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Wealth tax – good idea or grasping at straws?

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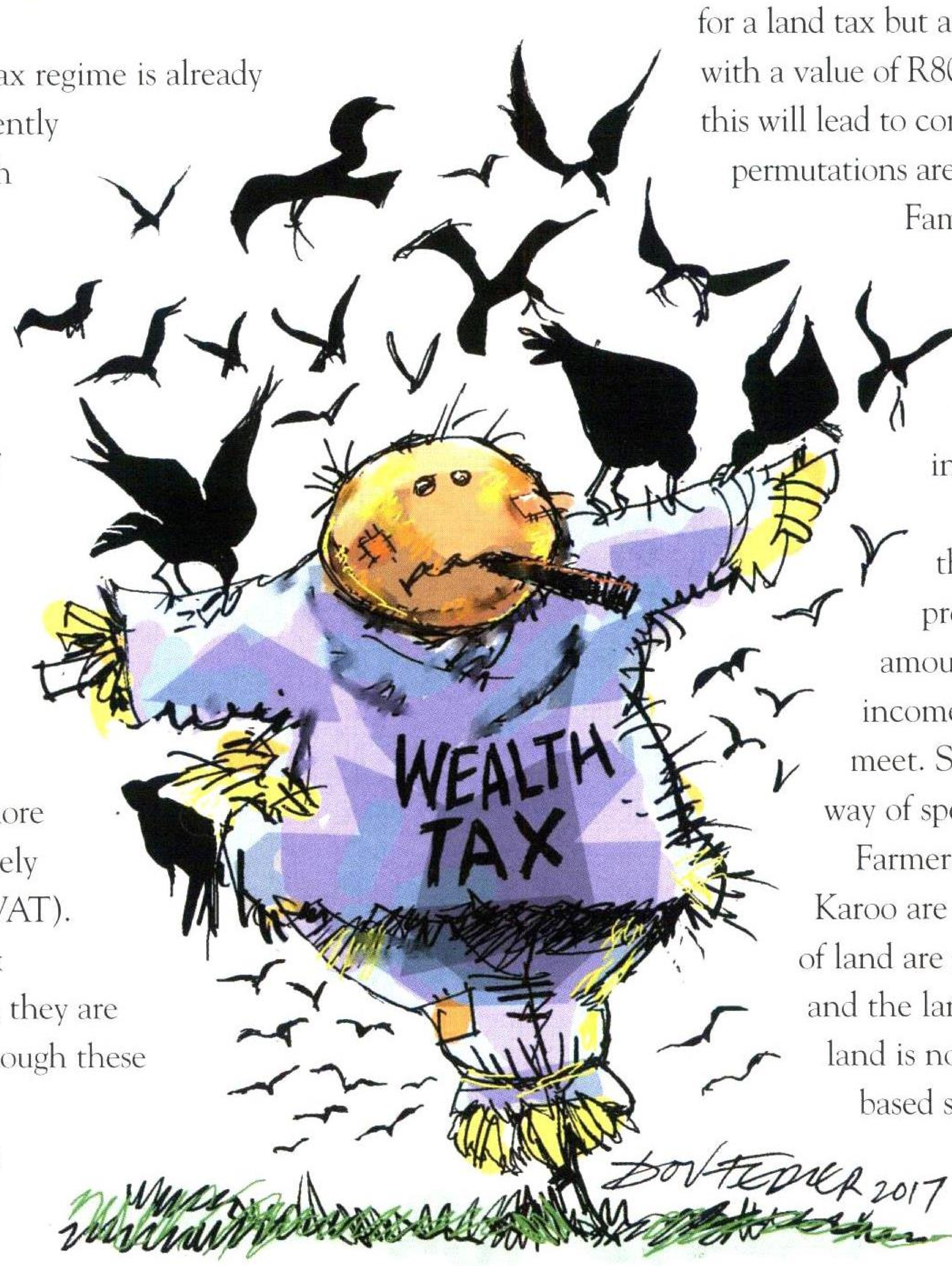
The premise behind the Davis Tax Committee's call for submissions on possible wealth taxes appears to be the notion that the wealthy in South Africa (whoever they may be) are not taxed sufficiently and that, as a result, financial inequality continues to exist at alarming levels.

