

# A COMPARATIVE STUDY OF THE PRIMARY TAX REBATE SYSTEM IN SOUTH AFRICA IN RELATION TO BRAZIL AND AUSTRALIA

by

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I dedicate this study to my late father, George, who is my hero.

## **ABSTRACT**

# **A COMPARATIVE STUDY OF THE PRIMARY TAX REBATE SYSTEM IN SOUTH AFRICA IN RELATION TO BRAZIL AND AUSTRALIA**

By

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The South African primary rebate is governed by Section 6 of the Income Tax Act (58 of 1962). This primary tax rebate entitles taxpayers to a tax-free income portion up to a certain level depending on the rebate amount (also referred to as the tax threshold). The concept of tax thresholds in a tax system in essence adhere to the first tax canon of Smith (1776:676), which suggests that individuals should pay taxes in proportion to each person's ability to pay tax. The implication of this tax canon is that individuals who have a limited or no ability to pay tax should only be subject to pay tax in relation to their ability. Therefore, before tax can be levied, an amount for the necessities-of-life must be deducted from the taxpayer's income (Vivian, 2006:85). The primary rebate system thus gives individuals a tax-free income portion which is supposed to first compensate for an individual's necessities-of-life expenses or put differently the costs to survive.

The main purpose of the present study is to critically analyse and compare the fairness of the primary rebates in South Africa in relation to other countries.

To meet the main purpose a comparison was done between South Africa's primary rebate and related government grant programs to that of Brazil and Australia. It was found that South Africa rebate system creates significant vertical and horizontal unfairness and that it compares poorly to the fairer multiple rebate and government grant systems of Brazil and Australia. Accordingly it was recommended that the unified primary rebate system of South

Africa is reviewed and brought in line with the multiple rebate systems implemented in countries such as Brazil and Australia.

Key words:

*Primary rebate*

*Fairness*

*Dependent rebates*

*Dependency ratio*

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# A COMPARATIVE STUDY OF THE PRIMARY TAX REBATE SYSTEM IN SOUTH AFRICA IN RELATION TO BRAZIL AND AUSTRALIA

## CHAPTER 1

### INTRODUCTION

#### 1.1 BACKGROUND

The South African Revenue Services (SARS) has defined its vision as: *To become an innovative revenue and customs agency that enhances economic growth and social development, and supports our integration into the global economy in a way that benefits all South Africans.* (SARS, not dated). From this statement there is no question that SARS aims to fulfil its duties in a manner that results in fairness for all citizens as they aim to benefit all South Africans. This conclusion is validated by referring to SARS's values of which one is *equity and fairness* (SARS, not dated).

The principle of fairness of taxation has been widely researched by Smith (1776), Bentham (1748-1832), Ricardo (1817), Mill (1848), Vivian (2006), Maroun *et al.* (2011) and Oberholzer (2006), to name a few.

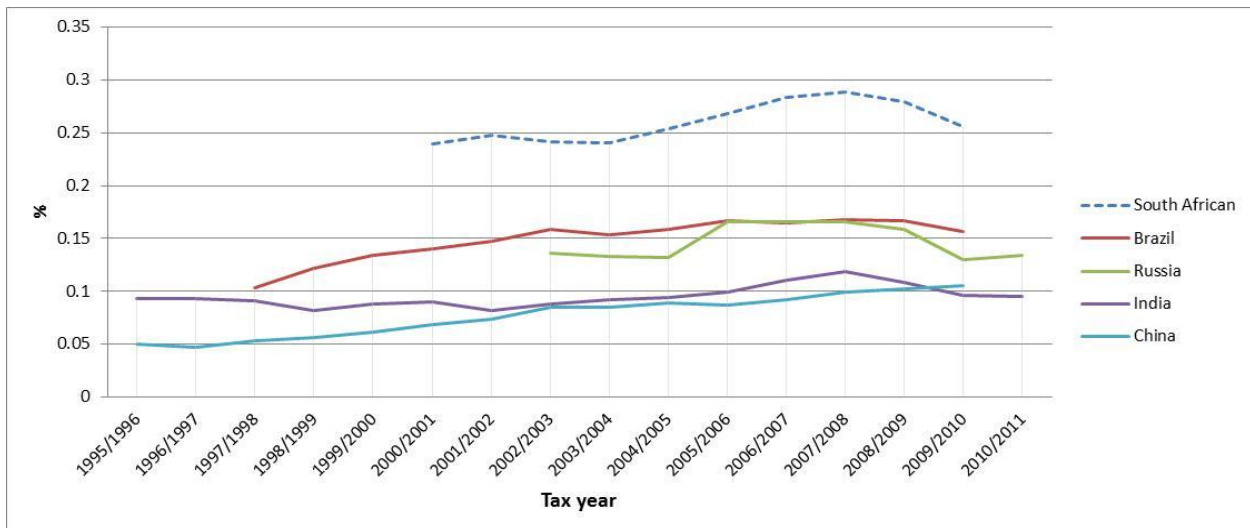
Fair is defined as *treating people equally without favouritism or discrimination* when used as an adjective and as *without cheating or trying to achieve unjust advantage* when used as an adverb (Oxforddictionaries.com, 2012). The Concise Oxford Dictionary (Fowler *et al.*, 1996:484) again defines fair as: Adjective: *just, unbiased, equitable, in accordance with the rules.* In theory a person should thus perceive being treated fairly when he/she is treated in line with the definitions set out above.

Oberholzer (2007) measured the perceptions of 260 South Africans towards taxation to formulate trends of these perceptions by various categories, such as by population group (black, white, Indian and coloured), by age, by monthly income and by support for the government. The results of the study visibly pointed out that the perceptions of South Africans differ. A disturbing trend however was that only 24.23% of the respondents

agreed that the amount of tax they pay is reasonable in relation to the benefits received (Oberholzer, 2007:102). Comparing this statistic to the vision of SARS (SARS, not dated) set out above, which ends with the words: *...in a way that benefits all South Africans*. there seems to be a major expectation gap between the tax burden and the perceived tax fairness.

Figure 1 below set out the trends of the South African tax burden (total tax revenue collected divided by the country's Gross Domestic Product (GDP)), in comparison to the other BRICS (Brazil, Russian Federation, India, China and South Africa) countries over the past few years as reported by the World Bank (2011a).

**Figure 1: Total tax to GDP – BRICS countries**



Source: World Bank, 2011a.

It is clear from this graph that South Africa has a significantly higher tax to GDP ratio than any other country in the BRICS economic grouping. However, considering the immense difference between the population sizes and GDP's of these countries, which has been set out in Table 1 below, it is acknowledged that the trends above may not be comparable. Similar trends have thus been compiled in Figures 2 and 3, where:

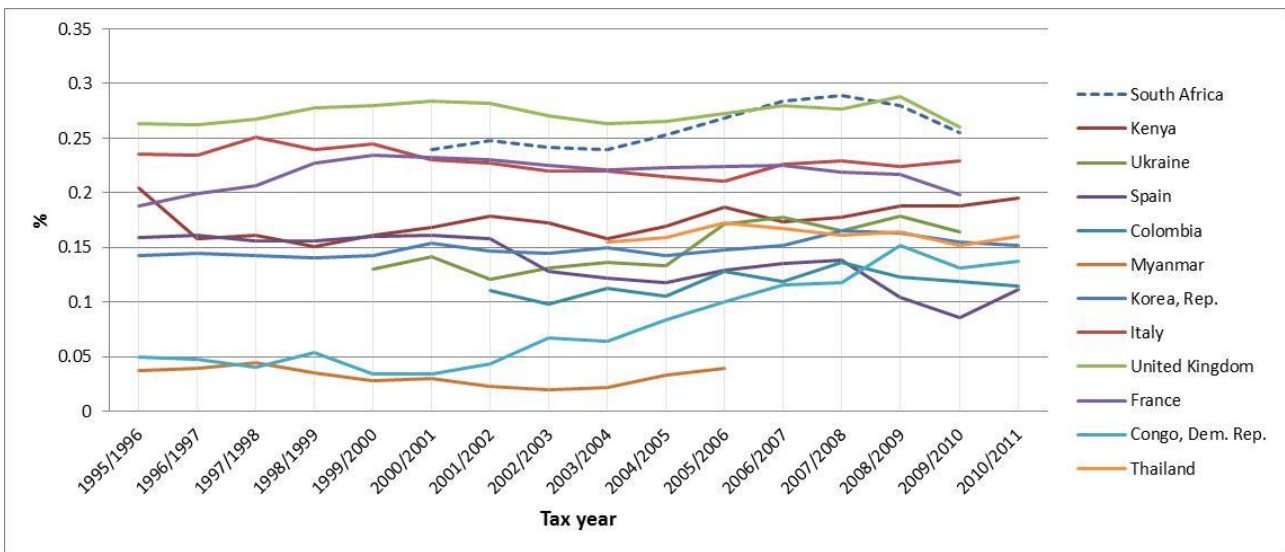
- Figure 2 sets out the tax to GDP ratio of 12 countries with population sizes similar to South Africa; and
- Figure 3 sets out the tax to GDP ratio 12 countries with GDP's similar to South Africa.

**Table 1: BRICS countries – Population sizes and GDP values**

Country	Population (in 2010)	GDP (in 2010 in USD)
Brazil	194,946,000	\$2,087,889,553,822
Russia	141,750,000	\$1,479,819,314,058
India	1,224,615,000	\$1,727,111,096,363
China	1,338,300,000	\$5,926,612,009,750
South Africa	49,991,000	\$363,910,425,628

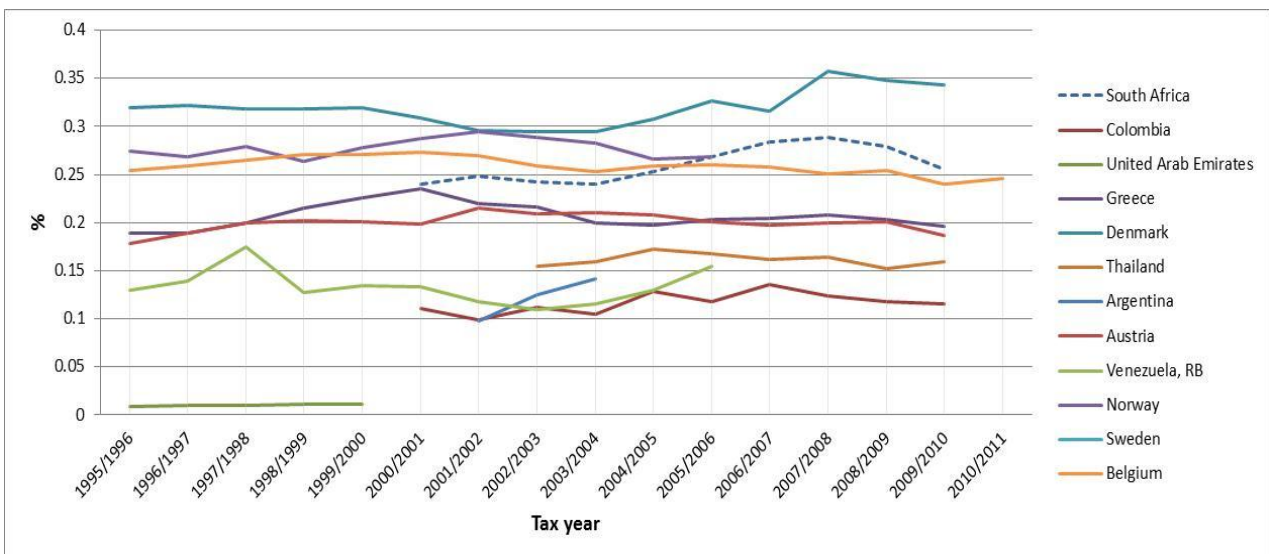
Source: World Bank, 2011b and 2011c.

**Figure 2: Total tax to GDP – Similar population sizes**



Source: World Bank, 2011a and 2011b.

**Figure 3: Total tax to GDP – Similar GDP values**



Source: World Bank, 2011a and 2011b.

From both Figure 2 and 3 it is apparent that South Africa's tax to GDP ratio remains extremely high (second highest in both instances). Only the United Kingdom and Denmark respectively ranked higher than South Africa in Figure 2 and 3. Both these countries are categorised as *High income: OECD* countries according to their income level by the World Bank (World Bank, 2011d; World Bank, 2011e). South Africa again is classified as *Upper Middle Income*, income level (World Bank, 2011f) and hence cannot be competing with such strong economies.

