Submission on the desirability and feasibility of possible forms of wealth tax, submitted by the Council of the Fiduciary Institute of Southern Africa (FISA®)

1. Executive summary

1.1. It cannot be assumed that all private owners of land are wealthy individuals. A land tax aimed at reducing inequality should take cognisance of this and a threshold value will have to be used.

1.2. Ownership of land is not a very reliable proxy for wealth at a level that should be visited with a wealth tax.

1.3. As a result of a need to discriminate between wealthy and not-so-wealthy land owners, a land tax will have to be so complex that it is doubtful whether it will be an efficient source of fiscal revenue.

1.4. A national tax on the value of property over and above municipal rates will suffer some of the same shortcomings as an annual land tax. Thresholds will have to be used again, with the result that ownership of residential property again will not be discreet enough as a proxy for wealth. A very wealthy individual may own several pieces of property which will all fall under the threshold.

1.5. An annual wealth tax will have to be extremely complex in order to target true wealth. The required level of complexity raises serious questions about the compliance and enforcement cost, as well as the ability to enforce.

1.6. The existing taxes in South Africa are already highly progressive with 3.5% of taxpayers paying 38.5% of all personal income tax, while thresholds for estate duty, donations tax, transfer duty and CGT ensure that less affluent individuals are not affected by these taxes.

2. A Land Tax

2.1. It is assumed that by a land tax is meant an annual tax on the value of land. Land, as is the case with all other property, is already taxed at death through the estate duty. Other instances of transfer of land are also taxed already through transfer duty and donations tax.

2.2. Conceptually a land tax can be levied on an annual basis at a fairly low rate. This raises the following questions, however:

2.2.1. Should all private ownership of land be taxed in this way?
2.2.2. If not, what uses of land should be excluded and why?
2.2.3. Should there be a threshold value and if so, what should be that value?
2.2.4. What will be the consequences for the collection of other taxes?

2.3. Should all private ownership of land be taxed?

2.3.1. It is submitted that at least primary residences should be exempt from a land tax, regardless of their value. This would be in line, to an extent, with the way primary residences are treated differently from other fixed property in for purposes of Capital Gains Tax (CGT). The justification for such an exemption is rooted in the fact that private ownership of residential property is an enabler for wealth creation, something which is desperately needed in South Africa. In our view taxes do not create wealth, but consume it, and can at best alleviate the consequences of poverty.

2.3.2. We submit, therefore, that a blanket tax on all private ownership of land is not appropriate.

2.4. What uses of land should be excluded and why?

2.4.1. The premise for a wealth tax is that it should tax the wealthy, and not by accident prejudice tax payers that do not qualify as wealthy. Therefore, it is submitted that the following uses of land have to be considered for exclusion from an annual land tax, regardless of the value of the land:

2.4.1.1. The normal exceptions for recreational, educational, religious, and charitable purposes, i.e. land belonging to sports clubs, schools, universities, religious groups, and all public benefit organisations (PBO's);

2.4.1.2. Private land in collective use, e.g. collective farming operations. It should also be borne in mind that many families "club together" to purchase farms and own family holiday homes in a variety of structures, including trusts and companies. Although the land could have a high market value, the value per individual sharing the property could be well below what could be regarded as the threshold of wealth. The result of an indiscriminate land tax in these circumstances will result in taxpayers outside the target group being burdened by the tax;

2.4.1.3. Land used by large agricultural corporations with many shareholders and employees may have a high value, but not belong

to any one individual who could be said to be very wealthy. To levy an annual land tax in such circumstances will place a further burden on already thin profit margins in agriculture.

2.4.1.4. Farmers in some areas of South Africa (e.g. the Karoo) are notably asset rich and cash poor. An annual tax on land will place them in an even more serious cash squeeze. It should also be borne in mind that, due to the amount of land needed to farm sustainably in these areas it is not really an option to sell off part of the land to generate sufficient cash to be able to afford and/or reduce liability for an annual land tax.

2.4.2. If not exempted from an annual land tax, the rent on rented residential property will experience upward pressure as landlords are unlikely to just bear the brunt of the tax. Landlords are likely to pass such a land tax on to the tenant, which will increase pressure on already stretched middle class citizens. To try to prevent the passing on of the cost of the tax through legislation could well be impossible due to the added complexity it will bring.

2.5. Should there be a threshold value and if so, what should be that value?

2.5.1. To be a wealth tax, land with a value under a certain threshold will have to be exempt from such an annual land tax.

2.5.2. However, this creates immediately the possibility that an extremely wealthy person with several pieces of land valued at below the threshold will effectively escape the tax. Therefore, another way to determine whether the individual is wealthy and should pay an annual land tax will have to be developed, leading to undesirable complexity again.

2.5.3. Landlords of industrial and commercial properties are likely to split properties up into the smallest possible units with each unit in a separate legal entity to reduce values as low as possible to keep as many properties as possible under any potential threshold. If the threshold is lowered to counter this, the tax will hit taxpayers who should not be subject to the tax.

2.5.4. What a threshold value should be depends obviously on what the threshold for wealth is deemed to be. We submit that, at best, such a threshold is bound to be arbitrary and, as experience with taxes has shown, is unlikely to be adapted for inflation regularly enough. A case in point is the year of death exclusion for CGT which has been static for five years now.

2.6. We submit that land ownership is an ineffective proxy to use as an indication of wealth. To be fair and only tax the wealthy, whatever definition for wealth is used, an annual land tax is bound to be extremely complex. It is, in our view, a fact that

the more complex a tax the more the opportunities for avoidance, which raises the cost of enforcement and reduces the net gain for the *fiscus*.