The reality is that the South Africa tax regime is already highly redistributive. There are apparently around six million tax payers in South Africa, with around sixteen million people receiving some form of social grant.

Income tax payers with taxable income in excess of R1m represent only 3.5% of the total number of taxpayers (approximately 256 000 individuals out of 7.4m), but they are expected to pay 38.5% of the income tax in the 2017/18 fiscal year, according to a table on p45 of the 2017 Budget Review published by National Treasury. As they have more to spend, they also pay a proportionately high percentage of value added tax (VAT). Due to thresholds for capital gains tax (CGT), estate duty, and transfer duty, they are also paying the bulk of collections through these taxes.

It is probably fair to say that these factors contribute to tax avoidance and international structuring to move wealth away from South Africa.



The Davis Tax Committee asked for submissions on three new possibilities to introduce further taxes on wealthy South Africans: a land tax, a national tax on the value of property (over and above municipal rates), and an annual wealth tax. All three possible taxes are bound to be extremely complex.

An annual tax on the value of land cannot be introduced indiscriminately and still be called a wealth tax as it will tax both the not-so-wealthy land owners and the wealthy. In some cases it could even let the wealthy get away, while the not-so-wealthy pay.

Land ownership is not a very accurate proxy for real wealth, which will necessitate the use of exemptions and thresholds. Exemptions will have to be extended to sports clubs, religious groups, educational institutions, and to all public benefit organisations.

Thresholds will be essential to prevent middle-class individuals being hit by such a tax. However, the moment thresholds are introduced, the possibility of exploitation of loopholes arises. For example, R2m will only buy a middle-class home in Cape Town. So, assuming a threshold of R2m for the land tax, someone with a R2.5m home in Cape Town can by no stretch of the imagination be called wealthy. This person may then be liable for a land tax but a landlord owning 10 lower-middle-class homes with a value of R800 000 each may escape the tax. Preventing this will lead to complex anti-avoidance measures as the possible permutations are endless.

Families also "club together" to own land for holiday-home purposes or family-based business purposes, for example farming. While the value of this land may be high, it is no indication of the wealth of the individuals involved.

Some elderly people have been living on the same property for 40-years or more and the property may now be worth a substantial amount but the individual does not have a high income and may actually be struggling to make ends meet. Some municipalities already recognise this by way of special rebates for elderly property owners.

Farmers in some areas of South Africa such as the Karoo are notably asset rich and cash poor. Large tracts of land are necessary to farm sustainably in these areas and the land is valuable but the income yield from the land is not particularly high. Imposing a "wealth tax" based solely on land value will be an extremely inaccurate way of taxing wealth and may be grossly unfair.

A national tax on the value of property over and above municipal rates will suffer from the same shortcomings as a land tax. It will not be possible to introduce it indiscriminately without exemptions and thresholds, without losing focus as a tax affecting only the wealthy.

Very few developing countries employ a general annual wealth tax, with good reason. Firstly, developing countries need to attract capital, and taxing wealth *per se* is not capital-friendly. Secondly, determining wealth to tax is not as easy as it seems.

At what net worth does a person qualify as wealthy? The question has different answers depending on the life stage and circumstances of the individual.