With such a high tax burden the question of fairness of tax on individuals in South Africa is very relevant. Mill (1848) cited by Vivian (2006:79) concluded that all taxes levied (regardless of it being direct or indirect) are ultimately carried by individuals. The question thus is, can South Africans afford such a high tax burden?

As fairness of taxation is such a comprehensive and possibly unrestricted field, this study aims to focus on the fairness principle, referred to as the first tax canon, laid down by the economist, Adam Smith (1776: 676). This canon by Smith (1776:676) suggests that individuals should pay taxes in proportion to each person's ability to pay tax. In other words the tax burden should be in direct relation to the income generated by individuals under the protection of the state (Smith, 1776: 676). The implication of the phrase is that individuals who have a limited or no ability to pay tax should only be subject to pay tax in relation to this ability. In other words, before tax can be levied an amount for the necessities-of-life must be deducted from the taxpayer's income. This is one of the oldest and most essential of all tax principles as indicated by Vivian (2006:85).

It is under this fairness principle that the primary rebate system was formulated. The current tax rebate system incorporated in South Africa entitles taxpayers to a tax-free income portion up to a certain level depending on the rebate amount (also referred to as the tax threshold). For the 2012/2013 tax year this tax threshold was R11,440 (SARS, 2012:2) which amounts to a tax-free portion of R63,556 (R11,440 divided by 18%). The theory thus is that this tax free portion exists to enable a taxpayer to first pay for his/her necessities-of-life (Vivian, 2006:91).

Vivian (2006:93) set out the history of the primary rebate in South Africa and points out that various types of rebates existed pre-1994, such as:

- i. rebates for children
- ii. primary rebates, which was different for:
  - a. married male persons;
  - b. unmarried persons; and
  - c. married women

The primary reason for these various rebates was to adhere to the first canon principle of Smith (Vivian, 2006:93). Considering the above rebates, the result was that individuals with children had less of an ability to bear tax (due to increased necessities-of-life) and hence were allowed an additional reduction in tax in the form of a rebate (Vivian, 2006:96). Similarly married taxpayer rebates differed from unmarried taxpayers as it was reasoned that the ability to bear tax is different between single and double income earning households (Vivian, 2006:94-95).

After the 1994 election the African National Congress (ANC) government appointed the Katz Commission and gave it the mandate to review tax policies with the goal of improving such policies (Manual, 2002:1; Vivian 2006:79; Steenekamp, 2012:41). One of the suggestions made by this Commission was the abolishment of the various rebates as set out above and the introduction of a unified/singular primary rebate (Vivian, 2006). From this point on all taxpayers were treated, from a primary rebate perspective, as though all have the same ability to pay tax. This unified rebate no longer regarded the amount of children which a taxpayer have to sustain or the amount of income streams in a household. Under South Africa's current tax legislation a married couple with four children for instance, where only the husband works, will only have one primary rebate, whilst a single male with no children, earning the same income as the husband aforementioned, will also have one primary rebate. Before the implementation of the unified primary rebate the husband with four children would have received a rebate for each child over and above his individual taxpayer rebate. On the same basis as Vivian (2006:91) puts it: *Various commissions, (especially the Katz Commission), had lost clear sight of the link between rebates and the necessities-of-life.* This expectation gap results in unfairness, as taxpayers with different financial abilities to pay tax are taxed similarly.

## 1.2 RESEARCH OBJECTIVES

Primary purpose:

- The main purpose of the present study is to critically analyse and compare the fairness of the primary rebates in South Africa in relation to other countries.

Secondary purposes:

- To clarify the theoretical constructs underpinning the fairness of primary rebates.
- To critically analyse the fairness of primary rebates from a South African viewpoint.
- To compare the primary rebates of South Africa in relation to other countries.

## 1.3 IMPORTANCE OF THE STUDY

The purpose of taxation is primarily to raise funds to finance government expenditure (Vivian, 2006:83; Obherholzer, 2007:1; SARS, not datedb). Government expenditure includes social and economic programmes, public goods and services, which includes schools, universities, hospitals, clinics and roads, as well as defence and security (SARS, not datedb).

In South Africa, government expenditure is mainly funded by taxation (Oberholzer, 2007:1). Taxation is thus a crucial funding vehicle to build and sustain infrastructure, such as roads and hospitals and provide basic services, such as education and safety.

Torgler (2002:1251) referring to Lewis (1982:165, 177) states that tax evasion increases where individuals' attitudes towards tax decrease. Farrar (2011:365) concluded that taxpayers react negatively towards taxation if it is perceived to be unfair. Hence it is possible to conclude that if the current primary rebate system does not meet the first canon of Smith's (1776:676) fairness principles of taxation it may lead to a decrease in tax compliance levels. As taxation plays such a fundamental part in the operation of a healthy economy, especially in South Africa, it is important to assess the fairness of tax in depth.

## **1.4 LIMITATIONS OF THE STUDY**

The aim of this study is to critically analyse and compare the fairness of the primary rebate system in South Africa in relation to other countries. Accordingly the study will be limited to South African income tax legislation applicable to individuals, with the exclusion of corporate taxpayers. The reason for this is that these primary rebates are only available to individuals according to section 6 of the Income Tax Act (58 of 1962).

This study is limited to horizontal and vertical fairness and therefore exchange fairness is excluded.

## **1.5 RESEARCH METHODOLOGY**

This study was based on an extended review of the literature.

## **1.6 STRUCTURE OF THE STUDY**

This study is divided into 4 chapters, being this Introduction (Chapter 1), the Literature Review (Chapter 2), the Comparison of the primary rebate of South Africa to other countries (Chapter 3) and the Conclusion (Chapter 4).



## CHAPTER 2

### LITERATURE REVIEW

#### 2.1 INTRODUCTION

Benjamin Franklin once said: Certainty? In this world nothing is certain but death and taxes (Burden, 2003:3). South Africans can be certain of paying taxes, however the question is: “Is the tax burden fair?”.

The purpose of this research is to critically analyse the fairness of the primary rebate system in South Africa in relation to other countries. In this chapter the aim is to formulate the theoretical constructs underpinning the fairness of the primary rebates in South Africa.

#### 2.2 FAIRNESS AS A CONSTRUCT

##### 2.2.1 OVERVIEW

Fairness is a relative concept. If one would walk into a shopping mall and ask people their definition of fair, you would almost certainly get as many different answers as the amount of people you asked (Oberholzer, 2007:3). This is due to individual’s varying backgrounds, personal obligations, preferences, cultures, and financial needs. The concept of fairness also differs vastly between taxpayer and tax collector if one considers the findings of Oberholzer (2007).

In Oberholzer (2007:102) study it was found that 87.69% of South Africans are of the opinion that waste and corruption in government in South Africa is high and only 24.23% indicated that the amount of tax paid is reasonable in relation to the benefits received. These results served as an indication that government’s income generation is not perceived as fair by South Africans as it is wasted or squandered by means of corruption and the benefits do not exceed the cost of taxation. The SARS on the other hand seem confident that their tax mandate is fulfilled in a fair manner as their vision includes that all

South Africans will be benefited from their tax collections (SARS, not dated). In stark contrast South Africa's Minister of Finance, Pravin Gordhan, pointed out in the 2012/13 tax budget speech that one of the underlying principles of the tax system is fairness (South African National Treasury, 2012a:13).

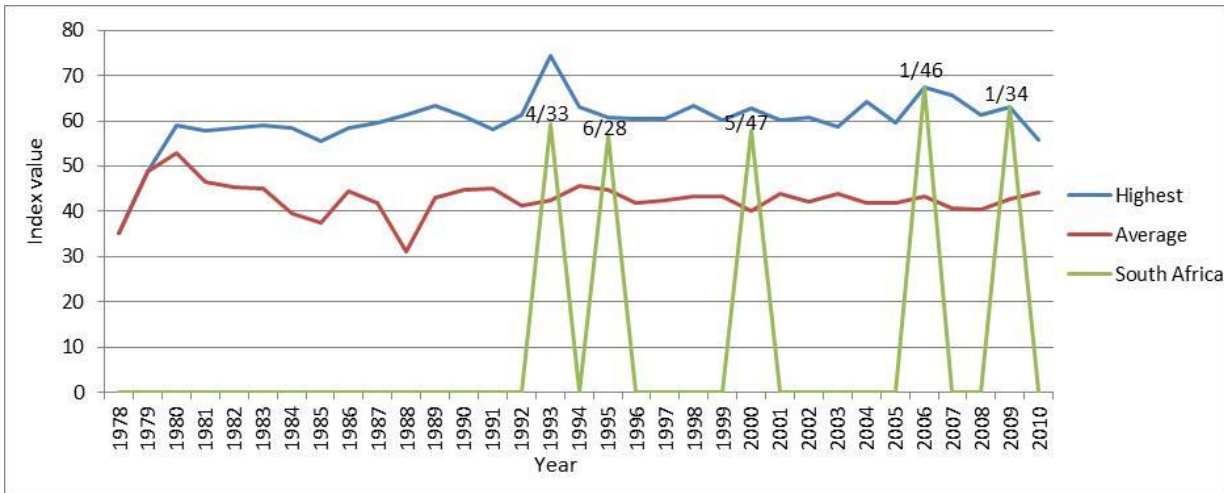
This expectation gap between taxpayer and tax collector is centuries if not millenniums old as Montesquieu (1748), as cited by Vivian (2006:84), indicated that a balance should be struck between the states financial needs and that of the citizens with regards to taxation. Maroun *et al.* (2011:436) formulated this point very well by stating: *A balance is necessary between the state's inexorable pursuit of revenue and the citizen's right to survive.* Hence it is necessary to clarify the concepts underpinning the construct of fairness of taxes in relation to this study.

## **2.2.2 MEASUREMENT OF FAIRNESS**

The Gini coefficient is the international standard for measuring the distribution of income and wealth in a country (Bosch *et al.*, 2010:1). The coefficient ranges from 0 to 1, where 0 implies that each individual received the same income (perfect equality) and 1 implies that only one individual receives all the income (perfect inequality) (Bosch *et al.*, 2010:3). The Gini coefficient is sometimes reported as the Gini Index which ranges from 0 to 100 (Bosch *et al.*, 2010:3). Thus, the higher the coefficient, the larger the gap between income classes.

The World Bank has surveyed and compiled the Gini Indexes of over 200 countries since 1978, including South Africa. Figure 4 below sets out these Gini Indexes and highlights the 5 years in which South Africa formed part of the survey (World Bank, 2011g).

**Figure 4: Highest and average Gini Index values as well as South Africa's Gini Index value as compiled by the World Bank since 1978**



Source: The World Bank, 2011g.

South Africa's rank, to the total number of countries surveyed, has been added in Figure 4. Figure 4 serves as indication, that South Africa has a very high Gini Index value by world standards with South Africa ranking number 1 of all the countries surveyed in 2007 and 2009.

The Gini Index provides an indication of the extent to which fairness does or does not exist between citizens of a country as it aims to calculate the income distribution. A zero Gini coefficient reflects that all citizens are in the exact same income bracket, whilst a 100 Gini coefficient points out that there are only two income brackets, namely one income bracket of zero which all citizens are in except the one citizen who is in the other bracket who earns all the income (Bosch et al., 2010:3).

There is most certainly a significant need to consider fairness in South Africa as the Gini Index value shows from the statistics in Figure 4 to have worsened since its first measurement in 1993. This indicates that the gap between rich and poor is increasing (vertical fairness). However, fairness of taxes does not only refer to vertical fairness between rich and poor, but also horizontal fairness between people with similar circumstances, as well as to exchange fairness.

### 2.2.3 HORIZONTAL, VERTICAL AND EXCHANGE FAIRNESS

To understand the concept of fair it is necessary to clarify the concepts of horizontal, vertical and exchange fairness.

Tax fairness or tax equity comprises of three categories, namely vertical, horizontal, and exchange fairness (Maroney *et al.*, 2002:1). Vertical tax fairness is the notion that taxpayers with different financial abilities, i.e. individuals not in the same income bracket, should not pay the same tax, but rather in line with their financial ability (Smith, 1776:676; Farrar, 2011:366). Horizontal tax fairness is the notion that taxpayers with similar financial abilities, i.e individuals within the same income bracket, should pay the same taxes (Farrar, 2011:366). Finally exchange tax fairness is the notion that the benefits received from paying taxes compares to the amount of tax paid (Farrar, 2011:366).

