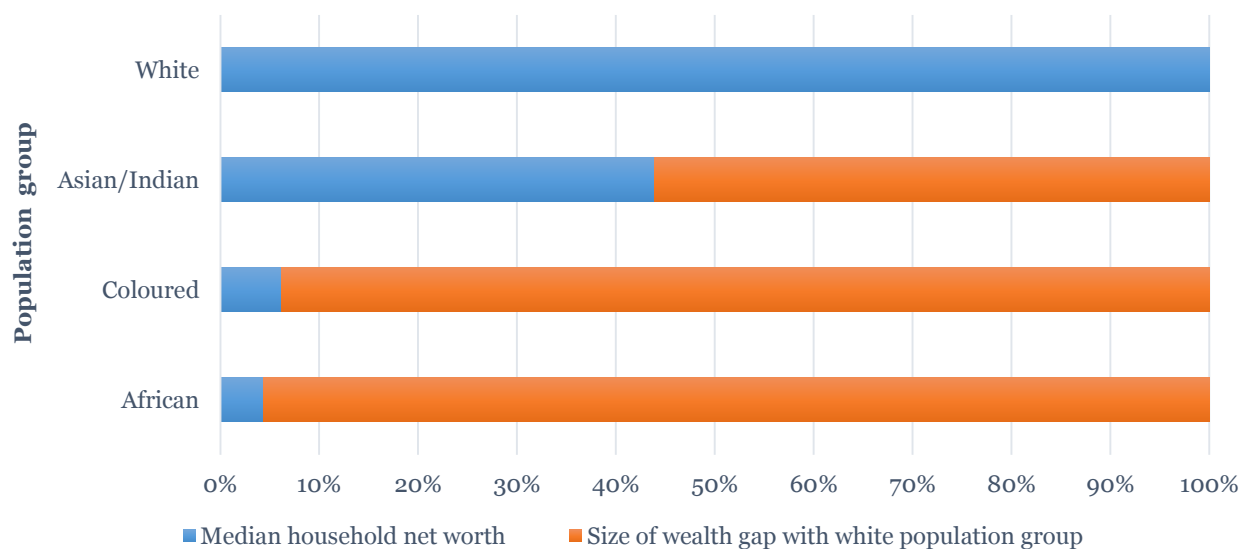
<sup>22</sup> Wave 2 (0.94) and Wave 4 (0.93).

household is less than 5 per cent of that of White households (Mbewe & Woolard, 2016).



Source: Mbewe and Woolard (2016).

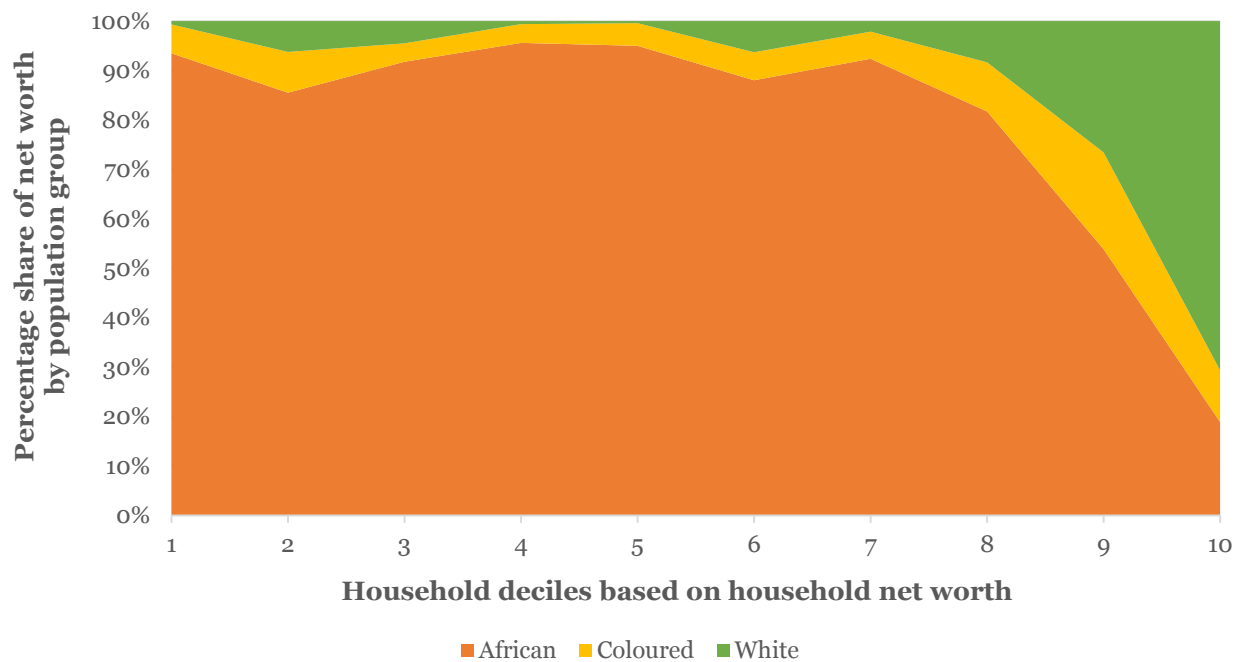
**Figure 5:** Size of racial wealth gaps in South Africa, NIDS Wave 2 (2010-2011)



Source: Mbewe and Woolard (2016).

**Figure 6:** Size of racial wealth gaps in South Africa, NIDS Wave 4 (2014-2015)

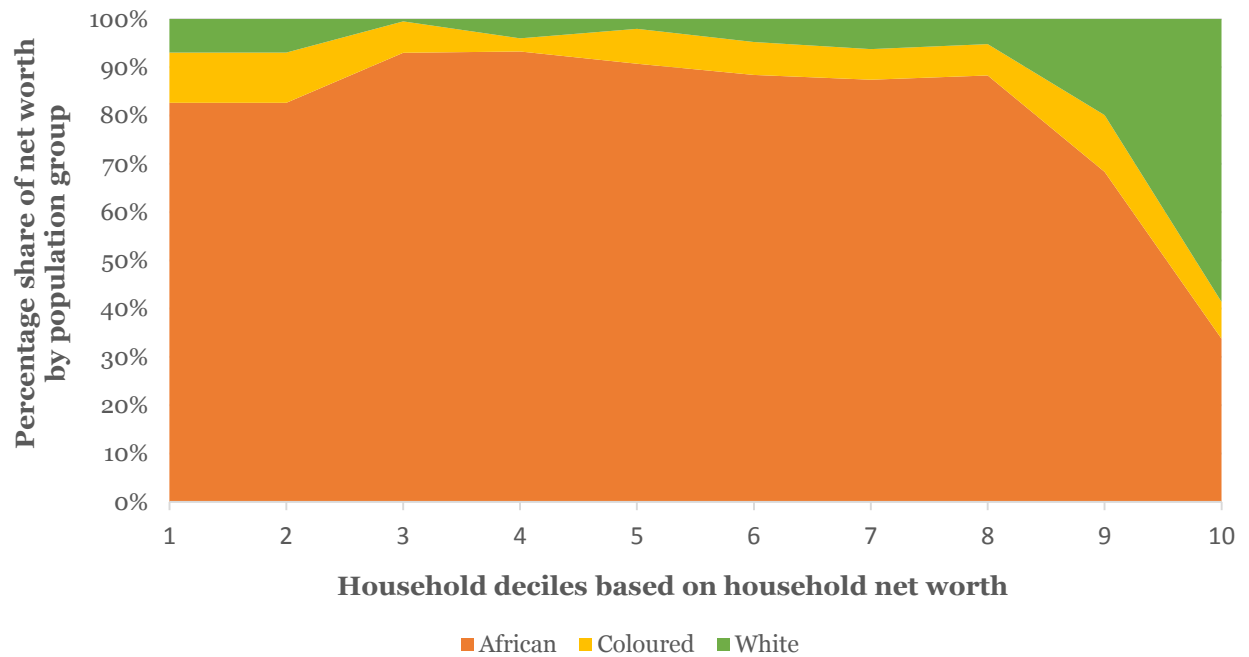
Furthermore, their results showed that wealth inequality is not only high between races but also high within race groups. For example, the measured Gini coefficient for wealth when looking only at African households was above 0.9 (Mbewe & Woolard, 2016). This is consistent with the findings of Orthofer (2016). They also gave more nuance to these racial inequality indices by analysing the distribution of wealth by race groups for Waves 2 and 4 as shown in Figure 7 and Figure 8. African households are largely concentrated at the lower end of the distribution while white households are concentrated at the upper end of the distribution.



Source: Mbewe and Woolard (2016).

Note: the Asian/Indian population group is excluded owing to small sample size.

**Figure 7:** Racial composition of deciles based on household net worth, NIDS Wave 2 (2010-2011)



Source: Mbewe and Woolard (2016).

Note: the Asian/Indian population group is excluded owing to small sample size.

**Figure 8:** Racial composition of deciles based on household net worth, NIDS Wave 4 (2014-2015)

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## Chapter 3: Economic Principles of (Net) Wealth Taxation

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The design of a tax system should be grounded on a clear set of economic principles. In contrast to other forms of taxation (such as income and consumption taxes), where there exist some well-accepted criteria, the theoretical literature of optimal taxation offers comparatively little guidance on wealth tax policy design. This helps to explain why there is so little global consensus on how best to approach this topic (Boadway, et al., 2010). In this chapter, we begin by setting out the theoretical principles that guide our thinking and then discuss some of the challenges in applying these principles.

A net wealth tax is a tax imposed on the difference between the sum of all gross assets (gross wealth) and the sum of all liabilities at a particular point in time. Gross assets may include real assets (such as immovable property, vehicles and real estate) and financial assets (such as life insurance, annuities, shares, bank deposits and bonds). Gross liabilities may include home loans, informal debt, vehicle finance loans and other forms of financial loans, such as educational loans.

A net-wealth tax can be further classified as either additive or substitutive, depending on how the government requires taxpayers to meet the tax liability. An additive wealth tax is a tax paid only when an asset of market value is sold whereas a substitutive tax is a fixed tax payment from either capital or annual income earned by owning an asset (Trotman-Dickenson, 1996).

The motivation for annual wealth taxes lies in two factors: first, the desire to seek redress on non-income benefits associated with the accumulation of personal wealth and, second, the exploitation of information on the behaviour and circumstances of individuals not accounted for by taxes on income, bequest or consumption (Astarita, 2015).

## Evaluating criteria of a wealth tax system

Boadway *et al.* (2010) offer a comprehensive discussion on the taxation of wealth. They outline that the three main constraints associated with the process of designing a tax system include efficiency, administrative costs and political constraints. Firstly, achieving tax efficiency becomes difficult when the extent to which an introduction of a wealth tax not only creates distortions on people's willingness to work but also distorts the decisions associated with wealth accumulation and disposal. Secondly, as opposed to taxes on wealth transfer, the administrative costs involved in administering a net wealth tax can be substantial especially as some forms of wealth are hard to measure and/or easy to conceal. A failure to tax some forms of wealth results in inequitable tax treatment. Thirdly, tax reform or implementation inevitably produces winners and losers. The introduction or abolition of a new tax provides opportunities for some individuals to exploit the changes in the tax regime.

Furthermore, Boadway *et al.* (2010) identify three standard criteria that have widely been used in tax reform. The *welfarist criterion* is the conventional criterion considered by economists in evaluating tax systems. Recent empirical work, however, has seen a shift to the use of two other criteria, *equality of opportunity* and *paternalism*.

### Welfarist criterion

Also known as the utility-based approach, the welfarist criterion has dominated the theoretical literature on optimal taxation. This approach assumes that the welfare of an individual depends on the consumption of goods and services, as well as the amount of leisure time she 'consumes'. Given this, government's goal should be to select a tax structure that aims to maximize social welfare, bearing in mind that, although there is a need to raise revenue to finance public expenditure, individuals are also sensitive to changes in the tax system. The core argument of the welfarist criterion is based on the idea that achieving improved social welfare requires an improvement in the well-being of individuals. The welfarist approach favours the taxing of all sources of well-being, without distinction.