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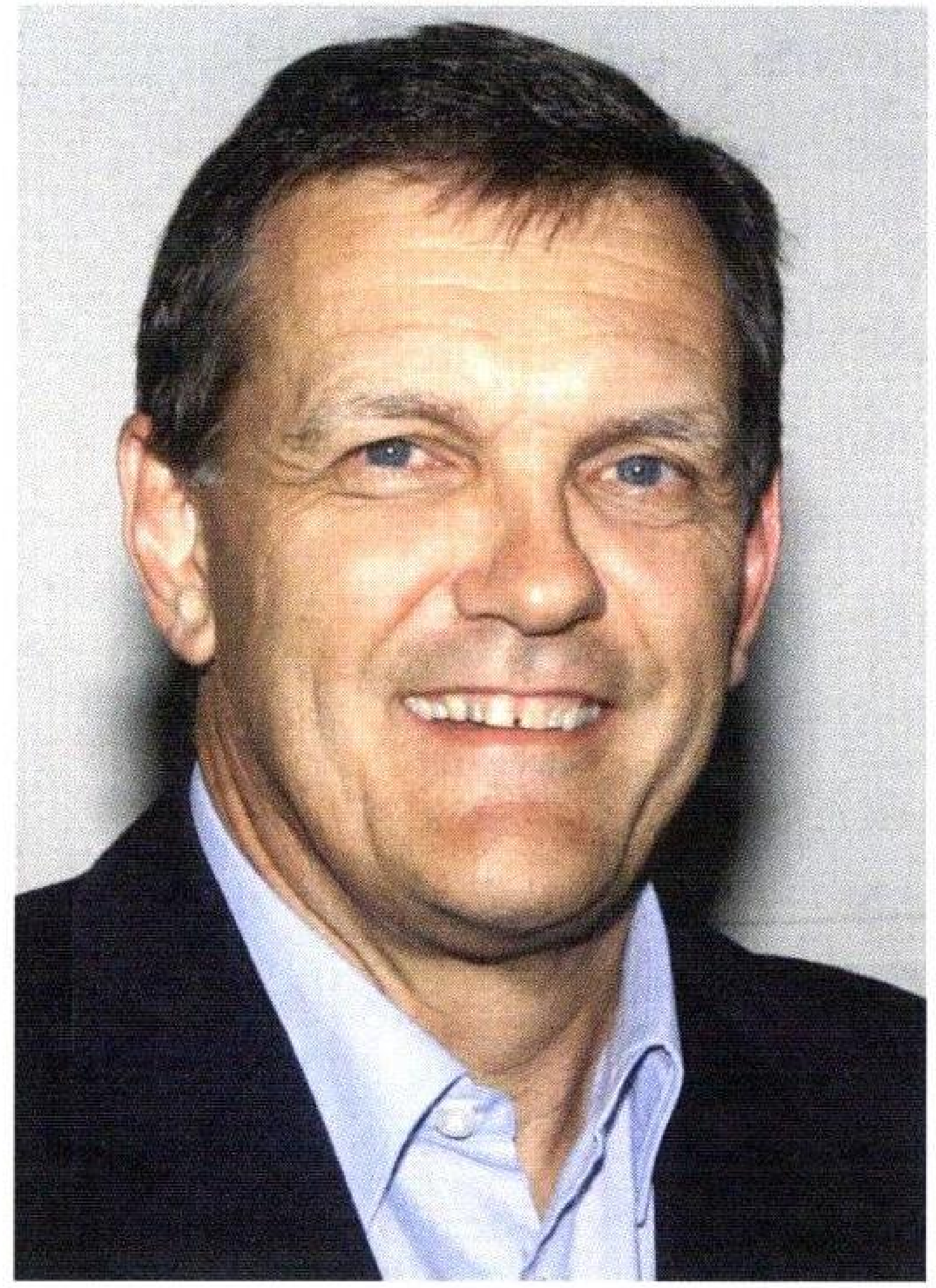
A 35-year-old person with investments of R15m may be regarded as wealthy by some. This is probably correct if the person is employed or owns business interests and earns a high annual income. If the 35-year-old person is disabled, however, R15m of capital on investment is not a large amount of money.

Upon retirement at the age of 65, having R15m in 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 already has too few financially independent retirees.



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Therefore, 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.

The valuation of assets will also pose serious challenges. For example, while it is very easy to value listed shares the same cannot be said of private company shares. An appropriate way to value a business depends to a large extent on the nature of the business, and the possible permutations are virtually endless. To determine this in a tax regime will lead to high levels of complexity which, in turn, will place a hefty burden on the enforcement agency.

A case in point is the valuation of private company shares for estate duty purposes. A senior revenue inspector has to sign off on valuations done according to a complex regime prescribed by s5 of the Estate Duty Act (45 of 1955). Backlogs exist from time to time even with regard to this limited activity. A complex valuation of private company shares for a wealth tax will be much more enforcement intensive, and the question can be asked whether the SARS will be able to cope.

It was stated at the outset that the South African tax regime is already highly redistributive. The high level of inequality is, therefore, not due to a lack of redistribution through the tax system but more the result of lack of economic growth and the failure of the education system in South Africa to produce entrepreneurs and employable individuals. ◆

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