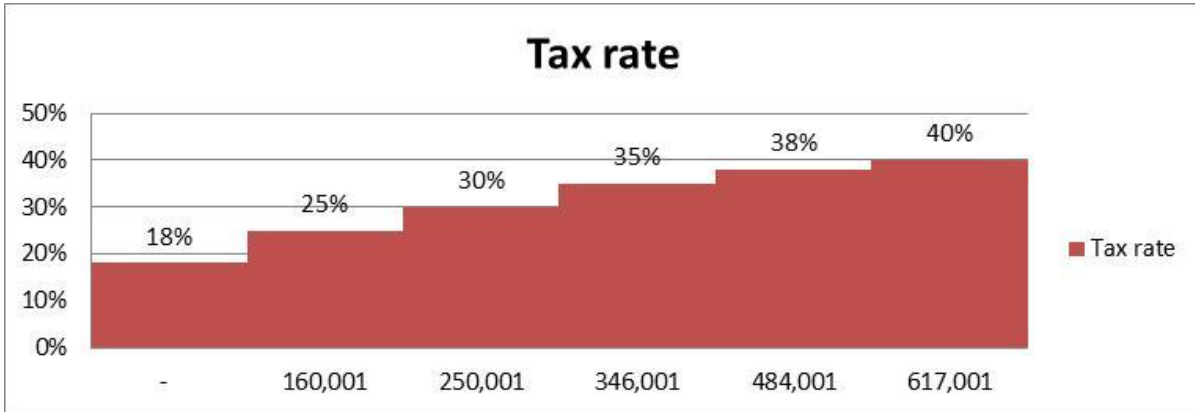
Smith (1776:676-677) articulated four canons which can contribute to an unfair tax system. The first canon determines that taxes should be raised against taxpayers in line with their ability to bear tax and not their ability to pay tax (Smith, 1776:676; Montesquieu, 1784 in Vivian, 2006:85). Although subtle, the difference is fundamental. The principle suggests that individuals should pay taxes in proportion to their financial abilities and not in proportion to the government's right to tax. This principle was so fundamental to Smith that he stated: *In the observation or neglect of this maxim consists, what is called the equality or inequality of taxation.* (Smith, 1776:676). The first tax canon was thus the most fundamental principle of all with regards to the fairness of taxation.

What is unique about this principle is that it is simplistic, logical and covers both horizontal and vertical tax fairness. Exchange fairness on the other hand will not be dealt with further in this study as this paper is only focussed on the vertical and horizontal fairness of the primary rebates.

A progressive tax system has been adopted in South Africa in an attempt to achieve vertical and horizontal equity (Davidson, 2005:1). There are many arguments for and against the fairness which this system creates (Davidson, 2005:1). In short a progressive tax system works on a sliding scale principle, where the percentage of tax payable

increases on a step basis the more a taxpayer earns. Figure 5 provides an overview of the taxing scales in South Africa for the 2012/13 tax year (SARS, 2012b:1).

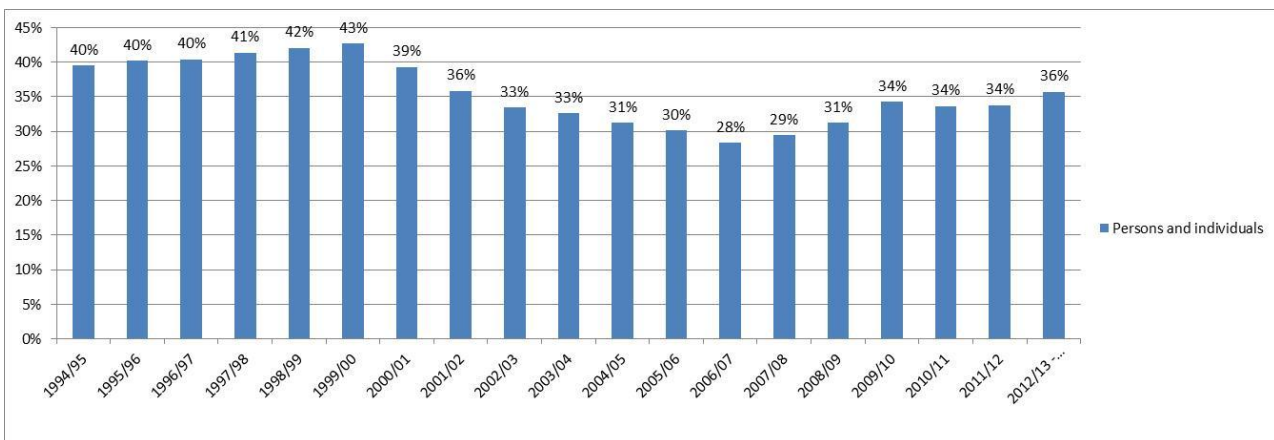
**Figure 5: The progressive tax scale applicable in South Africa for the 2012/13 tax year**



Source: SARS, 2012b:1.

Figure 5 indicate how the tax burden increases progressively with the increases in income. All individual taxpayers in South Africa are taxed on the above scales on a consistent basis. Tax on individuals is referred to as Personal Income Tax (PIT). PIT contributes the highest percentage of any tax type to the South African tax budget (SARS, 2012c:148-150. Figure 6 below sets out the percentages of PIT as a percentage of the total South African tax revenue from 1994 to 2013. On average PIT make up 36% of the total tax revenue over this 19 year period (SARS, 2012c:148-150).

**Figure 6: PIT as a percentage of total tax collected – 1994 to 2013**



Source: Self calculated. SARS, 2012c:148-150.

PIT is raised from different sources of taxable income, for instance salaries, pension, commission and interest (SARS, 2011:30). However, Section 23m of the Income Tax Act (58 of 1962) prohibits the deduction of specific expenditure from some of these taxable income sources. Many of the individuals contributing to PIT would accordingly only have the deduction of the primary rebate as permitted by Section 6 of the Income Tax Act.

In summary individual taxpayers in South Africa are not assessed individually for their financial abilities to pay tax. Instead an overall combined approach to taxing individuals has been implemented with limited deductions and a unified rebate available. As concluded by Vivian (2006:106) the tax system implemented after the Katz Commissions policy reviews between 1994 and 2000, is too simplistic and does not adhere to the first tax canon of Smith and accordingly results in vertical and horizontal inequities.

#### 2.2.4 NECESSITIES-OF-LIFE

Maslow compiled a hierarchy of basic needs in 1954 (Macleod, 2007). The hierarchy of these needs start from the most basic, the need to survive, to the ultimate need of self-actualisation. Maslow's theory suggests that an individual would first fulfil a lower level basic need before moving onto the next growth need (Macleod, 2007). This hierarchy is illustrated in Figure 7 below:

**Figure 7: Maslow's hierarchy of basic needs**



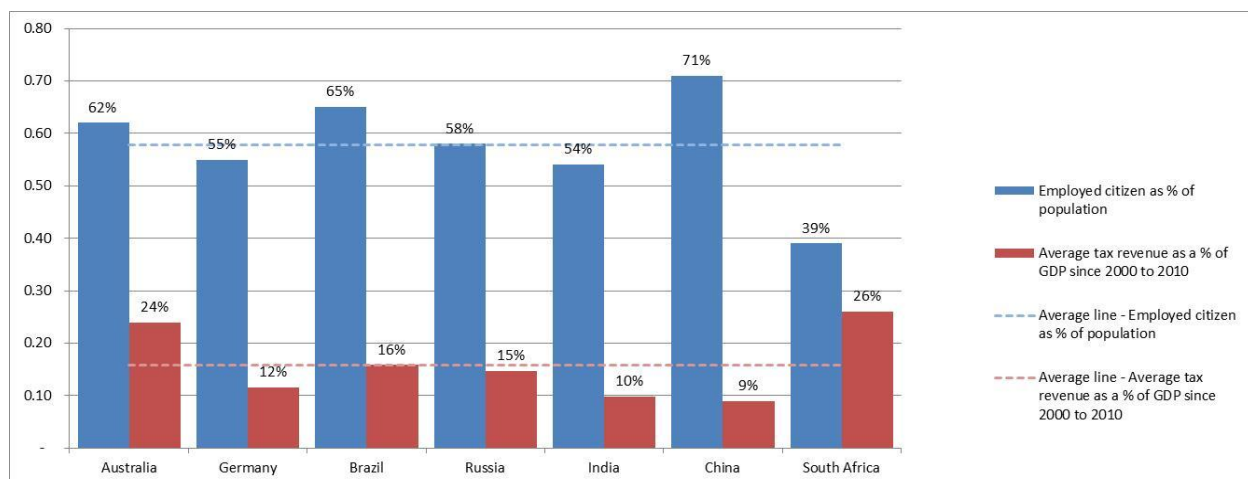
Source: Macleod, S.A., 2007.

The first tax canon of Smith (1776:676) supports this principle. The canon suggests that the payment of taxation should only be made after the payment for the basic needs have been covered (Vivian, 2006:85). Vivian (2006:85) continues to mention that this is an ancient principle and dates back to Plato (427BC-347BC) who stated: *Payment for the common meals should be excluded from [tax] calculations.*

An individual's basic financial necessities will differ from person to person, depending on circumstances. In South Africa the dependency ratio, referring to the amount of individuals an income earning individual has to sustain (Sach *et al.*, 2002:683), is very high due to South Africa's high unemployment rate.

A comparison of the employed citizen rates and the tax to GDP ratios of the BRICS countries and some other first world countries, namely Australia and Germany, are illustrated in Figure 8 below. Australia was included due to its climate and proximity similarities to South Africa, whilst Germany in turn was included due to the size of its population which is similar to the population of South Africa, 81,7 million and 50.6 million respectively (World Bank, 2011b). The averages were calculated by using statistics compiled by the World Bank over the period 2000 to 2010 (World Bank, 2011b). This 11 year period was used to eliminate the probability of skewed statistics which could result in years of uncommon economic activity, such as the 9 September 2001 terrorist attacks on America, which had significant irregular impacts on the world economy (Bram *et al.*, 2002:5).

**Figure 8: Employed citizen rates and GDP to tax ratios (2000 to 2010) – The World Bank**



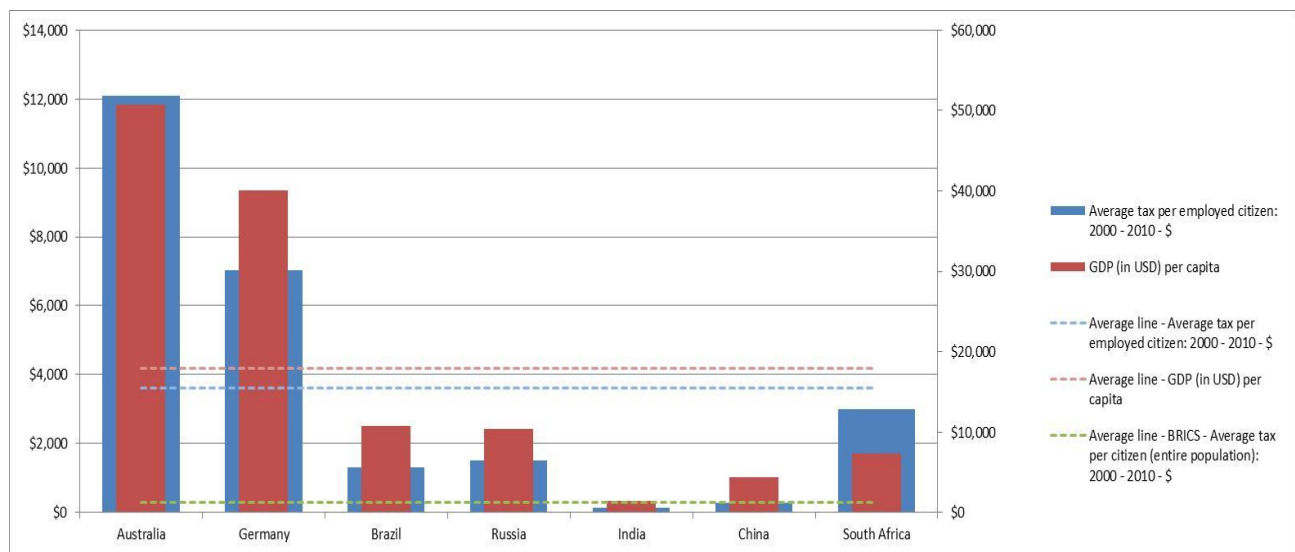
Source: World Bank, 2010. World Bank, 2011a.



What makes South Africa unique is that it has the lowest employed citizens' percentage and highest tax to GDP ratio (Figure 8). Or stated differently, South Africans have the highest tax burden of all the countries as indicated in Figure 2 and Figure 3 with the lowest employment rate as indicated in Figure 8. This tendency does not match up to the ability to pay principle laid down by Smith (1776:676). One would rather expect the tax to GDP ratio to be lower in a country where the employment is lower as it is argued that a lower level of employment will result in a lower ability to pay tax per person.