## Equality of opportunity

One of the non-welfarist criteria is equality of opportunity which acknowledges the fact that individuals have different preferences (Roemer, 2009). This approach draws a distinction between the ‘principle of responsibility’ and the ‘principle of compensation’. The latter favours the compensation of individuals for the disadvantages they are born with, especially those that have to do with limited control over productive capacity or innate ability relative to others.

In the context of a tax on wealth, the equality of opportunity approach stresses that wealth confers benefits, opportunities, status or power to a taxpayer which may not be available to other taxpayers. In such a case, the possibility of double counting becomes high. For instance, if holding wealth generates an income stream, such proceeds should be taxed directly as part of the income taxation system. It is only the additional benefit of holding wealth, over and above the income it generates, that should be taxed. Thus while the argument is that wealth is a separate and distinct tax base, it is not straightforward to implement a tax which complements the aspects already included in the income tax system.

## Paternalism

Empirical evidence suggests that, in the long run, individuals tend to make many decisions that turn out not to be in their best interests which presents a problem for public policy (Bernheim & Rangel, 2007). There are a range of reasons for this – inadequate information, the influence of social norms and poor personal judgement. Given this behaviour, a wealth tax may not only discourage saving but may lead to people not holding wealth to fund their needs in future. Government may attempt to correct such problems by predicating the behavioural aspect of individuals to align these with their personal interests. Paternalism of such an order, however, is problematic because it goes against the principle of consumer sovereignty.

## Tax treatment on wealth

Unlike taxes on wealth transfers, taxes on wealth serve as a supplement to income tax. When considering the taxation of capital income, wealth can be viewed and used



as an effective tax base also focused on taxing assets whose income or returns is unobservable with relative ease. As such, taxing wealth can generally be as a supplement for taxes on capital income.

Furthermore, wealth taxation, especially in a dual tax system where a tax on capital income is at a uniform rate, offers additional support in fulfilling redistribution agendas. Boadway *et al.* (2010) propose several ways of treating and taxing wealth in different circumstances.

### **Wealth as a source of utility**

Generally, taxpayers derive utility or satisfaction from wealth and its actual use. In certain cases, wealth tends to convey power or a rise in status. Wealth, if kept for precautionary motives, holds the value of self-insurance against unforeseen circumstances. Although holding wealth bestows some form of benefit to the owner, an issue of concern revolves around whether it is justified to tax such kind of benefits and, if so, what the appropriate tax rate should be.

### **Complexities of wealth accumulation**

The nexus of holding wealth and progressive taxation has a bearing on wealth accumulation. Holding wealth tends to give pleasure to the wealth holder. As such, economic agents tend to over accumulate wealth to derive such pleasures. Such behaviour may have an effect on other economic agents who seek to hold more assets. A progressive wealth tax system, however, usually hinders such desires which makes the ideal of holding wealth costlier than the expected marginal benefit derived.

### **Valuation of wealth**

When a tax on wealth becomes more comprehensive, the challenge of valuing assets tends to emerge. Trotman-Dickenson (1996) identifies two asset valuation methods, both used in different circumstances:

## Open market valuation

The most common form of valuation is open market valuation to determine the value of assets purchased in the market of regularly traded goods such as shares or stocks. In this case, the value at which the assets have been purchased or sold counts as its market price. It is problematic, however, to determine the value of inherited assets or assets purchased a long time ago without any existing records or account indicating the purchase. It is even more problematic to determine the value of rare goods or goods not presented for sale. An alternative way of determining the value of such assets could be by comparing them to the market value of similar assets sold or bought.

## Expert valuation

In exceptional cases, for example where the asset is a piece of artistic work, the judgement of an expert maybe required to value the asset through estimating its selling price in an open market. Challenges, however, emerge when the artistic work is an unrecognizable work of art. Expert valuations remain inherently subjective and expensive to facilitate. For this reason, a tax on a disposal of an asset is favoured by some in that the liability for tax is then based upon a fixed and determinable value. In certain cases, taxpayers have the opportunity to place a value on their assets especially if the assets fall below the taxable limit or threshold.

## Principles of taxation

Notwithstanding the aim of generating revenue and achieving the ideal of an egalitarian society, the design of taxes on wealth and wealth transfers intends to achieve some degree of equity. These taxes, however, fall short of some features of an efficient, effective and equitable tax system. Trotman-Dickenson (1996) relates the various principles of a good taxation system to wealth and wealth transfer taxation:

### Equity: the benefit principle and the ability-to-pay principle

Equity, as a criterion of consideration when designing a tax system, requires a comprehensive understanding of two guiding principles: the benefit principle and

the ability-to-pay principle. In practice, these two principles produce different policy recommendations and offer different measures of tax reform. Achieving equality requires the alignment of a taxpayer's willingness to pay with the benefits he or she will derive. Taxpayers would also be willing to pay tax if there are no benefits associated (Wicksell, 1896). Despite this, the benefit principle is a significant and individualistic standard that is applicable when evaluating a tax system because it mirrors the idea of public policy and the role of voluntary exchange.<sup>23</sup>

In practice it is often difficult to gain consensus on what taxpayers are willing to pay versus what they stand to benefit. Often, economic literature faces confrontation with discussions on the problem of substituting actual consent by hypothetical consent. An advocate of wealth taxation, for instance, may contend that an individual holding a vast stock of wealth accrues more benefits in the form of protection of property rights than a neighbour who earns a modest amount of labour income and without wealth. It appears evident that possessing assets, and not merely the incomes that flow from them, must be a valid consideration for taxation in accordance with the benefit principle. In concluding the discussion on the benefit principle, it is important to note that, at minimum, the benefit principle offers some meaning when evaluating proposals to do with introducing a net wealth tax. The applicability of the benefit principle, however, requires caution, as it applies to specific cases, as well as economies; therefore a decision to adopt a wealth tax should not rely only on the benefit principle. Owning assets or property need not mean that the holder is able to pay taxes on wealth or wealth transfer. In cases, where the asset is a farm, for instance, it becomes a challenge to sell-off part of the farm to pay for taxes and maintain the rest as a going concern. A more appropriate tax to levy on such wealth would be a capital gains tax although, in the presence of inflation, they might not be a real gains, but in fact, a tax liability due to the increased value of the assets due to inflation.

In practice, the ability-to-pay principle makes use of stocks of wealth and income to proxy for an individual's ability to pay. These proxies, however, not only provide an incomplete picture of actual welfare but the tax payments are also not a full

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<sup>23</sup> See Buchanan (1975) for further discussion.

representation of the actual welfare losses. By only using the ability-to-pay principle, it is not easy to arrive at a recommendation for the design of a wealth tax. For instance, complexities arise when individual **A** inherits wealth, such as a government bond, but does not have a job and relies on interest payments for consumption while Individual **B** has a job, owing to his university degree, but has neither wealth nor savings. Therefore imposing a wealth tax becomes complicated especially when factoring in human capital in the wealth tax base (in the case of **B**). At the same time, introducing a wealth tax that focuses only on taxing financial assets sets **A** at a disadvantage because he or she will not be able to sustain the same level of consumption after wealth taxation<sup>24</sup>.

The principle of horizontal equity requires that estates of equal sizes should receive equal tax treatments. A wealth tax that provides exemptions on some assets (e.g. pension funds or owner-occupied housing) can create horizontal inequities.

When taxes on wealth are levied, one of the intended goals is to ensure that the tax is progressive in nature — implying that a larger estate should pay more tax relative to a smaller estate. This can be achieved through a tax-free threshold or through setting different rates.

### Efficiency: Is this achievable under wealth taxation?

Amid the older literature, some contributions have argued that introducing a wealth tax increases economic efficiency by inducing taxpayers to search for more efficient investments. Ideally, if a government imposes a tax on wealth this will motivate taxpayers to search for efficient investments (Sandford, 1971). Taxing wealth poses the burden of reducing the income of an individual or household even before the realization of any capital income. Therefore it increases the satisfaction derived by an individual or household from earning an additional gross income obtained after investing any existing funds. By making comparison to a tax free world, everything else constant, individuals may be inclined to incur greater costs on informing themselves about investment opportunities. Such effects are, in turn, strengthened if revenue generated from taxing wealth offered support towards reducing marginal

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<sup>24</sup> See Schnellenbach (2012) for a more detailed discussion.

income tax rates. Largely, the nature of such arguments are questionable on the basis that, often, the task of collecting information is given to specialized agents by households who are wealthy enough to pay the wealth tax with a view to minimising the effect of the tax on the quality and quantity of information used in making investment decisions.

A possible approach to reducing the tax burden on marginal income from increasing work effort would be to substitute a wealth tax for an income tax. Such a policy initiative has the potential to increase work effort, in the present period, given that the burden of taxation shifts to a different, yet larger tax base comprising previous incomes and accumulated savings. A shortcoming of this argument lies in the fact that taxes on wealth have the ability to depress the culture of life-cycle saving if individuals respond sturdily to a supposed rise in future consumption. These effects may appear amplified in depressed investments into human capital (Ihori, 2001). Additionally, wealth taxes distort decisions associated with the labour-leisure margins<sup>25</sup> which would entice individuals to apply less effort to work at a young age when, in fact, they ought to build up their stock of life-cycle savings.<sup>26</sup>

The general effect on work effort of a tax reform, which replaces the taxation of wealth with that of income, lacks empirical evidence and is therefore uncertain. Burbridge (1991) also supports this claim and makes the conclusion that the effects of a tax on wealth could have a bidirectional causal link with work effort.

### **Certainty of wealth and wealth transfer taxes**

In principle, taxes should be certain. In the context of wealth and wealth transfer, this is usually not the case because how the tax liability is determined is dependent on factors such as when valuation is made, death, changes in asset demand, valuation method or inflation rate which may also affect the valuation of assets.

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<sup>25</sup> The optimal balance between what wage to earn and the time spent for leisure activities.

<sup>26</sup> See Burbridge (1991) for more details.

## **Simplicity**

The legislation governing wealth and wealth transfer taxes must be comprehensive due the need to close any loopholes. This, however, typically undermines the principle of a simple and easy to understand tax system.

## **Cost of compliance and collection**

The fact that wealth taxes are comprehensive makes their compliance costs high. This can lead to unequal treatment of taxpayers. Wealthy individuals tend to have the resources to seek advice from tax experts on how to reduce their tax burden or how to avoid wealth taxation completely. When this occurs, the burden of the tax falls on the less wealthy who do not have the resources to seek expensive tax advice. Furthermore, the administrative costs associated with tax collection can be high for wealth and wealth transfer taxes. Collection costs are generally high because of the required inspection and valuation of assets.

## **Convenience to pay**

In general, taxes on wealth and wealth transfers are much more inconvenient for taxpayers to pay in comparison to other forms of taxes. In certain cases, especially with annual taxes, servicing the tax liability requires the sale of an asset in order to achieve the required liquidity to make the tax payment. Selling assets, however, may not be easy when demand is low or the economy is in a recession. In this case, the taxpayer would have to sell assets in a depressed market just to finance a tax liability. This presents an unintended loss to the taxpayer over and above the tax payment.

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## Chapter 4: Selected Country Review

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The debate on wealth taxes generally takes different forms in different countries, depending not only on the objectives of imposing the taxes but also on the socioeconomic and political dynamics of the countries in question. For instance, the complexities surrounding tax administration, as well as enforceability, make part of the tax base either highly mobile or easily hidden from tax authorities, which would require careful policy consideration (Schnellenbach, 2012). While most, if not all, taxable assets require valuation, the different valuation methods across countries yield different administrative costs and burdens. Often, this questions the impartiality of the tax system — highlighting the fact that some taxes may not be efficient but rather symbolic, given the amount of revenue that they generate after factoring in all associated costs.

