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Burden of wealth tax will likely exceed benefits, tax practitioners warn as deadline for submissions to the Davis Tax Committee looms.

The compliance cost and market distortions associated with a wealth tax may exceed the benefits of introducing such a tax, practitioners have warned.

Against the background of the highly unequal distribution of wealth in South Africa, the Davis Tax Committee (DTC) has called for submissions on the desirability and feasibility of three forms of wealth taxes – a land tax, a national tax on the value of property (over and above municipal rates) and an annual wealth tax.

"It is well established that economic inequality inhibits economic growth and undermines social, economic and political stability," it said in a statement.

Stakeholders have until May 31 to submit proposals. A workshop for oral submissions will be conducted in June.

South Africa currently has three forms of wealth taxes – estate duty, transfer duty and donations tax, which collectively account for roughly 1% of tax revenue. Although some commentators argue that capital gains tax (CGT) is also a wealth tax, the DTC is of the opinion that it is an income tax.

David Warneke, head of technical tax at BDO, says many of the limited number of countries around the world that have previously implemented a wealth tax, have abandoned it because the cost of compliance exceeds the yield from the tax.

There are also a number of problems associated with the imposition of wealth taxes, such as market distortions. Often people don't have the liquidity to pay the tax. In the case of a land tax, people may have to sell the land in order to pay the tax, he says.

The cost of the tax may also be passed on to either the tenants of the land or included in the cost of food.

Warneke says there is a general feeling that government is in danger of "killing the goose".

The rates of tax in South Africa are high relative to what high net worth individuals receive in exchange. There is a danger of a flight of capital, emigration and a loss of skills should more taxes be imposed, he adds.

Andrew Wellsted, director at Norton Rose Fulbright, says the administrative cost of implementing any new tax is high.

"The additional regulatory framework to be administered by the State and the cost of implementation for taxpayers may well not generate the revenues hoped for. This has historically been the case, for example, with estate duty."

Lisa Brunton, an attorney specialising in tax and exchange control at Cliffe Dekker Hofmeyr, says the expense involved in implementing and administering a new wealth tax doesn't seem warranted given the low level of revenue wealth taxes generally amass.

"Countries that have sought to implement wealth taxes have found the exercise both difficult and costly."

Given the revenue target, there are simpler, more cost efficient tax forms that could be employed to significantly contribute to the tax revenue target, she says.

"Better yet, why not curb wasteful and/or irregular government spending before considering increasing existing tax rates or introducing new ones? The auditor-general estimated that the government wasted in excess of R30 billion in one financial year alone," she says.

Wellsted says the introduction of yet another tax to be borne predominantly by South Africa's small tax base could cause more harm than good.

South Africa is an interesting case study for a number of reasons – its economic growth figures and prospects are apparently poor, while its tax base is small relative to the population of the country. This makes funding the deficit by way of introducing new taxes which impact the same tax base problematic, he adds.

"In addition, there is already a proliferation of different taxes that are largely borne by the same tax base. These include transactional taxes such as value-added taxes, existing wealth taxes such as estate duty, transfer duty and donations tax as well as income tax, which has just been increased to a relatively high 45% in terms of the recent budget," Wellsted says.

The addition of yet another tax, such as a wealth tax, will simply be asking the same contributors to apply more funds towards the fiscus. Although a statistic more than a fact, there are a number of studies which show that at some point asking taxpayers to contribute too much can lead to a reduction in taxes collected, he adds.

Warneke says while inequality is a significant problem in South Africa, he doesn't believe imposing further taxes on high net worth individuals – which are particularly mobile – is the way to address the problem.

South Africa has got to find a solution that addresses inequality but at the same time fosters entrepreneurship and growth.

"[You] can't stifle growth and have redistribution," he says.

Brunton says in her opinion, not one of the proposed wealth tax options is desirable or feasible. The municipal property rates tax system, which has been in operation since 2004, is a land tax. To impose a national land tax, a single valuation roll would be required.

"This would create valuation problems since municipalities do not employ unified valuation methodologies across the board."

A national tax on the value of property, in addition to municipal rates, would be tantamount to national government's interference with a critical source of revenue for local government, she adds.

Moreover, an annual wealth tax would operate in contravention of the fundamental tax principle that tax ought to be levied at a time when it is most convenient for a taxpayer to pay it, Brunton says.

"If a taxpayer is illiquid at the time the wealth tax is levied, it becomes a burden."

Possible wealth tax in pipeline for SA

POLOKWANE – Glen Steyn, independent consulting economist from Glen Steyn and Associates, said the opportunity to comment on the desirability and feasibility of an annual wealth tax in South Africa should be welcomed and used.

DTC was established in 2013 by the minister of finance and is open for submissions on land tax, a national tax on the value of property over and above municipal rates and an annual wealth tax as possible forms of wealth tax until 31 May.

“Taxation is a complex issue that is based on considerable technical analysis, but also on strong emotional forces that are triggered by different views on justice and on behaviour,” Steyn said.

Some of the technical issues, which are generally referred to by economists as public finance, include the capital and operational costs that have to be funded in order to improve the level of development and competitiveness of a country. “Technical issues also include the size of the tax base, which indicates the number of tax payers in relation to the number of recipients of tax benefits. Thirdly, it includes an analysis of how efficiently tax revenue is being spent. Requests for additional tax to pay for projects that are widely supported, while available tax revenue is prudently managed by government authorities, are likely to be favourably considered if it can be afforded. Proposed projects that are not widely supported, especially under conditions where available tax revenue is not used efficiently, however, may not get a favourable response when a call is made for additional tax,” he explained.

“A fourth important technical consideration is medium and longer-term fiscal sustainability. When public expenditure is projected to rise at a faster rate in future than the projected rise in tax income, then a crisis could be forming. Timeous fiscal policy interventions that keep tax revenue and public expenditure in balance are essential to avoid fiscal crises from developing.”

Steyn said among the emotional issues related to tax, there was always the risk that widely opposing views and widely different behaviour among groups in a society could lead to polarisation and tension, rather than social cohesion and co-operation.

“Authentic leadership is essential to find common ground between groups and to form teams that can build on and expand the common ground for the benefit of everybody.”

He added the conversation about a wealth tax is therefore a complex issue. “It can be an effective instrument if it is appropriately designed and efficiently managed. If not, it could cause further polarisation and fiscal damage without generating any benefits for those who need it most.”

The distribution of wealth in South Africa is described as being highly unequal, with recent empirical evidence suggesting that the Gini coefficient for wealth is about 0,95 (in comparison with the Gini coefficient for income of 0,67). It is well established that economic inequality inhibits economic growth and undermines social, economic and political stability.

Currently, South Africa has three forms of wealth taxation, namely estate duty, transfer duty, and donations tax which together bring in about 1% of tax revenue.

In light of the above, the DTC invites submissions by 31 May on the desirability and feasibility of possible forms of wealth tax. Based on the written submissions received, this will be followed by a workshop for oral submissions during June.

Written submissions can be sent via e-mail to taxcom@sars.gov.za, indicate if an oral submission will be necessary to support the written submission.

Questions relating to this issue can be directed to the Secretariat for the DTC using the e-mail address provided above.