Figure 9 below supports this conclusion by reflecting the average taxation in US Dollars per employed citizen on the left hand Y-axis and the GDP per capita on the right hand Y-axis, which has also been calculated by the statistics provided by the World Bank (World Bank, 2011a and 2011c).

**Figure 9: Average tax per employed citizen (2000 to 2010) and GDP per capita – The World Bank**



Source: Self calculated. World Bank, 2011a, 2011c and 2011g.

From Figure 9 it's apparent that employed South Africans carry a high tax burden. Although this burden seems to be less than first world countries such as Australia and Germany, the GDP per capita is far less in South Africa than in these countries and accordingly so is South Africans' ability to pay taxes (World Bank, 2011a, 2011c and 2011g).



Considering all of the statistics above there is an increasing concern about the gap, which potentially is growing, between the real taxing system in South Africa and a taxing system based on fair principles as contemplated by various economists, philosophers and researchers, for instance Smith (1776), Vivian (2006), Oberholzer (2007), and Davidson, (2005).

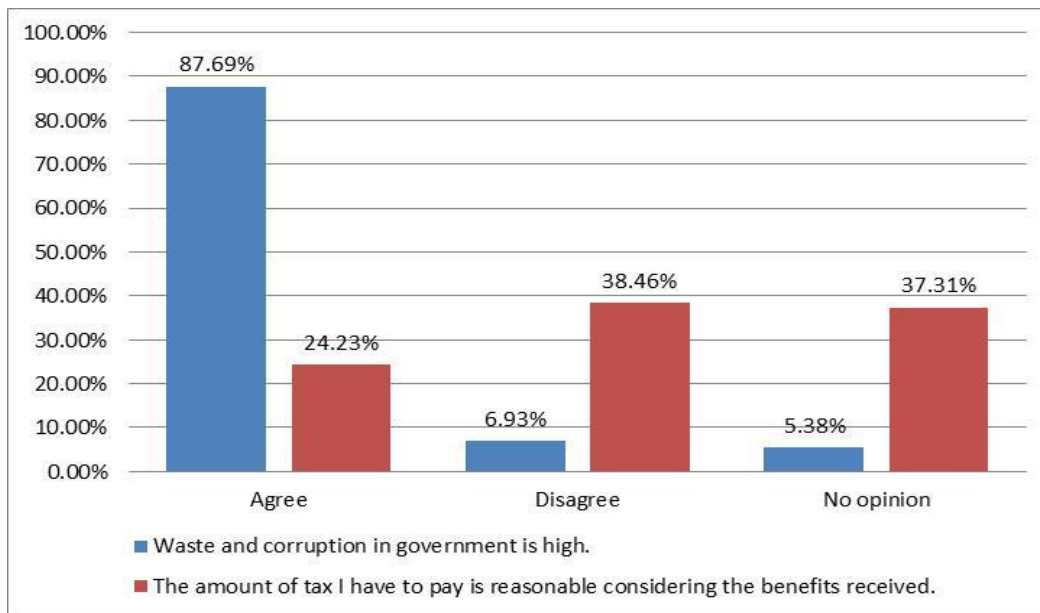
### **2.2.5 IMPACT OF AN UNFAIR TAX SYSTEM**

Davidson (2005:3-7) found that that high tax rates and productivity is negatively correlated, in other words productivity decreases with increased tax rates. He concluded that high tax rates increase the size of the illegal underground economy and leads to a higher unemployment rate under unskilled workers (Davidson, 2005:3-7).

This negative correlation might have a major impact on productivity and unemployment in South Africa. The current taxing system which places heavy burdens on a few individuals may have a counterproductive result as, based on the findings of Davidson (2005: 3-7), this may lead to decreased productivity and increased unemployment under unskilled labourers, which is not healthy for economic growth. It may also lead to increased criminal activity as suggested by the same study.

Oberholzer (2007:16-27) gave an extensive breakdown of economic and physiological theories and hypothesis as to why people evade taxes. Some of these included paying high taxes, the cost of tax not pairing with the benefits received and individuals perceiving the tax system as unfair. Some of Oberholzer's (2007:102) results of the assessed perceptions of South Africans regarding the fairness of taxation are illustrated in Figure 10.

**Figure 10: Extract of results from Oberholzer (2007:102) research**



Source: Oberholzer, 2007:102.

From Figure 10 it is clear that the overwhelming majority (87.69%) of taxpayers in South Africa are of the opinion that there is a high level of waste and corruption and that the benefits of taxation do not pair with the cost of taxation as only 24.23% agreed that the benefits received from taxation paid compare to the cost of taxation. The results support Torgler (2002:1251) who concluded that there is a negative relationship between perceived tax fraud and tax compliance, something that is a very real phenomenon in South Africa.

### 2.3 PRIMARY REBATES AS A CONSTRUCT

A rebate is also referred to as a credit (South African National Treasury, 2012b:41, 63). The purpose of a tax rebate is to decrease the tax liability of a taxpayer (South African National Treasury, 2012b:68) or as stated in Section 1.1 to provide a tax-free income bracket for. The implementation of this tax-free portion is an attempt to adhere to the first tax canon principle of Smith (1776:676), in other words the necessities-of-life premise. The National Treasury of South Africa confirms this by stating: *The purpose of the rebates is to provide relief for subsistence living* (South African National Treasury, 2012b:12).

The term “subsistence” is defined in Askoxford.com (Not dated) as: *the action or fact of maintaining or supporting oneself, especially at a minimal level*. A synonym for subsistence is bread and butter (Thesaurus.com, Not dated) or survival (Thesaurus.infoplease.com, Not dated). Hence it is possible to conclude that tax rebates in South Africa promotes the notion that tax is only paid once the basic costs to survive has been covered.

### **2.3.1 THE SOUTH AFRICAN PRIMARY REBATE SYSTEM**

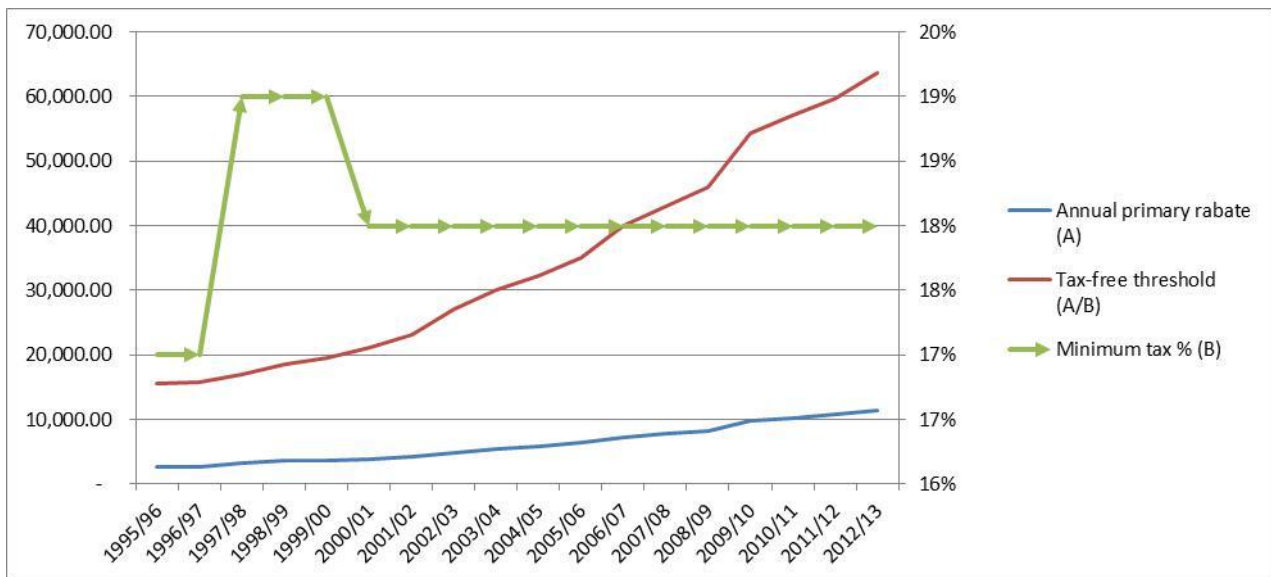
Section 6 of the Income Tax Act (58 of 1962) gives all individual taxpayers a tax free portion, which is commonly referred to as the primary tax rebate. This concept is in line with the first tax canon of Smith (1776:676). Taxes should be raised based on individuals’ ability to bear taxes and not individuals’ ability to pay (or as it is known today, pay as you earn). The primary rebate premise has been incorporated in South Africa since the inception of the first income tax act, being Income Tax Act 28 of 1914 as indicated by Oberholzer (2007:40) and Vivian (2006:93).

A significant change in the primary rebate system in South Africa took place after 1994. The Katz Commission suggested the abolishment of the then multiple rebate system and the incorporation of a unified primary rebate system (Manuel, 2002:4). Some of the reasoning for this view from the Commission included (Vivian, 2006:93-94):

- The child rebate promotes large families; and
- The rebate is unconstitutional as it provides different rebates depending on gender and marital status.

This unified rebate system was criticised by Vivian (2006:93) as being illogical, unfair and unique in the 200 years period preceding it. Since the implementation of the unified primary rebates system the yearly rebate has grown as set out in Figure 11 below:

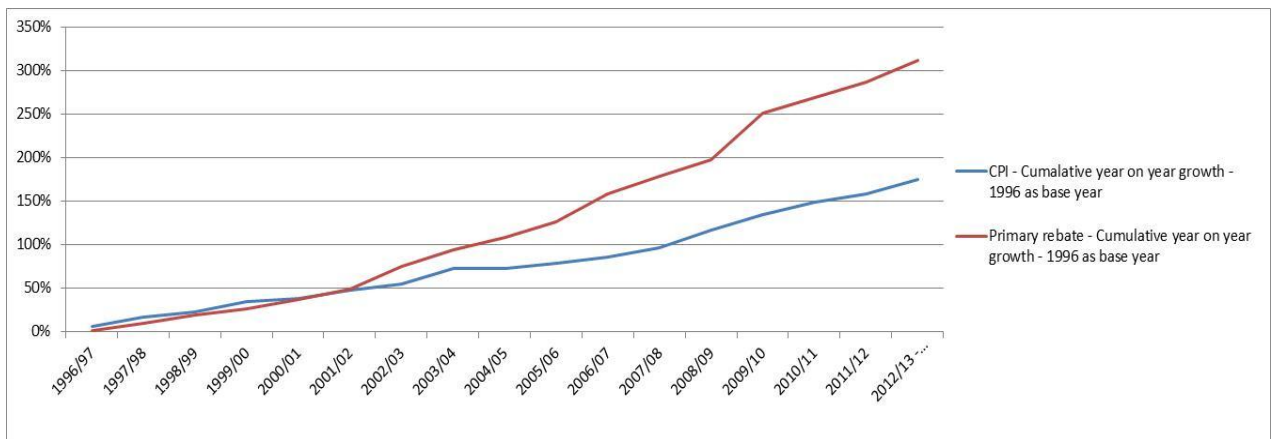
**Figure 11: Primary rebate trends from 1995 to 2013**



Source: South African National Treasury, 2004 and 2005. BDO South Africa, 2008. SARS, 2010b; 2011b and 2012a.

The purpose of the year-on-year rebate escalations is to adhere to the necessities-of-life principle as it compensates for the effect of inflation (Manuel, 2002:4). Figure 12 below reflects the cumulative increases in the CPI in comparison to the primary rebate, using the 1995/1996 tax year as the base year.

**Figure 12: Cumulative growth of the CPI and the Primary Rebate since 1995**



Source: Table 5. Statistics South Africa, 2009a and 2012a.

The trend reflected in Figure 12 is positive as it indicates that the cumulative growth in the primary rebate exceeds the cumulative growth of CPI over the last 18 years by 137%. If

every product, service and utility thus escalated by exactly CPI over the last 18 years, the growth in the primary rebate would have resulted in an improved ability to pay tax.

CPI however is an economic inflation indicator for a basket of products (Statistics South Africa, 2008a:2). In other words it takes all expenses of the average consumer into consideration to calculate the overall inflation percentage for households (Statistics South Africa, 2008a:2). This basis may not be a sounds basis for this study as the necessities-of-life or the expenses of an individual to survive are only a portion of the total expenses which is included in the CPI calculation.

Table 2 below reflects the expense categories and weights of each of the category which make up the CPI value (Statistics South Africa, 2008a).