The number of OECD countries that levy individual net wealth taxes has dropped from twelve in 1990 to only four in 2017. Examples of countries that repealed their wealth taxes include Austria (in 1994), Denmark (in 1997), Germany (in 1997), the Netherlands (in 2001), Finland (in 2006), Iceland (in 2006), Luxembourg (in 2006), Sweden (in 2007) and Spain (in 2008). After the financial crisis, Spain and Iceland re-introduced net wealth taxes as temporary<sup>27</sup> fiscal consolidation measures. Currently, France, Norway, Switzerland and Spain are the only OECD countries that still levy net wealth taxes. Wealth taxes in these four countries raise very little revenue, with the exception of Switzerland where 3.6% of tax revenue came from wealth taxes in 2015. In the other three countries wealth taxation accounted for less than 1% of total taxation in 2015 (OECD, 2017).

This chapter provides an overview of the state of wealth taxes in the world, with a particular focus on France, Germany, the Netherlands and India. These four examples were selected because they are in different phases of the wealth tax

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<sup>27</sup> Spain re-introduced the net wealth tax as a ‘temporary’ measure in 2011 but has extended it every year since then.

discussion. France has a well-established wealth tax, Germany is debating the creation of a net wealth tax, the Netherlands replaced its wealth tax with a presumptive capital tax and India recently abolished their net wealth tax. This chapter identifies any significant differences between the tax systems, as well as the instruments in use and what counterbalances (such as, exemptions and reduced rates) are in place. More importantly, this chapter is concerned with how wealth taxes meet the criteria of good tax systems in the four case studies.

## France

The first form of wealth taxation in France — termed the ‘Tax on Great Fortunes’ (*Impôt sur les Grandes Fortunes*, IGF) — was introduced in 1982 by President François Mitterrand and the Socialist Party (Piketty, 2014). Although Prime Minister Jacques Chirac eliminated the net wealth tax between 1987 and 1989, the re-election of President François Mitterrand in 1988 saw its re-introduction in 1989. This time around, it had assumed a different name, ‘the Solidarity Tax on Wealth’ (*Impôt de Solidarité sur la Fortune*, ISF) (Piketty, 2014; Astarita, 2015). The effect of the ISF was limited by not only introducing a cap but also streamlining the tax schedule.

It is worth noting that France has a long history of wealth taxes and it was only during World War I that France introduced taxes on income (Piketty, 2014). Indeed, from 1791 to 1914 a property tax constituted the central tool of government finance (Piketty, 2014; Astarita, 2015).

France also has other forms of taxes on wealth. These include a property tax<sup>28</sup> and an estate tax (Astarita, 2015). Figure 9 shows that ISF makes a contribution of approximately ten per cent to the total wealth tax revenue collected. Furthermore, the contribution of ISF has increased over the past two decades (Astarita, 2015).

## Tax migration from France: some existing evidence

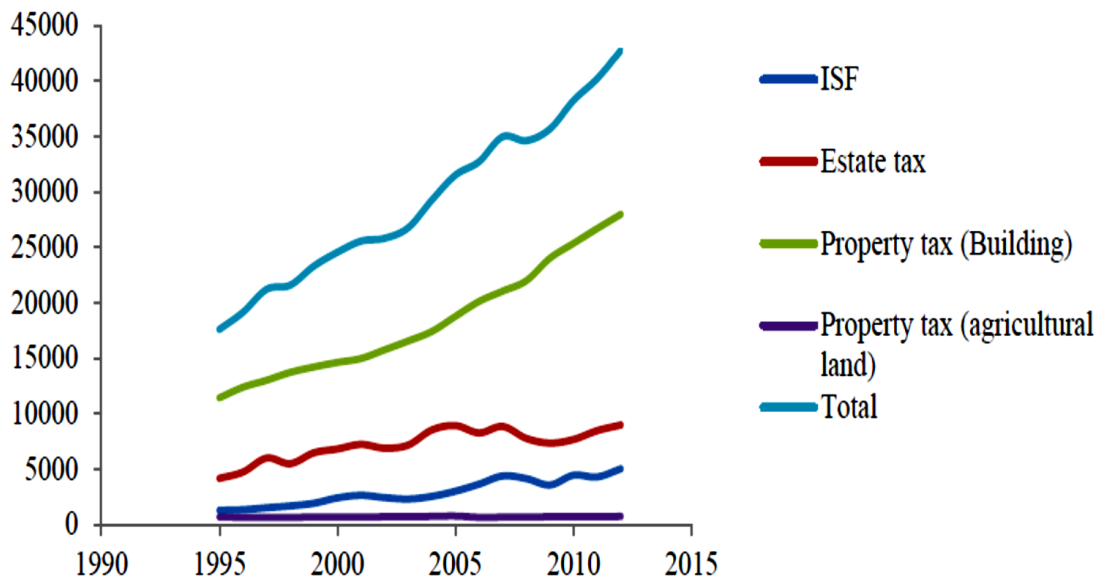
A significant part of the public debate about the ISF in France is the concern that ISF has resulted in tax migration (Astarita, 2015). While the precise magnitude of the

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<sup>28</sup> Split between a property tax on building and a property tax on agricultural land.

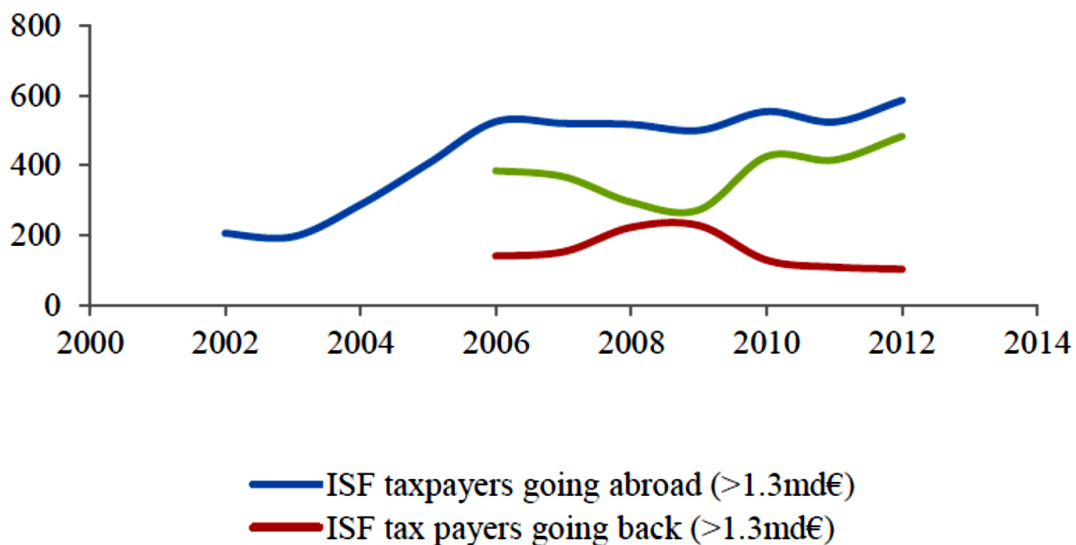


effect is impossible to quantify, given other tax changes that occurred at the same time and non-tax reasons for migration, the evidence suggests a link between the reintroduction of the ISF and increased migration. Astarita (2015) plots data from the French national treasury (Figure 10) drawing a distinction between gross and net outflows.

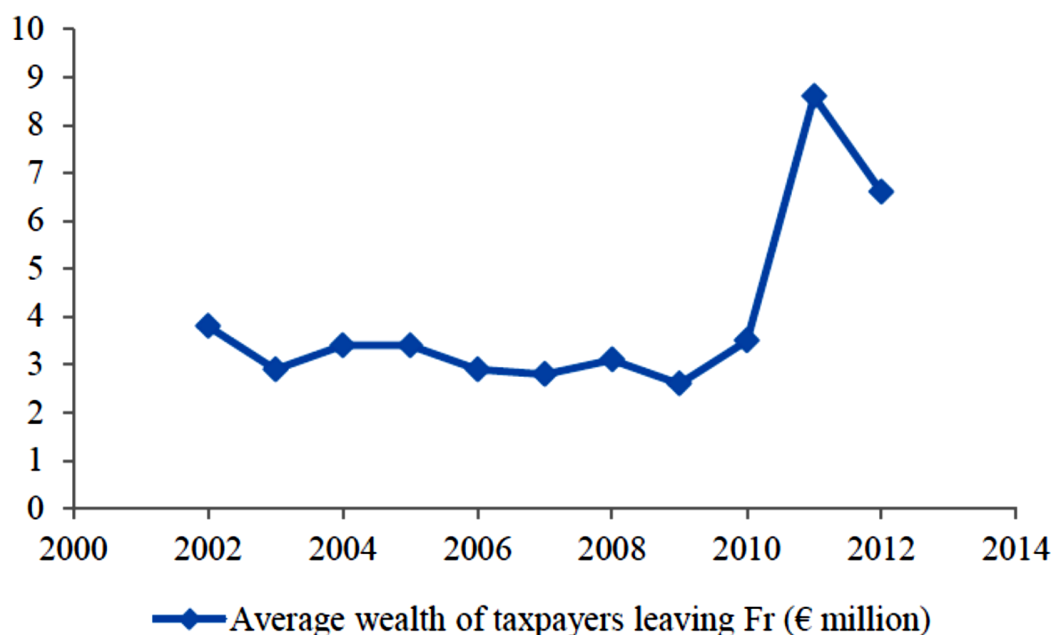


Source: Astarita (2015).

**Figure 9:** Evolution of revenues for different components of wealth taxation



Source: Astarita (2015).

**Figure 10:** Comparison of ISF tax payer emigration and immigration

Source: Astarita (2015).

**Figure 11:** Average wealth of taxpayers migrating from France, 2002-2013

What is evident, however, as presented in Figure 11, is that people moving abroad are generally wealthier than the average ISF taxpayer. Receiving countries of these tax migrants have included Switzerland and Belgium (Pichet, 2007; Astarita, 2015). The spike in the Figure 11 in 2011, however, is not primarily due to the ISF but several other changes made in the tax code. As a result, it is a daunting task to measure the specific causal impact of the ISF on emigration given that it can be both a source of an upward and a downward bias (Astarita, 2015).

A point of concern is overestimating the impact of ISF. It accounts for a small fraction of wealth taxes, not to mention the whole tax system (Pichet, 2007) therefore the tax system as a whole, rather than specifically the ISF, may be prompting tax migration. There is though a risk of underestimating the impact; for example, where the descendants of emigrants are not accounted for estate tax purposes.

Media estimates suggest that one third of French billionaires either live in – or at least hold substantial residential or financial assets in - Switzerland and Belgium (Astarita, 2015). Interestingly, almost no wealthy French citizens resided in Belgium

prior to 1981. This highlights the question of whether different wealth taxation systems between countries influences how people choose their country of residence.