3. A national tax on the value of property

3.1. Any tax over and above municipal rates on all property cannot be termed a wealth tax as it will place an extra burden on the middle classes as well, unless a threshold value is introduced. We submit that, as property ownership is desirable and aspirational for the burgeoning middle class, a threshold value will be an essential element of fairness for any tax of this nature.

3.2. The remarks above about the value of an individual property being a poor proxy for the wealth of the owner are equally appropriate in this case. Assume a threshold value of R2m (which will buy only a middle class home in Cape Town), and a landlord owning ten R800,000 homes in a middle to lower middle class area. The landlord could be much wealthier than anyone living in a R2.5m home, but will not pay this tax on his investment properties, while the clearly middle class owner of the R2.5m home in Cape Town will.

3.3. Again, any measures to combat this will lead to a highly complex tax regime which will create loopholes and increase cost of enforcement.

3.4. Furthermore, many elderly people hold on to their family homes. These homes can have quite a high value due to market movement, but their elderly occupants can be quite cash poor. This reality is recognised by many local authorities with special discounts on municipal rates for the elderly. It would be undesirable to ignore this for purposes of any tax on the value of property as it will force elderly people out of their homes. Also, the value of quality accommodation in retirement villages has increased by far more than the average increase in property values as sectors of the South African population's average age rose. Imposing this tax with too low a threshold will prejudice this already financially vulnerable sector of the population. Measures to cater for this will again open up loopholes.

4. An annual wealth tax

4.1. It is submitted that very few developing countries have an annual tax on wealth, apparently with good reason. Developing countries, by their nature, need foreign direct investment to grow and develop their economies. Therefore, they need to be attractive to investors to bring that desired level of foreign investment to grow and develop their economies. Extra taxes are always a potential deterrent to capital inflows.

4.2. Some developed countries have also reduced or abolished wealth taxes in recent years in a bid to promote capital retention and prevent capital flight to more friendly shores.

4.3. On a technical level the complexities of an annual wealth tax are as daunting and more when compared to the potential taxes discussed above:

4.3.1. To qualify as a tax on wealth, the net worth of the taxpayer will have to be determined. Gross asset values are no indication of wealth, as it ignores the liability side of the balance sheet.

4.3.2. To determine net worth on an annual basis will create a daunting compliance burden and could become an enforcement nightmare. For example:

4.3.2.1. Various ways exist to determine the value of company shares:

4.3.2.1.1. Listed shares are easy to value, as a market price is available on any trading day and annual weighted average prices can also be calculated with a high degree of accuracy;

4.3.2.1.2. Private company shares present totally different challenges. The nature of a business determines the appropriate manner of valuation. In some cases net asset value is appropriate, while in others the earnings yield, dividend yield, or outperformance of a business must play a role in an accurate valuation.

4.3.2.2. For estate duty a senior revenue inspector must sign off on private company valuations. Backlogs exist from time to time even with regard to this limited activity. How, it may be asked, will the SARS cope with the annual valuation of the wealth of a couple of hundred thousand “wealthy” taxpayers for this purpose?

4.3.3. The same point as mentioned above will have to be considered in any evaluation of an annual wealth tax – what about high value assets which yield very little income. The examples of the farmer with high value land and low income yield, or the elderly person with a high value home but a modest income are again to be borne in mind.

4.3.4. The compliance and enforcement burden could again hamper the efficiency of this tax. The SARS, very apparently, has enforcement challenges when it comes to trusts in general. How will the added burden be handled?

4.4. A further question is: At what net worth does a person qualify as wealthy? We submit that that question has different answers depending on the life stage and circumstances of the individual.

4.4.1. A 35 year old person with investments of R15m may be regarded by some as wealthy. This is probably correct if the person is employed or owns business interests and earns a high annual income.

4.4.2. If the 35 year old person is disabled, however, R15m of capital on investment is not a large amount of money.

4.4.3. At the age of 65, upon retirement, R15m on investment if it is the sole source from which income must be produced is similarly not a large amount of money. A quick calculation shows that R15m which consistently produces a yield of 9% (3% above an assumed inflation rate of 6%) will last less than 25 years if an annual inflation linked income of R850,000 is drawn from it. As things stand, South Africa has too few financially independent retirees already.

4.4.4. On this note, careful thought should be given to what assets should be included to determine a person's wealth. This is bound to lead to further complexity.

4.5. We submit that any annual wealth tax will require a level of complexity that will negate any perceived benefits.

5. Conclusion

5.1. While it is understandable that a country like South Africa cannot afford a perception that the tax system fails to tax the rich adequately on their wealth, great care should be taken to avoid hurting the middle class and future high net worth individuals.

5.2. It seems that, attractive as the idea may be to tax the wealthy on their wealth, any of the mentioned options are bound to be extremely complex taxes to introduce and administer.

5.3. It is submitted that much research will have to be done to determine whether any tax like one of those proposed will be efficient in terms of compliance and enforcement cost, compared to yield.

5.4. The existing taxes in South Africa are already highly progressive. Just in terms of income tax those taxpayers with a taxable income in excess of R1m make up only 3.5% of the total number of taxpayers, while contributing 38.5% of the income tax revenue.[1] The poor do not pay any estate duty, donations tax, transfer duty, capital gains tax or income tax. In fact, it is submitted that the high level of inequality is not due to a lack of redistribution through the tax system, but more the result of

[1] National Treasury, Budget Review 2017, 22 February 2017, p45.

lack of economic growth and the failure of the education system in South Africa to produce entrepreneurs and employable individuals.

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