**Table 2: CPI expense category weightings**

Category	CPI 2008 weights	Necessity/ Survival category	CPI 2008 weights - Necessity/ survival categories
Food and non-alcoholic beverages	18.28%	Yes	18.28%
Alcoholic beverages and tobacco	5.56%	No	0.00%
Clothing and footwear	4.42%	Yes	4.42%
Housing and utilities	21.04%	Yes	21.04%
Household contents, equipment, and maintenance	6.14%	No	0.00%
Health	1.48%	Yes	1.48%
Transport	17.79%	No	0.00%
Communication	3.13%	No	0.00%
Recreation and entertainment	3.93%	No	0.00%
Education	2.15%	No	0.00%
Restaurants and hotels	2.78%	No	0.00%
Miscellaneous and residual	13.30%	No	0.00%
<b>TOTAL</b>	<b>100.00%</b>		<b>45.22%</b>

Source: Statistics South Africa, 2008a.

Each of these categories were assessed in Table 2 in the light of the primary rebates purpose, which is a credit providing a tax-free threshold required to first cover the expenses required to survive (Vivian, 2007:107). Only 4 of the 12 categories provided by Vivian (2007:107) were identified as expenses required to survive, being:

1. Food and non-alcoholic beverages
2. Clothing and footwear
3. Housing and utilities
4. Health

All other categories are not deemed necessary to incur for an individual to survive. Only 45.22% of the full basket of products is thus deemed to be necessities-of-life expenses. On this presumption a recalculation of the survival CPI rate has been done in Table 3 using the detailed data reported by Statistics South Africa from 2007 to 2012 (Statistics South Africa, 2007a; 2008a; 2009b; 2010a; 2011 and 2012b). A period of 6 years was used to ensure that a stable and reliable average was.

**Table 3: Survival CPI**

Category	Aug-07		Aug-08		Aug-09		Aug-10		Aug-11		Aug-12		
	Y-Y CPI	SC	Y-Y CPI	SC	Y-Y CPI	SC	Y-Y CPI	SC	Y-Y CPI	SC	Y-Y CPI	SC	
Food and non-alcoholic beverages	2.4%	2.4%	8.8%	8.8%	1.1%	1.1%	0.3%	0.3%	1.1%	1.1%	0.8%	0.8%	
Alcoholic beverages and tobacco	0.3%	0.0%	0.3%	0.0%	0.7%	0.0%	0.4%	0.0%	0.4%	0.0%	0.5%	0.0%	
Clothing and footwear	-0.2%	-0.2%	0.3%	0.3%	0.2%	0.2%	0.0%	0.0%	0.1%	0.1%	0.1%	0.1%	
Housing and utilities	2.3%	2.3%	2.2%	2.2%	1.8%	1.8%	1.4%	1.4%	1.6%	1.6%	1.4%	1.4%	
Household contents, equipment and maintenance	0.4%	0.0%	1.2%	0.0%	0.4%	0.0%	0.1%	0.0%	0.1%	0.0%	0.1%	0.0%	
Health	0.5%	0.5%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.1%	1.0%	0.1%	0.1%	
Transport	0.2%	0.0%	1.2%	0.0%	-0.5%	0.0%	-0.1%	0.0%	1.0%	0.0%	0.8%	0.0%	
Communication	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	-0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	
Recreation and entertainment	0.2%	0.0%	0.6%	0.0%	0.5%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	
Education	0.4%	0.0%	0.2%	0.0%	0.2%	0.0%	0.2%	0.0%	-0.1%	0.0%	0.2%	0.0%	
Restaurants and hotels	0.0%	0.0%	0.0%	0.0%	0.3%	0.0%	0.2%	0.0%	0.2%	0.0%	0.2%	0.0%	
Miscellaneous and residual	0.1%	0.0%	0.1%	0.0%	1.5%	0.0%	0.9%	0.0%	0.8%	0.0%	0.8%	0.0%	
<b>TOTAL</b>	<b>A</b>	<b>6.7%</b>	<b>5.0%</b>	<b>15.1%</b>	<b>11.5%</b>	<b>6.4%</b>	<b>3.3%</b>	<b>3.5%</b>	<b>1.9%</b>	<b>5.3%</b>	<b>3.8%</b>	<b>5.0%</b>	<b>2.4%</b>
<b>AVERAGE SURVIVAL WEIGHTING AS CALCULATED</b>	<b>B</b>		<b>45.2%</b>		<b>45.2%</b>		<b>45.2%</b>		<b>45.2%</b>		<b>45.2%</b>		<b>45.2%</b>
<b>SURVIVAL CPI</b>	<b>A/B</b>		<b>11.1%</b>		<b>25.4%</b>		<b>7.3%</b>		<b>4.2%</b>		<b>8.4%</b>		<b>5.3%</b>

*Annotations:*  
 SC - Survival contribution to the CPI.  
 Y-Y CPI - Year on year CPI.

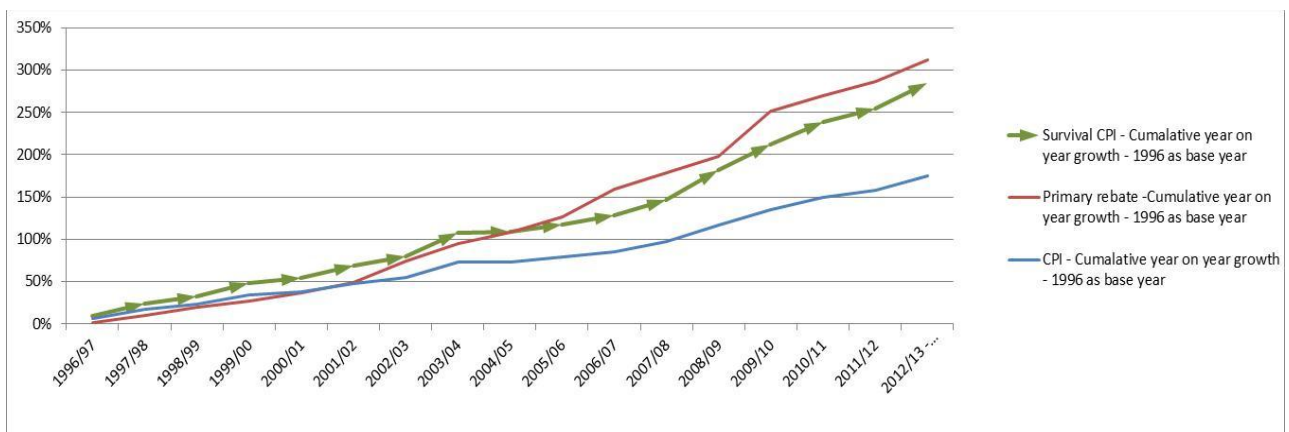
Source: Statistics South Africa, 2007a; 2008a; 2009b; 2010a; 2011 and 2012b.

In all of the 6 years presented in Table 3, the survival CPI percentage exceeds the actual year-on-year CPI percentage. The overall average by which the survival CPI exceeds the normal CPI amounts to 47%. Excluding the outlier in the data set above, namely 2008, the

5 year average (2007 and 2009 to 2012) by which the survival CPI still exceeds the year on year CPI amounts to 35%. 2008 is deemed to be an outlier due to the unique impacts of the 2008 Global financial crises which originated from the United States sub-prime mortgage bubble and impacted the South African economy severely (Chuma, 2008). A recalculation of the survival CPI since 1995 has been done and is set out in Figure 13 using the 35% excess value as the increase factor for every CPI value since 1995.

Adjusting the CPI values up by the more conservative 35% from 1995 the cumulative primary rebate growth graph and the cumulative survival CPI graph changes as follows:

**Figure 13: Cumulative growth of the Survival CPI and the Primary Rebate since 1995**



Source: Figure 12 and Table 3.

The primary rebate growth trend looks far less impressive against the recalculated survival CPI trend than against the overall CPI trend in Figure 13. These results make it possible to assume that the primary rebate increases since 1995 have tracked almost exactly the expenses which it is meant to cover, namely the necessities-of-life expenses.

### 2.3.2 QUANTIFYING THE FAIRNESS OF THE SOUTH AFRICAN PRIMARY REBATE SYSTEM

This paper has already established that the progressive tax system implemented in South Africa creates vertical unfairness (See Figure 5 in Section 2.2.3 of the current study) and the unified primary rebate system creates horizontal unfairness (See Section 2.3.1). Concluding that a system is unfair is simpler than quantifying the extent of the unfairness.

As eluded to earlier in the present chapter (See Section 2.2.2) the Gini coefficient is the international quantification of the gaps between rich and poor (a.k.a. vertical unfairness). Currently a unified primary rebate system is implemented in South Africa which results in horizontal unfairness. This is due to the unified system not considering individuals' ability to pay tax but rather following a one-size-fits-all approach (See Section 2.2.3). It thus gives all taxpayers the same tax-free threshold.

The problem is not the tax-free threshold provided to all taxpayers, but the fact that there is only one general rebate in South Africa. Section 6(1) of the Income Tax Act (1962 of 58), sets out the legalities of this aforementioned primary rebate. This Sub-section 1 of Section 6 limits the deduction of the unified primary rebate to each taxpayer's tax payable. In other words a taxpayer only has a single rebate and the rebate is limited to the tax payable. This rebate therefor adheres to the first tax canon of Smith (1776:676). There are however no other rebates available to compensate individuals for the maintenance of his/her dependents.

### **2.3.3 DEPENDENCY REBATES AND RATIO'S IN SOUTH AFRICA**

Askoxford.com (Not dated) defines "dependent" as: *unable to do without*. An alcohol dependent person for instance cannot live without alcohol (Edwards *et al.*, 1976:1060). In the same way a financially dependent individual is not able to sustain him-/herself financially without the financial support of another (Australian Taxation Office, 2002). For instance a financially dependent child cannot survive without the financial maintenance from his/her parent or guardian. In the same sense a non-working spouse depends on the financial support of the working partner.

The necessities-of-life expenses of an individual thus increases in line with the increase in financial dependents (Vivian, 2006:94). The non-existence of dependent rebates in South Africa is thus in direct contravention to the first tax canon of Smith (1776:676) as there is no regard for a person's ability to pay tax. South Africans are only allowed a primary rebate which takes no regard of a person's additional financial burden relating to dependents.



Based on the above relationship between dependents and necessities-of-life expenses one can conclude that dependent rebates should be higher in countries where the dependency ratio (See Section 2.2.4) is higher.

Statistics South Africa, calculates the unemployment percentage on an annual basis. This percentage is calculated as follows (Statistics South Africa, 2008b:8):

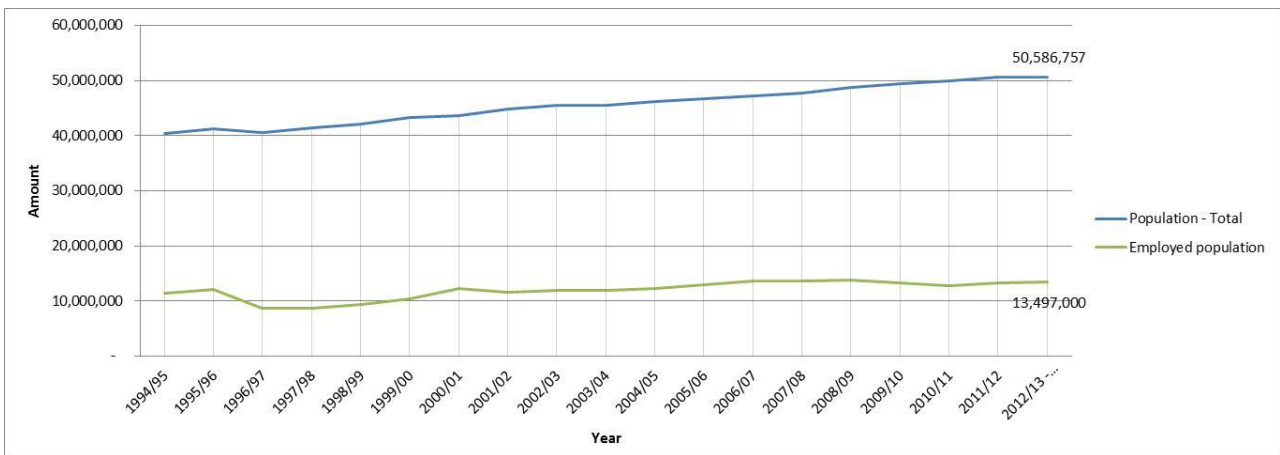
- Total population = A
  - **Minus:** citizens younger than 15 years of age = (B)
  - **Minus:** citizens older than 64 years of age = (C)
  - **Minus:** economically inactive citizens = (D)
- EQUALS: ECONOMICALLY ACTIVE CITIZENS = E**

The reason for the each of the deduction above is as follows:

- B - It is only legal to be employed from the age of 15 in South Africa. These individuals are thus excluded as all of them are unemployed due to legislation and not economic conditions (labourguide.co.za, Not dated).
- C - There is no law in South Africa prohibiting a person to work past the age of 64 (www.mbanetwork.co.za, Not dated), but it is accepted that the normal retirement age is 55, 60 or 65 (Western Cape Government, 2004). Statistics South Africa thus exclude the population above the age of 64 to cater for this anomaly as the inclusion of it would skew the actual value.
- D - Economically inactive citizens are those citizens who do not work and are not actively seeking for a job (Department of Labour South Africa, 2010:1). Examples of such citizens are housewives and discouraged individuals who have given up on seeking a job. These citizens are excluded from the unemployment calculation as well as it is reasoned that a true unemployment value must be calculated, in other words only people that cannot find work and are actively seeking for it.