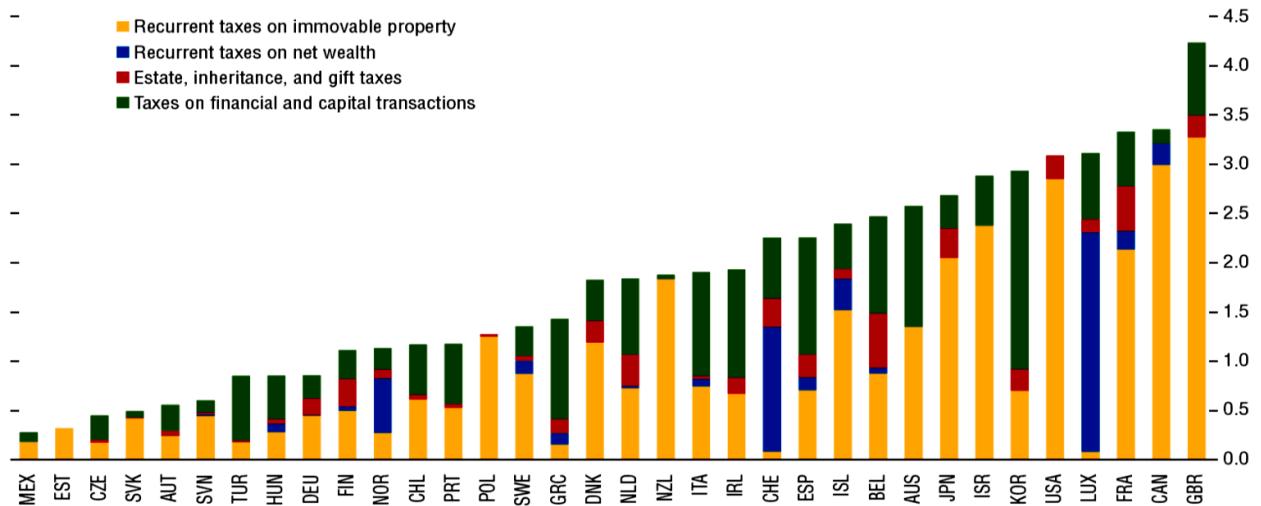
## Germany

In a number of OECD countries, particularly Germany, both income and wealth inequality have been on the rise. From the late 1990s to 2005, Germany's Gini coefficient rose substantially by four percentage points (Grabka & Groebel, 2013; OECD, 2014). The Household Finance and Consumption Survey of 2013 found that Germany has the most unequal distribution of personal wealth in Europe (Carroll, et al., 2014). At the same time, taxes have become less progressive due to increased international tax competition. What followed was a reduction in business and capital income taxes, as well as personal income taxes, while taxes on personal wealth have been discarded. Taxes on inheritance remain insignificant (Astarita, 2015).

Recently a contentious debate on the taxation of capital income and wealth has arisen in Germany. Politically, the need for higher taxes on the "rich" have been proposed and endorsed by left-wing parties (Biewen & Juhasz, 2012). The discussion has included the reintroduction of a recurrent or annual wealth tax, a once off capital levy aimed at reducing government debt, or decreasing tax privileges for company succession and other tax breaks by reinforcing inheritance taxes.

### Taxes on property and other forms of wealth in Germany

In the German tax system, the contribution of property and wealth-related taxes over the last decade has been minimal, compared to other countries in Europe (see Figure 12). They account for less than 1 per cent of GDP, with the largest contribution coming from taxes on real estate property, and in particular, from local property taxes and taxes on the transfer of individual property between states (IMF, 2013). The inheritance and gift tax is the only existing tax that focuses on taxing the "rich" or "wealthy strata of the population" though it contributes less than 0.2% of GDP (IMF, 2013).

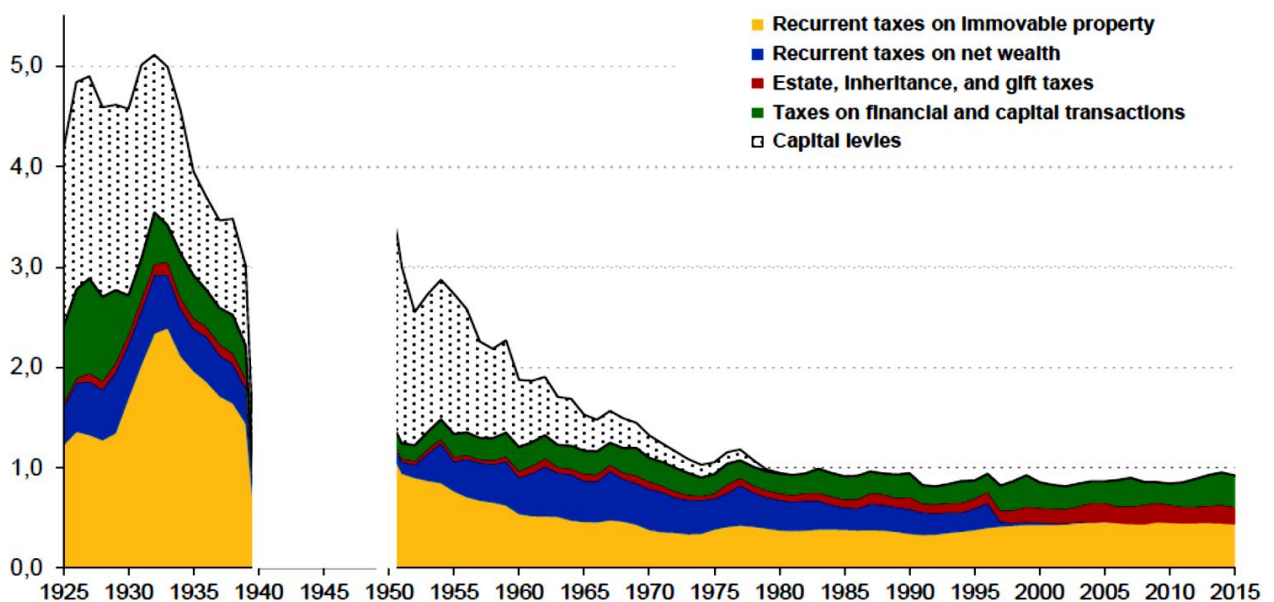


Source: Astarita (2015).

**Figure 12:** Average property taxes as a percentage of GDP in OECD countries, 2000-2011

On the other hand, Germany has had much success with personal wealth taxation, as well as other forms of wealth taxation in the past, as shown in Source: Astarita (2015).

**Figure 13.** Towards the end of the 19<sup>th</sup> century, recurrent wealth taxation and inheritance taxation were introduced in individual states, though they were later substantially raised after World War I (Bach, 2015).



Source: Astarita (2015).

**Figure 13:** Average wealth taxes in Germany, 1925 to 2015 as a percentage of GDP

Capital levies were later introduced with the aim of reducing the rapidly rising government debt though it was resolved through the hyperinflation of 1923 (Bach, 2015).

It has been argued that the main reason for the low revenue importance of wealth taxation in Germany over the last decades were the outdated "standard values" (Einheitswerte) of real estate properties which have not been updated since the 1960's. (Astarita, 2015). In 1997, the recurrent wealth tax system was suspended after the constitutional court<sup>29</sup> ruled that the undervaluation of real estate and business property (relative to other assets) was unconstitutional.

### Wealth taxation – the German Debate

In Germany, the introduction of wealth taxation has been a subject of tax policy debates in recent years. Various proposals have emerged which argue either for or against the introduction of personal wealth taxation. Among many, two proposals have received significant attention.

The first proposal was endorsed by the parliamentary group of the Bündnis 90/Die Grünen Party (2012). The party advocates for the introduction of a one-time capital levy<sup>30</sup> which would be used to service the debt incurred during the global financial crisis (Bach, et al., 2014). Ideally, only individuals with a net wealth greater than 1 million euros would be subject to the once-off levy. Corporations would be exempt from this levy since shareholders are subject to personal income tax. Following historical practices, payment of this levy would be made in instalments over a period of 10 years, subject to a standard interest rate for public debt. The levy effectively equates to a recurrent tax on capital income, thereby limiting the potential wealth and income effects of the tax burden.

The Sozialdemokratische Partei Deutschlands (SPD, Social Democratic Party of Germany) and several governments of individual states, governed by Social

<sup>29</sup> The Federal Constitutional Court is the supreme constitutional court of Germany.

<sup>30</sup> The one-time capital levy is meant to raise revenue equivalent to 4% of GDP in 2011.

Democrats, put forward a second proposal on personal wealth taxation. They submitted a draft bill proposing the re-introduction of recurrent taxation (Bach & Beznoska, 2012). Both corporations and individuals (including shareholders of corporations) would be legally responsible for wealth taxation. The issue of double taxation would be resolved by exempting half of any taxable wealth of corporations, as well as each shareholder's corporate shares (Bach & Beznoska, 2012).

An important aspect of the taxation of personal wealth entails determining which assets, such as financial, business, real estate and some household assets (less any liabilities), are taxable. In order to ascertain and appraise the tax base, reliance has been made on improved valuation procedures for gift and inheritance taxes since 2009.<sup>31</sup> Although the aim of improved valuation procedures is to capture the market value closely for tax commitments, standardised appraisals are a complex process<sup>32</sup> (especially for small firms and real estate properties). Some level of tax evasion will still be prevalent in respect of foreign-held assets as international cooperation among tax authorities is still inadequate (Bach & Beznoska, 2012).

### *Revenue and distributional impact*

Bach *et al.* (2014) have analysed the revenue and distributional impact of a net wealth tax for Germany.<sup>33</sup> Based on the fact that net wealth tends to be highly concentrated at the top end of the distribution, the data suggest that a personal wealth tax would raise significant revenue albeit that high personal allowances are granted; thereby limiting the number of persons to a reduced fraction of taxpayers. Tax experts highlight that wealth tax administration and compliance has been rather a heavily contested issue not only in Germany, but in other countries as well (Rudnick & Gordon, 1996; Boadway, et al., 2010).

### *Economic impact*

A significant downside of an annual wealth tax lies in its potential nature to discourage capital accumulation which tends to cause several behavioural responses

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<sup>31</sup> See the German Inheritance and Gift Act of 2009.

<sup>32</sup> See Rudnick and Gordon (1996).

<sup>33</sup> See Bach and Beznoska (2012) and Bach *et al.* (2014) for a detailed analysis.

by economic agents towards decisions made in relation to investment and location, financing, tax evasion, administration, legal form and other strategies associated with wealth tax avoidance (Bach & Beznoska, 2012). Notably, a recurrent wealth tax can be linked to the taxation of capital and business income although a recurrent wealth tax is exposed to more risk because it does not account for fluctuations of income nor any associated losses (Astarita, 2015). In the context of small and medium enterprises (SMEs), the imposition of a wealth tax can create liquidity problems. The effects are far greater for SMEs with restricted access to capital markets. It can be argued that a tax break for SMEs would solve this problem but this would concurrently lead to a reduction in tax revenue, distort the market and increase administrative as well as compliance costs (Bach, et al., 2014).

Given the prevailing low interest rates, where obtaining a nominal interest rate of even two per cent has proved difficult for safe investments (such as, bonds or bank deposits), an excess burden of this nature would seem to be impractical. In fact, this could possibly instigate constitutional concerns with respect to over-taxation (Astarita, 2015)<sup>34</sup>.

A study by Bach and Beznoska (2012) analyses the possible impact of such a tax hike on capital and business income by employing relevant taxable income elasticities. Given a set of holistic assumptions<sup>35</sup>, their findings suggest that a one per cent increase in the tax burden will lead to a 0.25 per cent reduction in the tax base. They also find that such a tax hike will have a negative impact on economic growth, direct and indirect tax revenue.

In comparison, a once-off capital levy can be imposed over a recurrent wealth tax to the existing wealth stock. Dependent on the degree to which taxpayers do not expect the imposition of a once-off capital levy, instant tax evasion cannot be incentivised as soon as the levy is imposed and assessed (Bach & Beznoska, 2012). In accordance with the standard theory of optimal taxation, the once-off capital levy would not impose an excess burden nor result in any substitution effects. This highlights the

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<sup>34</sup> There has been a huge constitutional debate in Germany over the burden of recurrent wealth taxes methodically exceeding rate of return on investments, which is seen to be in conflict with the constitution concerning how property rights are set out.

<sup>35</sup> Accounting for limited opportunities for both international evasion, as well as tax avoidance.

fundamental benefit of a once-off capital levy in contrast to recurrent capital, and business wealth or income taxes (Boadway, et al., 2010).

Conversely, if prospective taxpayers anticipate that the capital levy will recur, this may have the effect of not only depressing investment and saving in the long-term but also stimulating the flow of illicit finances and the punitive realities of capital flight (Bach, 2015). In a case where the reappearance of a levy cannot be entirely dismissed, Eichengreen (1990) contends that such a levy can be used as a tool to improve welfare, especially in cases of redressing problems of high debt emanating from unexpected economic situations. It can be expected that such levies will give rise to political backlashes and opposition, especially from the wealthy who may feel that government is targeting them. In summary, the IMF (2013) notes that a levy can only serve as a tool to improve welfare in times of unexpected economic situations. The renewed focus on wealth taxation in countries with rising debt in Europe supports this argument.

## Netherlands

In 2001 the Netherlands abolished the tax on personal capital income and substituted it with a presumptive capital income tax “which is in fact a net wealth tax” (Cnossen & Bovenberg, 2001). The main objectives of the introduction of the presumptive capital income tax were: reducing the tax avoidance opportunities that were prevalent in the tax system before the fundamental tax reform of 2001; simplicity for taxpayers and especially for the tax administration; stable tax revenues for the government; and reducing the tax-induced incentive for capital flight and tax evasion (OECD, 2017).

Instead of taxing actual investment income, the ‘deemed income’ from investments is taxed as part of the income tax system. This is known as ‘Box 3’ taxation and the deemed income is calculated at a fictitious rate set by the tax authorities.<sup>36</sup> Importantly, there is no capital-gains tax in the Netherlands.

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<sup>36</sup> As from 2017, the system has been made more progressive by using more than one (fictitious) rate of return. The larger the size of the portfolio, the higher the presumed rate of return.



The theory behind the system is quite neat. The central idea is that in keeping with the welfarist criterion, all income flows (both real and in the form of increases in a person's stock of wealth) should be taxed. 'Box 1' income is income from the labour market and pension income. 'Box 2' income is dividend income from closely held companies (in which the individual has at least 5% ownership). Box 3 income is the *deemed* income from the investment portfolio, e.g. cash, stocks and shares, based on the 1 January position/value of each year. While the tax rates for the three 'boxes' are set differently, the key principle is to try to treat all income in a broadly similar way and thereby to reduce tax arbitrage.<sup>37</sup>

The system is not without criticism. Firstly, investments in the form of pension fund holdings are excluded which significantly erodes the base. If pension funds were included, this would reduce wealth inequality (Anon., 2014). The Netherlands has an extensive system of social security, thus it is largely the middle and wealthier classes that invest in additional retirement vehicles. Retirement contributions are also deductible, meaning that a significant tax subsidy goes to people with retirement products.

Secondly, owner-occupied housing is excluded from the calculation of Box 3 assets. Instead, owner occupied housing is treated as a form of income in Box 1. A presumptive rate of return is applied on the market value of the property and mortgage payments can be deducted. As the presumptive rate is set quite low (1.25%), this means that many people will report negative income from their owner-occupied housing. For individuals with high salaries (who are facing marginal personal income tax rates of more than 50%), it makes sense to fully mortgage their home and rather use their own equity to invest in 'Box 3' investments. This has driven up house prices, caused people to over-invest in housing and created an asymmetry in the treatment of the costs of debt and equity: the nominal interest costs of debt remain deductible at progressive rates in Box 1, whereas the alternative

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<sup>37</sup> Some capital income items are included in Box 1. The most important ones are the proceeds of capital that proprietors employ in their own businesses and the income from owner-occupied housing, *i.e.*, presumptive rental income minus mortgage interest. Interest, rental income and realized capital gains on assets put at the disposal of closely-held companies by dominant shareholders are also allocated to this box. This anti-avoidance provision prevents shareholders from shifting their taxable income away from Box 1, which is subject to relatively high marginal tax rates, towards Box 3, which attracts lower effective tax rates.

investment of equity capital in the capital market is taxed at a proportional rate of only 30 % on a presumptive return in Box 3.

Thirdly, taxing capital income on a presumptive basis violates the principle of ability-to-pay when measured in terms of income (Cnossen & Bovenberg, 2001). Under a presumptive capital income tax such as Box 3 taxation, the government exempts all income arising from above normal returns. This is inconsistent with the treatment of ‘exceptional’ earnings in the labour market or from business income. If a person earns an above average return on their human capital they pay tax (at progressive rates) under Box 1. If their business earns above average returns, they pay tax on this under Box 2.

## India

Wealth taxation was implemented in India after suggestions by the Kaldor committee<sup>38</sup> in 1956. A main recommendation was to broaden the tax base through the introduction of a net wealth tax, a capital gains tax, an expenditure tax, as well as a general gift tax (Kaldor , 1956). Based on these recommendations, gift and wealth taxes were introduced as components of the Indian Wealth tax Act of 1957, and the Gift Tax of 1958.<sup>39</sup> According to Kaldor (1956), the motivation for introducing a wealth tax was three-fold:

- to reduce the possibility of tax evasion;
- to account for an individual’s capacity to pay; and
- to promote an egalitarian society using redistributive measures that provide no disincentive effects both, conceptually and operationally.

A recommendation made by the Tax Reform Committee<sup>40</sup> was that the taxation of wealth should be restricted only to forms of wealth that are unproductive which was previously not the case. To execute the recommendations of the Tax Reform

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<sup>38</sup> The Kaldor committee, led by a renowned economist Nicholas Kaldor, submitted a report on Tax prospects of Indian Tax Reform in 1956.

<sup>39</sup> In 1998, the Gift Tax was abandoned.

<sup>40</sup> See Government of India, Tax Reforms Committee Report of 1992 for details of recommendations and reforms made.

Committee, a number of changes had to be put in place. A distinction was drawn in the Budget for 1992/93, regarding what would qualify as productive and unproductive wealth in order to determine what could be subjected to wealth taxation (Pandey, 2006).

The Wealth Tax Act was comprehensively revised in 1993, based on recommendations of the Chelliah Committee (Tax Reforms Committee, 1992).

### **Challenges associated with wealth tax administration**

According to Pandey (2006), wealth tax administration in India was associated with several challenges. Firstly, the problem of valuation of assets created certain inequities due to the exemption of some assets from taxation. Secondly, tax authorities did not account for the indexation of wealth taxation with respect to inflation. Thirdly, the tax burden of the collective incidence of wealth tax, income and other forms of taxes (such as property tax) imposed a heavy burden on the assessee.

In the post reform period, the office of the Comptroller and Auditor General of India (CAG) undertook a study, published in 2001, with the following objectives:

- to examine the efficiency with which the provisions of the Wealth Tax Act were implemented;
- to examine the quality standards of wealth tax assessments; and
- to examine if there was tax leakage at any stage of the wealth tax assessment.

The report indicated that the number of wealth assessees had decreased while the number of income assessees had increased — suggesting that certain taxpayers did not file their wealth tax returns, despite having taxable assets liable for wealth taxation (Pandey, 2006). The report further showed the persistent case of lapses by tax assessing officers to establish a relationship and correlate income, as well as wealth tax records, to ensure there was no tax evasion, despite receiving directives from the Central Board of Direct Taxes. Hence, there was a fall in revenue during the period (1994 to 1995 and 1998 to 1999) from the Wealth Tax — suggesting that assessees were either not filing wealth tax returns or not disclosing the true value of their wealth (Pandey, 2006).

## Abolishing the Wealth Tax and increasing the surcharge

Though the Indian government was successful in enacting the Wealth Taxation Act in 1957, it decided to abolish the tax in 2015 for several reasons. The nominal revenue collected was inadequate to match the administrative burden on the tax authority and the compliance cost on the taxpayer.<sup>41</sup>

More importantly, unproductive assets (which were the only ones subject to wealth taxation) such as luxury cars, jewellery and so on, are difficult to track down and hard to value. As a result, wealth tax collection had not presented substantial progress but had brought about inconsistent administrative burdens on tax authorities and complex compliance burdens on taxpayers.

To compensate for the expected loss of revenue when the wealth tax was abolished, the government introduced an additional two per cent surcharge levied on high-income earners (Batra, 2015). It was considered more efficient and equitable to tax the income rich than to continue to try to tax the wealthy, many of whom were able to evade wealth taxation by obtaining expensive tax advice (Batra, 2015).

## Summary: lessons from other countries

In the last 20 years, several countries have abandoned the taxation of net wealth. In most cases, the rising costs of classifying and measuring net assets, structuring the tax collection system, and above all, accounting for global assets have been causes for concern. For instance, the Labour government's attempt to implement a net wealth tax in the UK in 1974 was constrained by issues of designing a tax structure that would generate revenues that outweighed costs (Glennerster, 2012).

Furthermore, exemptions on net wealth taxes have been considered politically necessary and this has created a platform for coordinated lobbying. In a country with a narrow wealth tax base, wealth taxation can only generate sizeable revenue if the tax rate is high. A high tax rate, however, imposes a substantial economic burden on taxpayers, particularly those without the means to exploit tax loopholes through

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<sup>41</sup> Assets like jewellery require that a valuation report be obtained from the registered valuation officer.

seeking expensive tax advice. For example, India abolished the wealth tax owing to the lack of its effectiveness, its negligible contribution to the total tax revenue and the difficulties associated with valuation.

Additional challenges arise when identifying the tax base. The risk that the wealth tax will be paid mainly by the 'fairly wealthy' whose key assets are residential property in the country of residence increases because the wealthiest people tend to hold an intricate and diverse set of assets, usually abroad — thereby making it easy for them to avoid taxes. Given such difficulties, public support for wealth taxation has been rather limited. Furthermore, evidence suggests that tax migration has been prevalent, e.g. in France. Although wealth inequality may have declined in France, one could argue that it has been at the expense of rising wealth inequality in neighbouring countries (Belgium and Spain) where French wealth holders chose to invest.

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## Chapter 5: The South African case

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### Justification for a wealth tax

Based on the literature surveyed in this report, the evidence has shown that wealth inequality (with a Gini coefficient above 0.9) in South Africa is extremely high and much higher than income inequality (which has a Gini coefficient of 0.67). Of even greater concern is that wealth inequality in South Africa is also higher than global wealth inequality.

The evidence presented on wealth distribution in South Africa has shown that the top 10 per cent of the population own more than 90 per cent of total wealth in the country – leaving 80 per cent of the population with virtually no wealth. It therefore comes as no surprise that, with such statistics, the so-called ‘middle class’ is basically non-existent in South Africa when using wealth as a measure of living standards.

The point of departure is that economic inequality, which encompasses inequalities of income, wealth and consumption, is a pressing issue in post-Apartheid South Africa. The current pattern of wealth ownership in South Africa reflects our history of colonialism and apartheid policies and cannot be undone without the intervention of the state. Although progressive income taxes have aimed at achieving redistribution objectives (such as creating opportunities for the poor, promoting economic stability or providing public goods), the income gap between the rich and the poor has continued to widen. New evidence has highlighted that the wealth inequality is even wider than income inequality.

A most important consequence of a highly unequal distribution of wealth in society is the undermining of social, political and economic stability; in particular the principle that everyone has an equal stake in the society in which they live.

As Anthony Atkinson puts it: *“When measuring inequality, we are concerned not just with the consumption of the rich – important though this may be – but also with the power that wealth can convey. This power may be exercised over one’s*

*family, as with the passing on of wealth to heirs, or more generally in such ways as control of the media or influence with political parties” (Atkinson, 2015).*

In South Africa there are direct benefits from holding wealth. Thus, wealth must be a legitimate, but highly contentious tax base in its own right. Consequently, there is justification to further explore alternative forms of wealth taxation.

However, a wealth tax is not the only available nor necessarily the best instrument to address the inequities of income and wealth. Other methods of redress include land reform and programmes on the expenditure side of the fiscal budget such as increased access to quality health and education and the provision of infrastructure as well as effective government leading to growth and employment.