Figure 14 sets out the comparison between the total South African population and the employed population (using the calculation set out above).

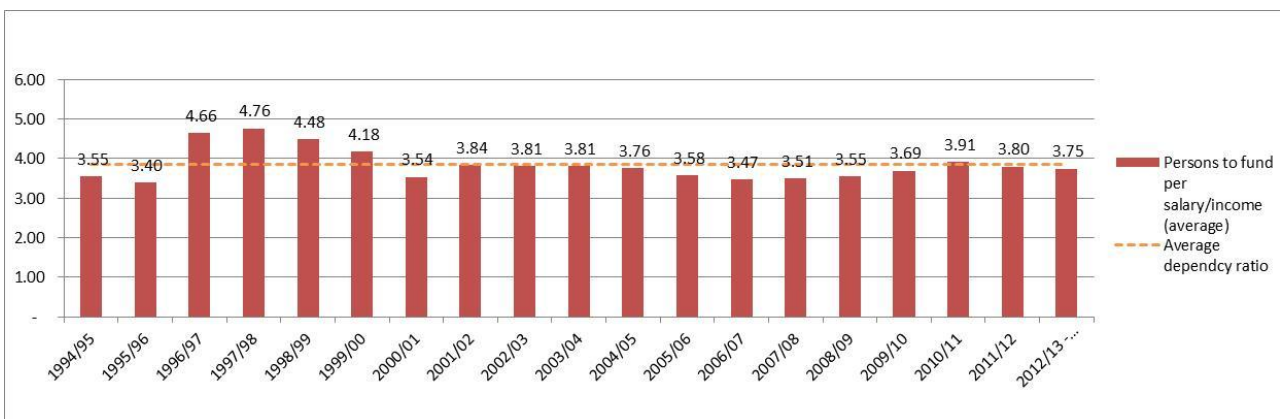
**Figure 14: Comparison between South Africa's total and employed population**



Source: Statistics South Africa, 1995; 1996; 1997; 1998; 1999; 2007b; 2008c; 2010b and 2012c.

In this visual format it is clear that a fairly small percentage of the population is employed. This is important to take into consideration in this study as all citizens have a need to income to finance their survival. Figure 15 reflects the comparison of Figure 14 as a ratio of the individuals that need to be maintained on average by every employed person in South Africa, referred to as dependency ratio (Sach *et al.*, 2002:683).

**Figure 15: Dependency ratio trends**



Source: Self calculated using information from figure 14.

The average dependency ratio, depicted by the dotted orange line, from 1994 to 2012 equals 3.85. Therefore, one (1) income earning individual on average has himself and 2.85 other dependents to sustain. The primary rebate system in South Africa however only provides for a deduction for 1 person out of 3.85 persons that this taxpayer has to sustain. In this lies a significant fairness flaw of the rebate system in South Africa in that 1

individual maintaining 3.85 individuals would have a higher cost of survival than 1 individual only maintaining himself. Stamp (1921:14-15) stated that it is not enough to ask how much a person's income is to determine how much taxes to pay, it is also important to ask how much a person has to pay, taking cognise of the size of the family and other factors.

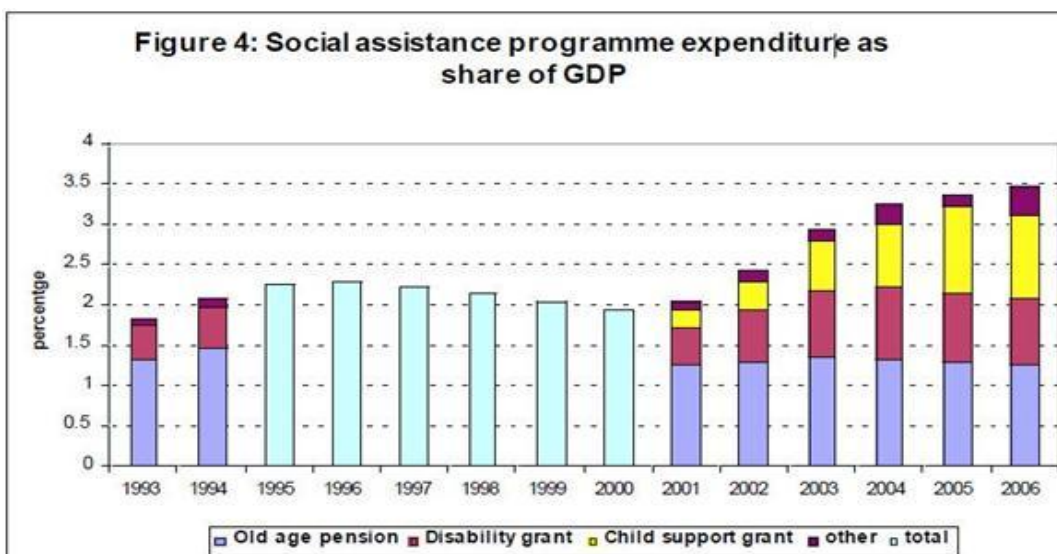
## 2.4 CONCLUSION

Instead of implementing the fairness principle for tax rebates in South Africa, the South African Government has decided to implement a unified rebate system which concludes that all South Africans have the same ability to pay tax and it also does not provide for other scenario's such as the dependency ratio which is very relevant in South Africa.

However it appears as though government acknowledges that many poor South Africans have dependents which they cannot support. In an attempt to address this need a significant grant system has been implemented with the purpose of subsidising those individuals who cannot support themselves, specifically referring to disability grants and children grants.

Figure 16 illustrates the effect of the grant system in South Africa in relation to the GDP.

Figure 16: Social grant trends – 1993 to 2006



Source: Seekings, 2007:15.

This current grant system in South Africa however is not expected to have positive impacts on the economy, such as improvement in the employment rates or decrease in poverty levels (Seekings, 2007:21-23). It can however not be abolished with the unfairness created by the unified primary rebate and non-existence of dependent rebates in South Africa.

## **CHAPTER 3**

### **COMPARISON OF THE PRIMARY REBATE IN SOUTH AFRICA WITH OTHER COUNTRIES**

The primary aim of this study is to critically analyse and compare the fairness of the primary rebate system in South Africa in relation to other countries. This primary objective is supported by the objective to compare the South African primary rebate system to that of other countries.

In a comparison the subject matters being compared must have common grounds. In this chapter the selection methodology and countries selected will first be clarified to ensure that the common grounds exist to support the comparison.

A second and equally important aspect of a comparison is selecting the criteria bases from which to do the comparison, with specific reference to the purpose of the comparison. The criteria ultimately should provide insight from which conclusions can be drawn which is relevant to the purpose of the study.

This chapter has been divided into 3 main sub-categories, being the selecting countries for comparison, the comparison and finally the conclusion.

#### **3.1 SELECTING OF COUNTRIES FOR COMPARISON**

In selecting the countries for comparison, countries must have a high level of comparability to South Africa to ensure that conclusions can be drawn. As this is a limited study the number of countries for comparison was limited to only two countries.

South Africa is widely considered to be a developing economy with the goal to grow into a developed economy. Accordingly one of the countries needs to also be a developing country similar to South Africa. For comparative purposes this study also selected a developed country comparable to South Africa.

### 3.1.1 DEVELOPING COUNTRY

The BRICS countries have become a well-known economic group of developing countries. Hence, this provides a useful platform to select a developing country from.

The acronym “BRICS” refer to **B**razil, **R**ussian Federation, **I**ndia, **C**hina and **S**outh Africa. Following wide research and statistical comparison it was decided to use Brazil as the BRIC country to compare to South Africa. The reasons for this selection are:

- i. Both countries have implemented progressive taxing systems with a tax free threshold (SARS, 2012b:1[2]; Deloitte, 2012:3[4]). The main purpose of this study is based on the comparison of the tax free threshold or rebates and accordingly this similarity results in relevant comparability.
- ii. A number of other studies have also found that Brazil and South Africa have a high level of comparability (Council for Scientific and Industrial Research (CSIR), South Africa, 2002:1-4; African Research Institute, 2007:1, Saraiva, 2009:1[8]; Duman *et al.*, 2009:3[37]). Some of the reasons identified in these studies include:
  - Both countries have an unequal dispersal of wealth (CSIR, 2002:1). This is validated by the high average Gini coefficients of South Africa and Brazil which amount to 60.85 and 58.67 respectively (World Bank, 2011g). With such high levels of uneven wealth distribution there will be similar issues in these two countries with regards to tax affordability for those citizens who battle to make ends meet. Accordingly the first tax canon principle of Smith (1776:676) is very relevant in both South Africa and Brazil.
  - These inequalities in South Africa and Brazil are deemed to have a significant impact on the high crime rates which is present in both countries (CSIR, 2002:2). Crime has a material impact on the daily living of citizens and the manner in which money is spent in a country’s budget.
  - The South African and Brazilian economies are the strongest economies on their respective continents from a GDP perspective (African Research Institute, 2007:1; World Bank, 2011c). There will accordingly be similar economic pressures on each of these two countries with regards to the support provided to their respective continents.

- South Africa and Brazil have both gone through major governmental transitions and political unrest (CSIR, 2002:2; Duman *et al.*, 2009:3[37]). Brazil finally transformed from a military regime to a democracy in 1986, whilst South Africa transformed from an apartheid government to a democracy in 1994 (CSIR, 2002:2). These transitions in South Africa and Brazil are relevant to this study as these governmental changes would have brought policy changes such as South Africa's policy changes as suggested by the Katz Commission which resulted in the abolishment of the multiple rebate system and the implementation of the unified primary rebate (Vivian, 2006:93-94; Manuel, 2002:4).
  - Saraiva (2009:2[8]) argued that there are more similarities than differences between South Africa and Brazil's foreign policies. The similarities will result in similar international trading complexities and stumbling blocks which is very relevant to taxation and this study.
- iii. South Africa and Brazil are classified as *Upper middle income* by the World Bank in terms of their income or wealth levels (2011f; 2011h). Many statistical institutions such as the World Bank (2011a) calculate the tax of a country as a percentage of its GDP. With these two countries being classified in the same wealth category it is argued that their tax systems are comparable as the income pools on which taxes are raised are similar as are the survival requirements of them.

### **3.1.1.1 Conclusion**

Based on the similarities and comparability set out in Section 3.1.1, it is concluded that Brazil is a country that has a high level of comparability and accordingly will be used as the developing country in the comparison.

### **3.1.2 DEVELOPED COUNTRY**

Selecting a first world country which is comparable to South Africa is less simple. The fact that clear distinctions are made between developed and developing countries decrease the likelihood of comparability.

Australia was selected as the first world country in the comparison. The reasons for this selection are:

- i. A number of South African tax studies have included comparisons to Australia such as, the 5<sup>th</sup> report of the Katz Commission (1997), Foreign Investment Advisory Service (FAIS) (2006), Taljaard (2008), Alexander Forbes (2011) and Du Toit (2012). These comparison were possible because of the similarities between the two countries' taxing systems. This view has also been taken in this research paper and it is thus argued that Australia is comparable to South Africa.
- ii. Both countries have implemented progressive taxing systems with a tax free threshold (SARS, 2012b:1[2]; pwc, 2011:42). The main purpose of this study is based on the comparison of the tax free threshold or rebates and accordingly this similarity results in relevant comparability.
- iii. South Africa and Australia use to be British Colonies and therefor there are similarities in the legislative, including tax legislation, development of South Africa and Australia.
- iv. Australia is an isolated economy like South Africa. Although South Africa is not the only country on the African continent, it has the strongest economy (World Bank, 2011c). It accordingly does not have the option of countries such as Greece and Spain, to be bailed out by economic counterparts or neighbouring countries.