Based on the wealth inequality considerations alone, there can be no doubt as to the desirability of the need for redistribution and thus the need to consider additional or alternative forms wealth taxation. However, reservations exist with regard to the feasibility of implementing even the simplest forms of additional or alternative wealth taxation. Above all, the legislative and administrative processes required for both SARS and the taxpayer will be significant and must not be underestimated.

### **Policy considerations: the existing tax base of South Africa**

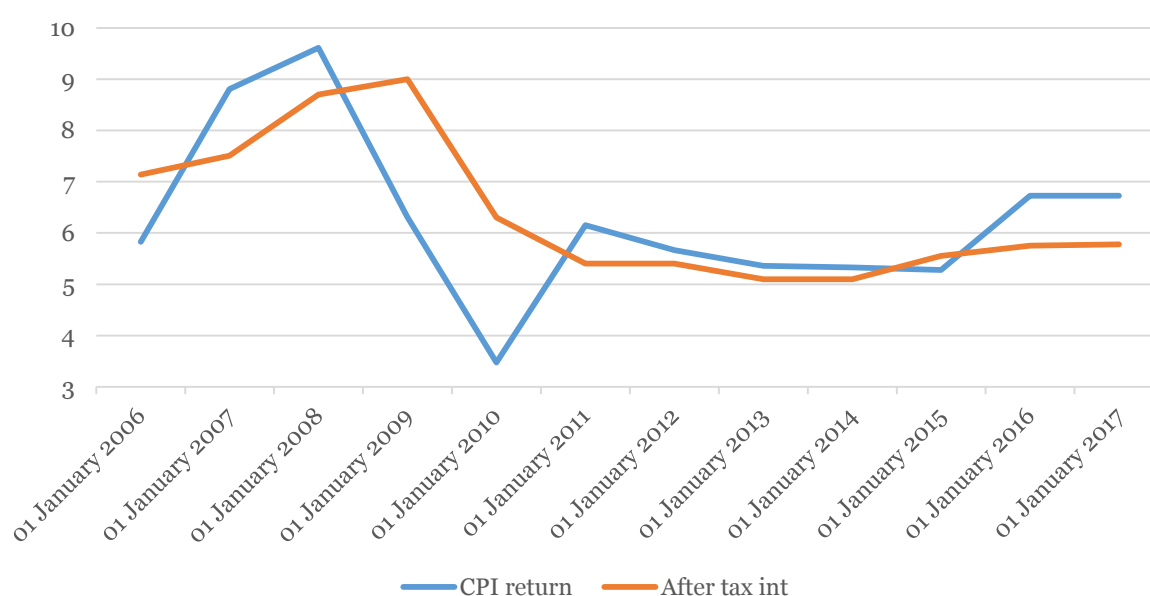
The imposition of alternative or new forms of wealth taxation in South Africa must be very carefully considered. As indicated, wealth taxation is a highly contentious and complicated issue and by no means a quick fix solution to South Africa’s current revenue needs.

The adverse consequences of wealth taxation such as capital migration, disincentives to save, the effect on entrepreneurship and employment must be thoroughly considered.

In particular, income streams arising from wealth are today taxed on a far wider base than 20 years ago. It is thus necessary to briefly take stock of recent developments and the existing tax base.

## Cash and savings

The interest returns on cash and savings fall within the definition of gross income in terms of the Income Tax Act. (See also s 24J of the Act which stipulates the manner in which interest is taxable.) Individual taxpayers are granted an annual basic exemption of R23 800 (for taxpayers below 65 years old) and R34 500 (for taxpayers above 65 years old). Taxable income in excess of the basic annual exemptions from interest received or accrued within the tax year is subject to taxation at marginal rates ranging from 18% to 45%. Post-2000 South African interest rates have declined considerably.



**Figure 14:** CPI vs after tax interest returns in South Africa, 2006-2017

As a result of the above, the after-tax interest rate today is already below the inflation rate. If cash and savings are to be subjected to wealth taxation the real growth rate of savings will fall even further below the inflation rate. This will aggravate South Africa's poor savings culture even further. It may also result in more retired individuals, who are living on savings, being unable to sustain themselves without exhausting their savings before they die, thereby becoming reliant on the State or others.



It would seem contradictory to create savings incentives by way of retirement funds, interest exemptions and even tax-free savings accounts and then introduce a wealth tax on these very savings.

### Listed investments and collective investment schemes

Prior to the imposition of the Capital Gains Tax regime (on 1 October 2001), most disposals of listed investments and collective investment schemes were exempt from taxation (other than minor marketable securities taxes).

In the debate leading up to the implementation of capital gains tax on 1 October 2001, it was argued that a ‘mild and simple’ form of capital gains tax was justifiable as a means of narrowing the opportunities for tax arbitrage between capital and revenue income. At the time, in the pursuit of simplicity, it was suggested that by limiting the capital gains tax inclusion rate (to 25% for individuals and 33% for corporates and trusts) there was no need to allow for ‘tapering’ or inflationary adjustment of the capital gain. Thus, in the case of individual taxpayers the maximum exposure of an investment to capital gains tax was only 10% (being a 25% CGT inclusion rate applied against the then maximum marginal rate of 40%).

Table 2: Capital Gains Tax (CGT) raised, 2007/08 – 2016/17 (in R million)

	Individuals	Companies	Total
Prior to 2007/08	1 850	3 241	5 091
2007/08	1 167	2 494	3 661
2008/09	3 807	4 136	7 943
2009/10	4 357	6 023	10 380
2010/11	2 012	7 049	9 061
2011/12	1 550	5 263	6 813
2012/13	2 166	5 008	7 174
2013/14	6 970	4 633	11 603
2014/15	5 538	6 135	11 672
2015/16	7 526	9 155	16 681

2016/17	9 638	7 422	17 061
Cumulative	46 581	60 559	107 140

Source: National Treasury & SARS (2017)

As shown in Table 2, CGT collections reflect a substantial increase since its implementation on 1 October 2001. This has not only resulted from the gradual phase-out of the pre-2001 capital gain component (which was exempt from tax), but CGT inclusion rates have also been increased substantially without the introduction of tapering for the effects of inflation.

With effect from the 2016 year of assessment, the CGT inclusion rate was increased to 80% (corporations) and 40% (individuals) with effect from the 2017 year assessment. In addition, it must be noted that the 10% rate of secondary tax on companies (STC) was increased to 15% when dividends tax replaced STC in 2012. The dividends tax rate was then raised to 20% with effect from 1 April 2017.

**Table 3:**

	Company		Trust		Individual	
	Capital	Revenue	Capital	Revenue	Capital	Revenue
Income	100.00	100.00	100.00	100.00	100.00	100.00
Inclusion rate	80.00	100.00	80.00	100.00	40.00	100.00
Taxable income	80.00	100.00	80.00	100.00	40.00	100.00
Tax rate	28.00	28.00	45.00	45.00	45.00	45.00
tax liability	22.40	28.00	36.00	45.00	18.00	45.00
Dividend tax	15.52	14.40	-	-	-	-
Total tax	37.92	42.40	36.00	45.00	18.00	45.00
Top effective rate	37.92	42.40	36.00	45.00	18.00	45.00

The combined emphasis on CGT and dividends tax has increased substantially since 2001. Thus, there should now be some concern when considering the imposition of a wealth tax on investments. It is universally agreed that capital-related taxes not only have much lower revenue potential than elsewhere, but might also undermine the country's simultaneous efforts of encouraging capital formation and lowering the dependency on foreign capital inflows. To this must be added the concern that excessive taxation on investment can reach the point that the South African capital is invested abroad, legally or illegally.

## Retirement funds

A substantial proportion of South Africa's wealth (R2,2 trillion)<sup>42</sup> is held in retirement funds. Indeed, it can be argued that any form of wealth taxation will be largely ineffective if the retirement funds are granted complete exemption.

Table 6: Investment pattern of pension funds registered in terms of the Pension Funds Act (Note 2)

Assets	2015 Rm	% Of total assets	2014 Rm	% Of total assets
1. Cash	97 640	4.30	67 020	3.19
2. Commodities	6 228	0.27	3 075	0.15
3. Debt instruments (including Islamic debt)	192 208	8.46	181 780	8.67
4. Investment and owner-occupied properties (Note 1)	26 851	1.18	12 955	0.62
5. Equities (including demutualisation shares) (Note 3)	400 001	17.62	376 613	17.96
6. Insurance policies	923 937	40.68	866 707	41.34
7. Collective investment schemes	164 035	7.22	190 993	9.11
8. Hedge funds	12 595	0.56	7 092	0.34
9. Private equity funds	6 866	0.30	5 399	0.26
10. Investment in participating employer(s)	11 002	0.48	12 475	0.59
11. Derivative market instruments	470	0.02	1 236	0.06
12. Other assets (Note 5)	2 559	0.11	6 043	0.29
13. Foreign investments (Note 4)	426 730	18.80	365 283	17.42
<b>Total</b>	<b>2 271 122</b>	<b>100.00</b>	<b>2 096 671</b>	<b>100.00</b>

Notes:

1. Property, plant and equipment, housing loan facilities, surplus improperly utilised receivable, transfers receivable, accounts receivable, contributions receivable and cash at bank are not included above (see Table 11).

2. Table 7, dealing with non-submission rates, needs to be taken into consideration when interpreting this table.

3. Equities comprise local listed equities, equity index-linked instruments, preference shares and unlisted equities.

4. Foreign investment includes listed foreign equities and unlisted equities.

5. Other assets represent a combination of derivative market instruments and investments not listed in the table.

While the overall incidence of tax on savings and investments has shown a dramatic increase since the implementation of CGT in 2001, the position has actually reversed when it comes to investments in retirement funds. In particular and in summary:

<sup>42</sup> 2015 Annual report of the Registrar of Pension Funds.

- Retirement funds have been exempt from CGT since inception in 2001.
- Retirement Funds Tax ‘RFT’, implemented by the Tax on Retirement Funds Act, 1996, following the proposals of the Katz Commission of Inquiry, was withdrawn in 2007. (Revenue stream forfeited: R7bn per annum)
- Retirement fund death benefits were exempted from Estate Duty in 2009.
- STC was levied on all dividends (including dividends paid to retirement funds) prior to 1 April 2012. On conversion from STC to the dividends tax regime a blanket dividends tax exemption was granted to retirement funds. (revenue stream forfeited R5bn per annum)
- The retirement fund contribution limits were established at 27.5% of taxable income, limited to R350,000 per annum, effective 1 March 2016.
- Provisions relating to retirement age have been largely deleted from the Income Tax Act allowing the taxpayer to accumulate wealth, tax-free within the retirement fund post actual retirement. This allows wealth to be passed on to future generations applying the estate duty exemption granted to retirement funds.

The tax incentives and exemptions granted to South Africa’s retirement funds are well motivated - South Africa’s overall life expectancy is expected to increase to 70 by 2030 (StatSA) resulting in further aggravation of South Africa’s desperate underfunding of pension savings. On the other hand, it can also be argued that the retirement funds of South Africa have become relative tax havens for the wealthy (in comparison to the privately held savings and investments).

The imposition of a wealth tax on retirement funds has every potential to create enormous administrative complexity unless it is imposed at a flat rate on the gross assets of the retirement funds. Such a proposal would make no distinction between rich and poor pension fund members.

According to information furnished to the DTC by ASISA, there are currently 6.79 million South Africans with some form of retirement savings. Of this population, approximately 5 million are below the UIF ceiling of R178 000 *p.a.*, of whom approximately 3 million are even below the current income tax threshold of R75 000 *p.a.* It can thus be concluded that retirement funds represent a major component of the wealth of the lower income earners of South Africa.

Further consideration must also be given to the declining returns achieved by retirement funds in recent years.

Table 6.1: Return on investments

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The return made by pension funds on the value of investments shown in Table 10.1 is calculated by using the following formula:

$$R = \frac{2i}{A + B - i}$$

Where R = Return on investments  
A = Initial value of investments  
B = End value of investments  
i = Interest, dividends, rent, policy income, net profit or losses on realisation of investments and the amount by which investments were written up or down to fair value. Funds are required to disclose in their financial returns the method used for determining accrued, vested or provisional income from insurance policies. Non-vested policy income is included in or excluded from the revenue account at the discretion of funds.

By applying this formula to the total investments of all the self-administered funds, the return on investments for the past five years is calculated as follows:

Calendar year	2011	2012	2013	2014	2015
% returns	9.9	12.1	17.3	16.2	9.8

Notes:  
1. The statistics for 2011 to 2015 are for all types of retirement funds registered with the FSB.  
2. The sample of funds for 2014 is 1 958, while for 2015, it is based on 1 860 submissions (includes 485 of the largest funds comprising 95% of total assets and membership).

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It is important to note that investment returns on retirement funds are currently under pressure. The imposition of a wealth tax based on the valuation of retirement funds has the potential to erode the overall return rate towards the inflation rate resulting in minimal real growth in retirement savings.

As indicated, the current population estimates released by StatSA in 2017 reflect that the average life expectancy of South Africans will attain 70 years old by 2030 and this will inevitably create an enormous retirement funding problem for all South Africans that will have to be addressed. The imposition of a wealth tax on retirement funds will inevitably have far-reaching implications in the long term.

Notwithstanding this observation, it is noted that the concessions granted to retirement funds in recent years are perhaps overly generous. In particular, the exemption of retirement funds from dividends tax, effective 1 April 2012, although admirable in its intent, may be overly generous in the context of the economic challenges facing South Africa today.

## Immovable property (including land taxes)

The remaining large asset class is immovable 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 immovable property.

A land tax is essentially a narrow form of a property tax<sup>44</sup>; 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 immovable 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.

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<sup>44</sup> By property tax we therefore mean a recurrent tax that is based on the value of the land or on land and improvements.

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 principal 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.

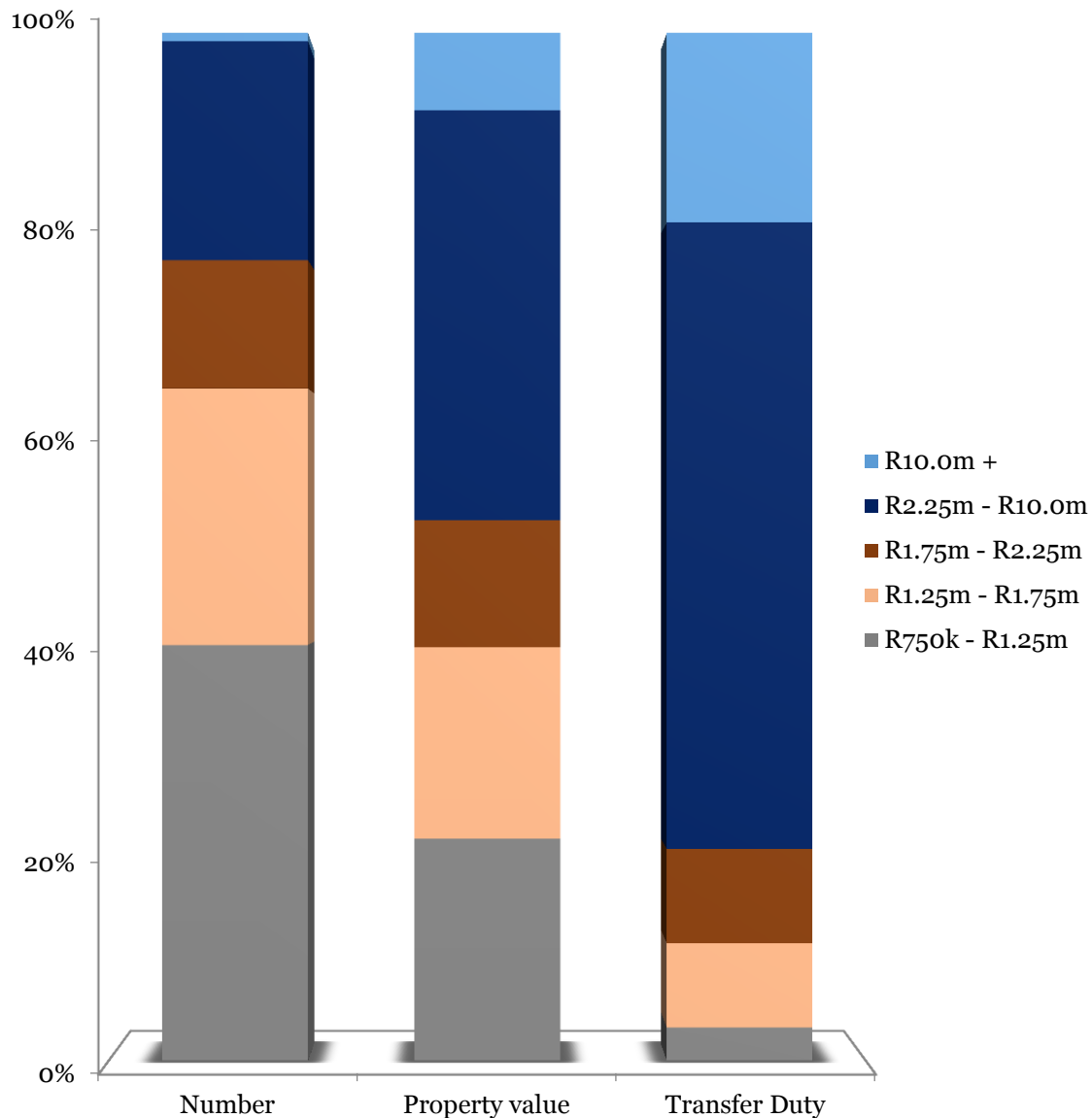
Given the difficulties that municipalities face in terms of collecting municipal rates and the extent of corruption within some municipalities, it is not clear that a national system will easily succeed. As the OECD has recommended (OECD, 2015), “as a first step, problems at the local level should be 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%.

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 high-end 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.

### Recurrent taxes on net wealth

A net wealth tax is a tax imposed on the difference between the sum of all wealth and the sum of all liabilities. Measuring net wealth is a complex process and requires a clear understanding of what constitute assets and liabilities. Gross assets are often placed into categories of real assets (immovable property, vehicles, real estate and other real assets), financial assets (life insurance, shares, bank deposits, bonds and other financial assets) or annuities (immediate, deferred). Gross liabilities include mortgage loans (with focus on home-secured loans), informal debt, vehicle loans and other forms of financial loans, including educational loans.

Of the 132 submissions received, fewer than five were in support of a recurrent net wealth tax. COSATU and SACTWU made a joint submission in which they supported the idea of a recurrent tax on net wealth and tentatively suggested that the rate could lie in the range 0,5%-2,5%. In their submission they proposed that the tax should be progressive and should not apply to those with less than, say, R1m in net wealth. SACTWU and COSATU highlight some issues that would need to be carefully explored if a net wealth tax were to be introduced:

- Should all wealth be included? In particular, should retirement savings be included?

- Which liabilities should be included?<sup>45</sup>
- Is the individual the most appropriate tax unit or should the tax apply to households/couples?
- How should one treat residents versus non-residents?

The answers to these questions are by no means straightforward. In particular the question of which forms of wealth to include is a particularly vexed one, especially in the light of the vast amount of wealth which is held in retirement funds.

In the following chapter the DTC attempts to plot a way forward.

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<sup>45</sup> To quote the COSATU/SACTWU submission: “Which liabilities to include in the net wealth calculation are also a matter for considerable pause. One’s liability should be unable to be reduced by assets that do not produce taxable income, like your main home, interest-free loans, jewellery, antiques and vehicles” (page 38).

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## Chapter 6: Recommendations

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Since 1994 South African fiscal policy has placed little emphasis on wealth taxes, save for recent increases in the rates of transfer duty and estate duty. Given the disturbing levels of wealth inequality in South Africa, a taxation system that would ignore such disparities of wealth will lack the important requirement of legitimacy in the tax system.

The process of creating a wealth tax in South Africa as a means to redress South Africa's levels of inequality would need to start with the consideration of a very simple form of an annual net wealth tax. The decision on whether to implement an annual net wealth tax cannot be made without the following:

1. Further consideration as to the appropriate tax base (i.e. which forms of wealth to include within the scope of the tax);
2. Comprehensive data on the pattern of wealth ownership;
3. An evaluation as to whether the revenue generated would exceed the administrative and economic burden on taxpayers and the revenue authorities.

In relation to the first question, the most important single question is whether retirement funds should fall within the scope of the tax. As is apparent from the DTC's discussion in chapter 5 this is a controversial and complex issue which requires intensive engagement from Treasury, SARS and the relevant stakeholders, including the retirement industry and trade unions.

To implement a wealth tax in South Africa the quality of existing data with respect to wealth would have to be significantly improved. To this end, the DTC recommends that all taxpayers and beneficial owners of wealth (which includes control of trusts as well as beneficiaries thereof) that are required to submit an income tax return must be required to include the market value of all readily ascertainable wealth in a revised tax return for the 2020 year of assessment. Taxpayers should also be required to disclose the existence of other forms of wealth where the market value is not readily available (membership of defined benefit pension funds, shares in private

companies, intellectual property, personal assets above a basic threshold, etc.). It is also recommended that the non-disclosure penalty provisions of the Tax Administration Act be revised to make provision for the implementation of substantial penalties where taxpayers fail to disclose the existence of their wealth. This disclosure will have the further benefit of enhancing income tax collections through the reconciliation of whether the reported income streams are broadly in line with the taxpayer's underlying assets.

It is apparent from these recommendations that the introduction of a wealth tax cannot be implemented in the short term. Given the DTC's findings on the extent of wealth inequality and the importance of the legitimacy of the tax system there are interim measures that could be implemented to promote these objectives. In particular, we refer again to the First and Second estate duty reports of the DTC which, save for the introduction of section 7C of the Income Tax Act and the increase in the rate of estate duty in the 2018 Budget for estates in excess of R30 million, have not been implemented. For this reason, the DTC recommends that the focus should initially be on increasing estate duty collections given that the necessary administrative capacity already exists.

Finally, most of the wealth tax submissions received by the DTC point to the fact that progress could be made in reducing South Africa's levels of inequality by eradicating wasteful/corrupt government expenditure and curbing the levels of tax evasion that currently exist. Although government expenditure is not a part of the brief of the DTC, the Committee emphasises that the enhancement of existing wealth taxes, coupled with a decrease in unauthorised and wasteful expenditure and enhanced tax morality will go some way towards reducing South Africa's unsustainable levels of inequality.

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## Appendices

### Appendix A

**Table A.1:** Inequality of labour income across time and space

Share of different groups in total labor income	Low inequality (≈ Scandinavia, 1970s–1980s)	Medium inequality (≈ Europe 2010)	High inequality (≈ US 2010)	Very high inequality (≈ US 2030?)
The top 10% (“upper class”)	20%	25%	35%	45%
Including the top 1% (“dominant class”)	5%	7%	12%	17%
Including the next 9% (“well-to-do class”)	15%	18%	23%	28%
The middle 40% (“middle class”)	45%	45%	40%	35%
The bottom 50% (“lower class”)	35%	30%	25%	20%
Corresponding Gini coefficient (synthetic inequality index)	0.19	0.26	0.36	0.46

*Note:* In societies where labor income inequality is relatively low (such as in Scandinavian countries in the 1970s–1980s), the top 10% most well paid receive about 20% of total labor income; the bottom 50% least well paid about 35%; the middle 40% about 45%. The corresponding Gini index (a synthetic inequality index with values from 0 to 1) is equal to 0.19. See the online technical appendix.