Fairness of tax is set on principles that are universal regardless of the strength of an economy (Smith, 1776:676-678). These fairness principles, which are also referred to as tax canons, laid down by Smith (676-678) are:

- i. Taxes should be imposed in proportion to an individual's ability to pay tax (Smith, 1776:676).
- ii. The taxes levied on an individual should be definite and not random (Smith, 1776:676).
- iii. Taxes should be collected at the time which is most convenient for the taxpayer (Smith, 1776:677).
- iv. Each tax should be imposed in such a manner that it takes out and keeps out the minimum amount of money from taxpayers' pockets (Smith, 1776:678).



It has been found that the fairness or unfairness of a tax system of a country has far reaching implications on the economy as eluded in Section 2.2.5 of this study. As the primary purpose of this research is to critically analyse and compare the fairness of the primary rebate system in South Africa in relation to other countries, the comparability is possible to the extent that fairness principles are compared.

### **3.2 COMPARISON OF THE FAIRNESS OF PRIMARY REBATES BETWEEN SELECTED COUNTRIES**

A number of matters were identified in chapter 2 which needs to be considered when assessing the fairness of the primary rebate. These matters are:

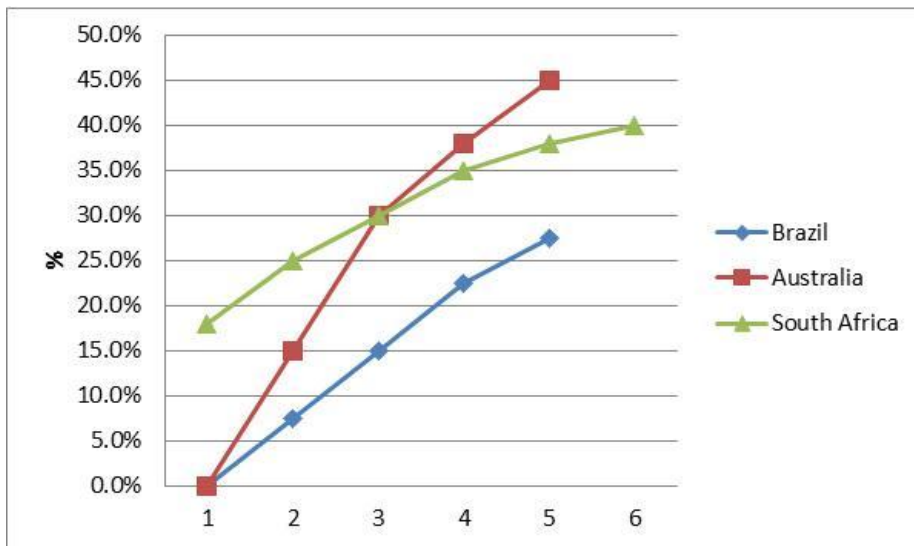
- i. The value or amount of the primary rebate - See Section 2.3.1;
- ii. The dependency ratio and rebates – See Section 2.3.3; and
- iii. The level of social assistance in comparison to GDP of a country – See Section 2.4.

Each of these subject matters have been used in the comparison of the fairness of the primary rebate below.

#### **3.2.1 COMPARISON OF THE VALUE OF THE PRIMARY REBATE BETWEEN SELECTED COUNTRIES**

Both Australia (Australian Tax Office, 2012a) and Brazil (Deloitte, 2012) have tax-free thresholds which function similarly to the primary rebate of South Africa. It however is not referred to as rebates but rather the lowest tax bracket which is taxed at a rate of 0%. Figure 17 below illustrates the income tax sliding scales of all three countries:

**Figure 17: Tax sliding scale percentages**



Source: SARS, 2012b. Australian Tax Office, 2012a. Deloitte, 2012.

Figure 17 also indicate that all three these countries have progressive taxing systems. The main differences between the progressive taxing systems in these countries are:

- i. South Africa has six tax brackets in comparison to the five of Brazil and Australia.
- ii. South Africa does not have a 0% tax bracket whilst both other countries do. The 0% tax bracket of Brazil and Australia has the same implication as the primary rebate of South Africa.
- iii. Australia has the steepest rise in tax rates from one bracket to the next and also has the highest tax percentage in its last tax bracket, being 45%. South Africa's highest tax bracket is 40% whilst Brazil's is 27.5%.
- iv. Brazil consistently has the lowest tax rates in all of the tax brackets except the first where Australia also has a 0% tax rate.

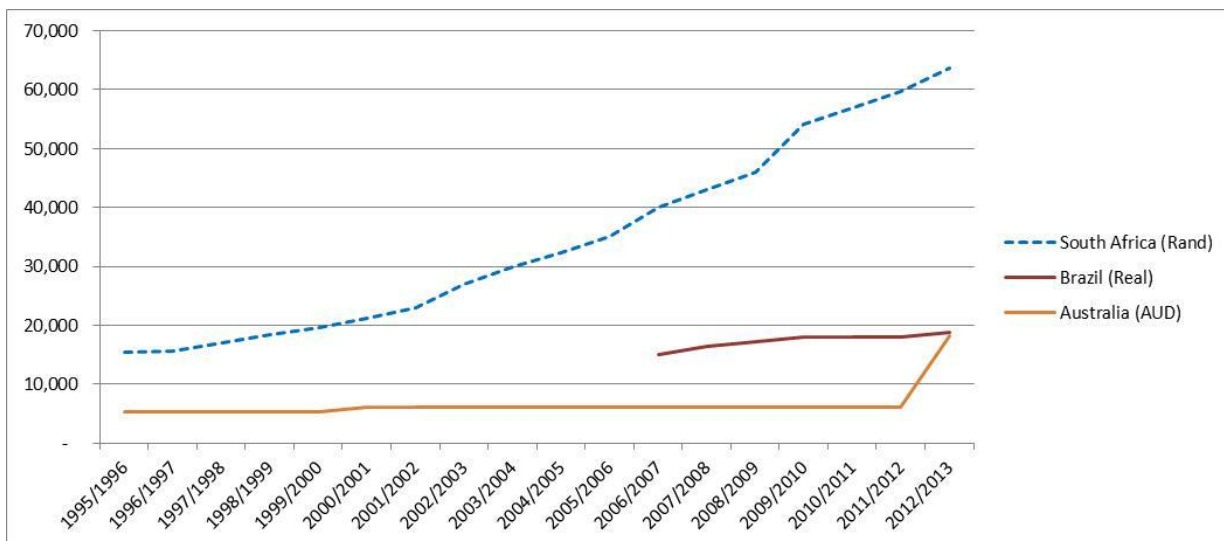
Based on the points above the 0% tax bracket of Australia and Brazil will be used as these countries primary rebate. For the remainder of this study both the 0% tax bracket and the primary rebate will be referred to as the tax-free threshold.

Comparing the quantum/value of different countries' tax-free threshold should be done with caution. It has been established that the purpose of a tax-free threshold is to compensate taxpayers for the necessities-of-life expenses (See Section 2.3 of the present study). The necessities-of-life expenses however will not be exactly the same in every

country, but the quantum can be interpreted with reference to comparable economic indicators such as GDP per capita and employment rates. This approach has been adopted in this study.

Figure 18 depicts the tax-free threshold trends of all three countries over the last 18 years (no information could be obtained for Brazil prior to the 2006/2007 tax year).

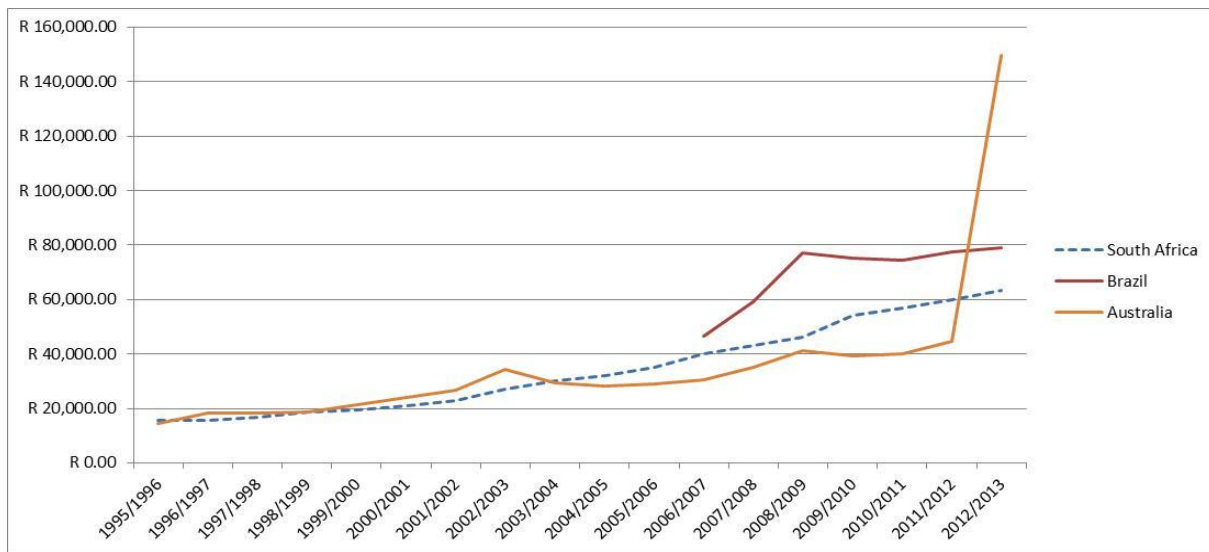
**Figure 18: Tax-free threshold trends in local currency**



Source: Figure 12. Ernst and Young, 2006. KPMG, 2007. Taxrates.cc, 2011. Deloitte, 2012. Australian Tax Office, 2011 and 2012a.

This analysis reflects the trends on localised basis as it reflects the tax-free threshold in the relevant countries' currency. To establish comparability the thresholds were recalculated in South African Rand by multiplying the threshold in the local currency by the average Brazilian Real:ZAR and Australian Dollar:ZAR exchange rates for the years reflected above, as reported by Oanda.com (1996-2012). Figure 19 sets out the recalculated tax-free threshold trends in Rand.

**Figure 19: Tax-free threshold trends in South African Rand**



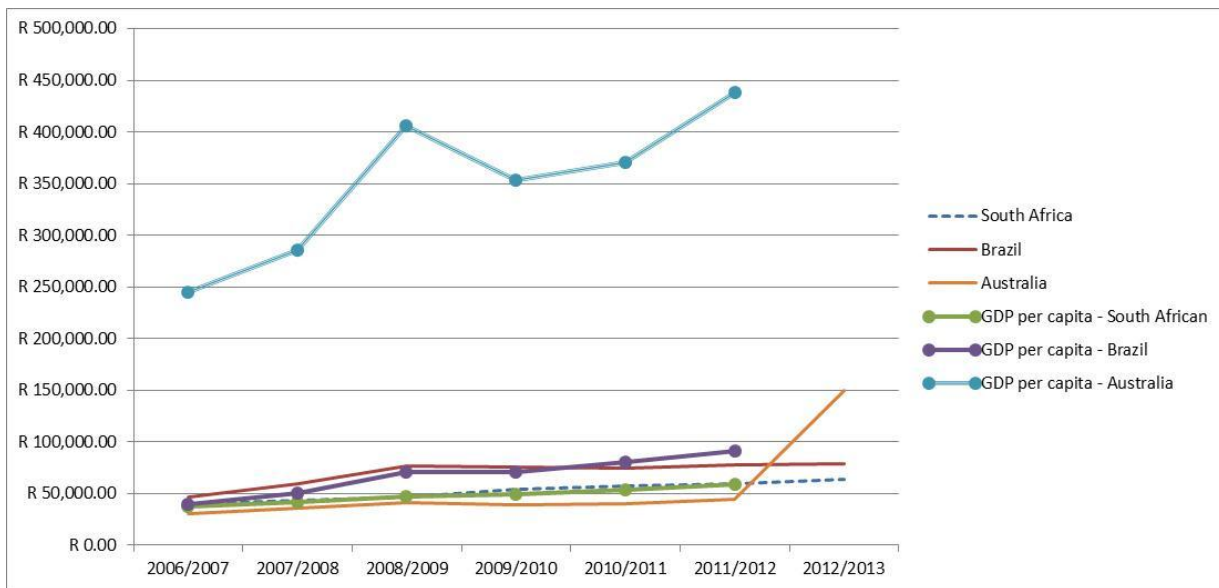
Source: Self calculated using figure 18. Oanda.com, 2012.