Source: Piketty (2014)

**Table A.2:** Inequality of capital ownership across time and space

Share of different groups in total capital	Low inequality (never observed; ideal society?)	Medium inequality (≈ Scandinavia, 1970s–1980s)	Medium–high inequality (≈ Europe 2010)	High inequality (≈ US 2010)	Very high inequality (≈ Europe 1910)
The top 10% “upper class”	30%	50%	60%	70%	90%
Including the top 1% (“dominant class”)	10%	20%	25%	35%	50%
Including the next 9% (“well- to-do class”)	20%	30%	35%	35%	40%
The middle 40% (“middle class”)	45%	40%	35%	25%	5%
The bottom 50% (“lower class”)	25%	10%	5%	5%	5%
Corresponding Gini coefficient (synthetic inequality index)	0.33	0.58	0.67	0.73	0.85

*Note:* In societies with “medium” inequality of capital ownership (such as Scandinavian countries in the 1970s–1980s), the top 10% richest in wealth own about 50% of aggregate wealth; the bottom 50% poorest about 10%; and the middle 40% about 40%. The corresponding Gini coefficient is equal to 0.58. See the online technical appendix.

Source: Piketty (2014)



**Table A.3:** Inequality of labour income and capital ownership across time and space

Share of different groups in total income (labor + capital)	Low inequality (≈ Scandinavia, 1970s–1980s)	Medium inequality (≈ Europe 2010)	High inequality (≈ US 2010, Europe 1910)	Very high inequality (≈ US 2030?)
The top 10% (“upper class”)	25%	35%	50%	60%
Including the top 1% (“dominant class”)	7%	10%	20%	25%
Including the next 9% (“well- to-do class”)	18%	25%	30%	35%
The middle 40% (“middle class”)	45%	40%	30%	25%
The bottom 50% (“lower class”)	30%	25%	20%	15%
Corresponding Gini coefficient (synthetic inequality index)	0.26	0.36	0.49	0.58

*Note:* In societies where the inequality of total income is relatively low (such as Scandinavian countries during the 1970s–1980s), the 10% highest incomes receive about 20% of total income; the 50% lowest incomes receive about 30%. The corresponding Gini coefficient is equal to 0.26. See the online technical appendix.

Source: Piketty (2014)

## Appendix B

Summary of recommendations contained in the second Davis Tax Committee report on Estate Duty and Donations Tax

### Chapter 1

#### *Estate duty*

- Introduction
  - The estate duty regime must be reviewed in order to establish an effective and equitable package of major abatements and rates.
- Retirement fund abatement
  - Following the “capping” of retirement fund contributions the retirement fund abatement should be retained.
  - The maximum threshold for tax-deductible retirement fund contributions (R350 000) should be increased to take account of inflation.
- The inter-spouse abatement
  - The problems inherent in the section 4(q) abatement should not be ignored on pragmatic grounds alone (as suggested by the Katz Commission) as this results in the inconsistent treatment of married and single parent families.
  - The inter-spouse abatement should be withdrawn and replaced with a substantially enhanced primary abatement, thus ensuring the consistent equitable treatment of all taxpayers.
- Primary abatement and rate
  - The DTC recommends that the primary abatement should be substantially increased to R15 million for all taxpayers, irrespective of marital status.
  - SARS should further integrate its revenue and national compliance analyses, to support systemic compliance risk management within the estate duty system.
  - The estate duty rate be increased from 20 per cent to 25 per cent of the dutiable value of an estate exceeding R30 million.



- Capital Gains Tax
  - The DTC does not concur with the argument that the imposition of estate duty and CGT on death is tantamount to “double taxation.” CGT is widely regarded as an income tax on capital income and not a wealth tax. Estate duty and donations tax are wealth taxes.
  - The CGT rollover provisions of the Eighth Schedule of the ITA relating to inter-spouse bequests should be repealed and replaced with a generous exemption death exemption of R1 million.
- Donations Tax
  - If the inter-spouse abatements and allowances are to be removed for estate duty and CGT purposes it stands to reason that the inter-spouse exemption within the donations tax system should also be removed, save for providing an exemption for the reasonable maintenance of the taxpayer and family.
  - The taxation concept of an “enduring benefit” should be applied to determine a reasonable level of exemption for cash inter-spouse donations.
  - In order to prevent the diminution of estates in anticipation of death, the section 56 (1)(c) exemption (*donation mortis causa*) should be removed.
  - Transfer of assets in terms of a divorce order should be subject to the exemptions similar to a death benefit for estate duty and CGT. However the taxpayer’s death benefit abatements or subsequent divorce abatements would be reduced by the quantum of any allowances claimed during the taxpayer’s lifetime.
- Bare dominium and usufruct arrangements
  - SARS should establish comprehensive records of all bare dominium and trust arrangements. This process should include, but not be limited to, the requirement that all holders of part interests in property be required to submit tax returns irrespective of income levels.

## Chapter 2

### Trusts

- Statistical analysis
  - Statistics obtained from SARS are indicative of a very prevalent use of trusts in SA today. The disparity in the number of registered trusts, compared to the number of tax returns received, is cause for concern and warrants substantial further investigation of trusts by SARS.
  - The fact that 87,8 per cent (88 344 out of 100 590) of prima facie compliant trusts are apparently *inter vivos* trust arrangements reflects the need for a comprehensive analysis of each trust to ensure that the trust is compliant with the ITA and EDA.
  - The very fundamentals of the legislation should also be considered.
- Estate duty and trusts
  - NT should consider the possibility of extending the provisions of section 3(3)(d) of the estate duty act to include deeming provisions that identify “deemed control” of a trust through a loan account between a trust and a “connected person(s)”, where the loan is not subject to interest or is subject to interest at below the official rate. In these circumstances, the loan provides the lender with de facto control over the trust.
  - All trust arrangements should be examined by SARS on registration of trust arrangements and upon transfer of assets into trusts. This should reduce aggressive tax planning and, at the same time, provide a level of assurance to taxpayers that their affairs are indeed in order.
- Capital Transfer Tax
  - Further investigation be conducted into the implementation of wealth taxes in SA. This will be addressed in a separate report of the DTC during 2016.
- Income Tax: Vested trusts
  - Donors and beneficiaries of all vested trust arrangements should be subject to stricter disclosure requirements and enforcement measures.

- SARS should develop risk-profiling analysis to identify and examine trust arrangements.
- Estate duty assessment procedures of SARS should concentrate on the examination of any trusts in which the deceased may have enjoyed a vested interest in order to ensure that all income and capital has been brought into account for both income tax and estate duty purposes.
- Income Tax: Discretionary Trusts
  - Only where a trust deed confers upon its beneficiaries an indisputable and irrevocable vested right to both the capital and income of a trust, should the income, both capital and revenue, be taxed in the hands of the beneficiary.
  - In all other cases:
    - Revenue income must be taxed in the trust in accordance with the definition of “gross income” contained in section 1 of the ITA.
    - Capital income, generated while assets are held in trust on anything other than a vested basis, must be taxed within the trust up to the time of vesting or disposal as defined in paragraph 11 of the Eighth Schedule to the ITA.
- Trust tax rates and CGT inclusion rates
  - The flat rate of tax applied to trusts should be retained at its current level and be subject to adjustment in line with changes in the maximum personal income tax rate.
- Foreign Discretionary Trusts
  - The comprehensive examination of foreign trust arrangements should not be confined to the application of the ITA when vesting or distribution occurs. SARS should also examine the substance of arrangements prior to vesting or distribution. Information sharing between tax authorities may well be the starting point for such investigations.
  - SARS should establish a separate investigations unit to thoroughly and comprehensively examine foreign trust arrangements. Where

disclosure deficiencies are detected, the penalty provisions of TAA should be rigidly applied.

- Offshore retirement funds :
  - These arrangements should be further investigated by SARS.

## Country Abbreviations

Code	Name of country
AUS	Australia
AUT	Austria
CAN	Canada
CHL	Chile
CHN	China
CZE	Czech Republic
DEU	Germany
DNK	Denmark
ESP	Spain
EST	Estonia
FIN	Finland
FRA	France
GBR	United Kingdom
GRC	Greece
HUN	Hungary
IDN	Indonesia
IND	India
ISL	Iceland
ISR	Israel
ITA	Italy
JPN	Japan
KOR	Korea
LUX	Luxembourg

MEX	Mexico
NLD	Netherlands
NOR	Norway
NZL	New Zealand
POL	Poland
PRT	Portugal
SVK	Slovak Republic
SVN	Slovenia
SWE	Sweden
TUR	Turkey
USA	United States

## Submissions Received

1	Guillaume Cillie
2	Bridget Salt
3	Zachie de Beer
4	Andre Troskie
5	R Baker
6	Neil Yorke-Smith
7	Arno Hayes
8	Gerhard Visagie
9	Heinrich Holt
10	David Naude
11	David Roome
12	The Social Project
13	Steve Midgley (3)
14	Crispin S Harrison
15	Marlise Schmidt (2)
16	Elma Delport
17	Zwelakhe Eric Phukwana
18	Eugene Hope
19	Oliver Werneyer (2)
20	Nico Fourie (2)
21	Linda Boyce
22	Trevor Robertson
23	Barry Zetler
24	Dirk Hall
25	Ilze Venter

26	Rado Moskov
27	Craig Webber
28	Martin Molteno
29	Alan Berghoff
30	Annette Taylor
31	LA Naidoo
32	Robert Edwards
33	Marthinus Senekal
34	Cyril Glaser
35	Gail Gibson
36	Hermann Botha
37	Ronny Cassel
38	Roland Agar
39	Joe Soap
40	Carin Malan
41	Richard Caddy
42	John Smale
43	Gert Hayword
44	Ed Hardwick
45	Dhanyal Davidson
46	Richard Cheesman
47	Niel Venter
48	Thane Duff
49	Tassa Consultants
50	Philip Amos
51	Stephen Meintjes
52	Shaun Demosthenous
53	Rudi Strydom



54	Marc
55	Willem Cronje
56	Rianie Oelofse
57	Centaur Asset Management
58	Peter Moseley
59	James Smith
60	Ian Glass
61	GastrowBloch Philanthropies
62	Pieter Pretorius
63	Nichabiz Financial Consultants Incorporated
64	Heinz Klug
65	David Clegg
66	Jonathan Goldin
67	David van Rooyen
68	Colenbrander
69	Carrin Martin
70	Cox Yeats
71	Macie Mayazi Consulting
72	Jay Jayem
73	Leon van Heerden
74	Inyathelo
75	Nick Hall
76	Tim Fearnhead
77	Forestry South Africa
78	Agri Western Cape
79	SAIPA
80	Virginia Tech University
81	Sandy McGregor

82	Richard Emslie
83	BDO
84	Bina Akoobhai
85	John Harwood
86	AfriBusiness
87	PWC
88	Cape Chamber of Commerce
89	OUTA
90	Brian Evison
91	Agri SA
92	Andrea Roberts
93	Integral Asset Management 1
94	Tax Consulting
95	Integral Asset Management 2
96	SA Institute of Race Relations
97	Integral Wealth Management 3
98	Co-operating Computing
99	Wildlife SA
100	Citadel Fiduciary
101	Integral Wealth Management 4
102	Columbus Stainless
103	KPMG
104	AIDC (amended)
105	SACPRIF
106	Ndifuna Ukwazi
107	CAIA
108	Anna Vayanos
109	ABSIP

110	Metope
111	CB Musto
112	Keith Harvey
113	SAPOA
114	SP Keegan
115	FISA
116	Southern African Catholic Bishops' Conference
117	Thoko Modonko, Dullah Omar Institute & Public Service Accountability Monitor
118	ENS
119	Free Market Foundation
120	Standard Bank
121	BUSA
122	SACTWU & COSATU
123	Maurice Fluxman
124	Tourism Business Council SA
125	Sentinel International
126	BASA
127	SA REIT Association
128	Chamber of Mines
129	PSG
130	SAICA
131	SAIT
132	ASISA