From Figure 19 it can be concluded that:

- i. South Africa currently has the lowest tax-free threshold of the three countries.
- ii. The Brazilian, Australian and South African thresholds have all tracked similarly in all material respects over the depicted period except for the tax year 2012/2013 in which Australia significantly increased its tax-free threshold.
- iii. The significant increase in the tax-free threshold of Australia in 2012/2013 was implemented in a drive to realign the taxation liability to only be payable once the necessities-of-life have been paid for (Australian Government Department of Families, Housing, Community Services and Indigenous Affairs, 2012).

Conclusions cannot be made on the quantum of the tax-free thresholds of various countries due to the differences in the costs of surviving in each country. Common grounds thus need to be established. The GDP per capita is an international indicator which calculates the wealth per citizen of a country. This indicator has been combined into Figure 20 using the same graph as in Figure 19 (the data range was reduced to only the last 7 years as information could only be obtained for Brazil for this period. This will result in comparable data being available for all the countries in all the years illustrated).

**Figure 20: Tax-free threshold and GDP per capita trends in South African Rand**



Source: Figure 19 combined with World Bank, 2011g.

From Figure 20 one can conclude that South Africans are the poorest of these countries based on the fact that they have the lowest GDP per capita, with Brazilians second and Australians the wealthiest (World Bank, 2011g). Taking this into consideration, with the fact that South Africa's tax-free threshold is the lowest, gives rise to a double negative hit for its citizens. In other words, South Africans have the lowest ability to pay taxes as they are the poorest, but this fact does not seem to translate to the tax-free threshold which should be higher in countries where the citizens have a lower ability to pay for the necessities-of-life.

### 3.2.2 COMPARISON OF THE DEPENDENCY RATIO AND REBATES OF SELECTED COUNTRIES

As set out in Section 2.3.3 of this study the dependency ratio is the ratio of the individuals that need to be maintained on average by every employed person in a country (Sach *et al.*, 2002:683). It was further concluded in this mentioned section that a higher dependency ratio results in a heavier financial burden on the employed community as these individuals will have to maintain a significant amount of individuals with only 1 income stream. Based on Smith (1776:676) first tax canon principle, countries with a high dependency ratio should have more rebates available as the necessities-of-life expenditure per income

earner will be higher due to the higher amount of individuals that these citizens maintain (refer to Section 2.2.4 and Section 2.3.3 for details on this conclusion).

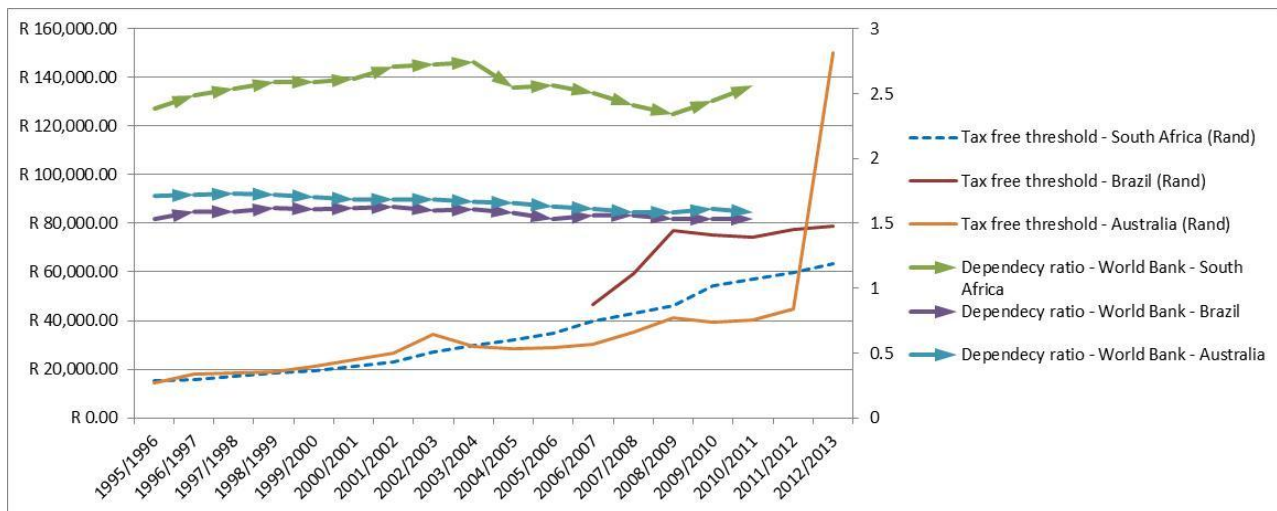
Section 2.3.3 concluded that South Africa has a high dependency ratio due to the low employment rate of its citizens. However, even with a high dependency ratio South Africa has a unified primary rebate system (see Section 2.3.1 of this study). In this section a comparison will be drawn between South Africa, Brazil and Australia's dependency ratio's and the rebates available to citizens which specifically has been implemented to compensate for the additional cost of maintaining dependents.

### **3.2.2.1 *Dependency ratio***

Section 2.3.3 of this study established that there should be a direct relationship between dependency ratio and the tax-free threshold. In other words the higher the unemployment rate, the higher the necessities-of-life expenses per income earner. Using Smith's (1776:676) first tax canon principle it can be concluded that individuals with higher survival expenses should be allowed a more significant tax-free threshold.

The World Bank (2010) does not report on dependency ratio's, but on the percentage of the population with employment (**A**). By dividing **A** into 1 one calculates the dependency ratio. The dependency ratio's for the three countries in this comparison has been calculated using this calculation and is illustrated in Figure 21. It will be noted that the dependency ratio of South Africa differs in Figure 21 in comparison to the values set out in Figure 15. This difference is due to differences in the sources from which the data has been extracted. The information in Figure 15 was obtained from South Africa based sources whilst Figure 21 was obtained from the World Bank data base. It was however decided to recalculate the South African dependency ratio by using the World Bank (2011) statistics to ensure comparability.

**Figure 21: The comparison of the dependency ratio and the tax-free threshold in Rand**



Source: Figure 19. World Bank, 2010.

From Figure 21, it can be seen that Brazil has the lowest dependency ratio, with Australia following closely in second place and South Africa in last place by a significant margin. The average dependency ratio of each of the three countries over the years illustrated is:

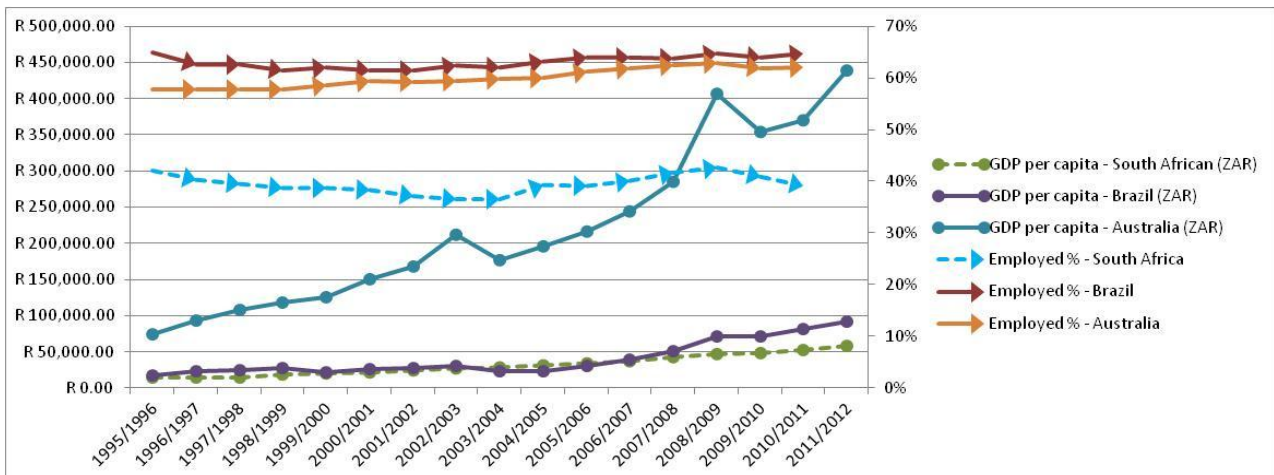
- Australia - 1.66
- Brazil - 1.58
- South Africa - 2.54

On average South Africa’s dependency ratio is thus 61% higher than that of Brazil and 53% higher than that of Australia. With South Africa having the highest dependency ratio by a significant margin it is expected that it would have the highest tax-free threshold as the necessities-of-life expenses per income earner is higher. This however is not the case as Figure 21 illustrates that Brazil had the highest tax-free threshold until 2012/2013 when Australia surpassed it.

Figure 22 depicts the GDP per capita compared to the employed citizen percentage over an 18 year period. The GDP per capita is an statistical value which gives insight into the wealth of citizens of a country.



**Figure 22: GDP per capita in South African Rand and employed citizens' percentage trends**



Source: World Bank, 2010 and 2011g. Oanda.com, 2012.

Figure 22 illustrates that South Africa has the poorest citizens of the three countries in this comparison. Overall South Africa thus has the highest dependency ratio with the poorest citizens. Both of these factors indicates that South Africans have the highest necessities-of-life expenses and accordingly in theory should be enjoying the highest tax-free threshold which is not the case.

### 3.2.2.2 Dependent rebates

In chapter 2 it was established that the current unified South African primary rebate system replaced a number of rebates which was intended to establish adherence to the first tax canon laid down by Smith (1776:676) (See Section 2.3.1 of the current study). Chapter 2 concluded that the current one-size-fits-all primary rebate system does not consider a taxpayer's ability to pay taxes. Researches such as Vivian (2006:106) criticised the post-1994 government for this move and concluded that it created significant unfairness of taxes.

In this section general rebates or similar deductions available to Brazilian and Australian taxpayers who maintain dependents are investigated which reduces taxpayers tax liability in relation to their actual ability to pay tax.



### 3.2.2.2.1 Australia

The words rebate and tax offset are used interchangeably in Australia. The Australian Tax Office (2012b) defines the term as follows: *Tax offsets (sometimes referred to as rebates) directly reduce the amount of tax you must pay. An tax offset or rebate is a tax value which decreases a citizen's tax liability by the value of it. In other words it is not a deduction on income earned to calculate taxable income but rather a deduction on tax calculated.*

The purpose of these offsets is to bring fairness into the tax system by allowing additional tax reductions for individuals with different financial abilities (Australian Tax Office, 2012b). The rebates which are specifically relevant to this research paper are:

- i. Taxpayers with dependents rebates
- ii. Low income earners rebate
- iii. Education Tax Refund or Schoolkids Bonus

These rebates are clarified below:

#### **i. Dependents rebates:**

Australian citizens maintaining a spouse or relative are entitled to this rebate (Australian Tax Office, 2012b). A taxpayer is deemed to have maintained a dependent if any of the following apply:

- The taxpayer and dependent resided in the same house.
- The taxpayer provided food, clothing and housing.
- The taxpayer assisted the dependent in paying for their cost of living, healthcare and education.

This tax offset is divided into two main categories, being (the sub-divisions of each of the offsets have also been set out below):

A. The dependent spouse offset:

1. Dependant spouse;
2. Housekeeper; and
3. Child-housekeeper.

B. The dependent relative offset:

1. Invalid spouse;
2. Carer spouse; and
3. Invalid relative.

Each of the above offsets has been discussed below under its above referenced numbering.

**A.1: The dependent spouse offset** is available to all taxpayers who maintained their spouse during a tax year, as long as both individuals were Australian residents. The definition of spouse includes another person (whether same or opposite sex) who are legally married or if not legally married, lived together in the same house.

Maximum tax offset available:

Australian Dollar (AUD) 2,355 per annum.

Limitations:

- A significant change to the dependent spouse offset came in on 1 July 2011. From this date this offset was only available to taxpayers maintaining spouses who were born on or before 1 July 1971 (in other words, spouses 40 years and older).
- This offset is not available to taxpayers with a taxable income exceeding AUD150,000 for the 2011-2012 tax year. This offset is thus not intended for the very wealthy.
- The offset is not available where the spouse's taxable income exceed AUD9,702 for the 2011-2012 tax year.

Conclusion:

This offset adheres to the ability to pay tax principle as it recognises that taxpayers maintaining a spouse have a lower ability to pay taxes than those taxpayers who do not.

The 1 July 2011 limitation however restricts this horizontal fairness to taxpayers with spouses that were born on or before 1 July 1971.

It further seems to be focussed only on the taxpayers who are not very wealthy as it is only available to those who earn less than AUD150,000 of taxable income in a year. This is also an indication that it adheres to the first tax canon principle.

**A.2:** The **housekeeper offset** is available to taxpayers who have a full time housekeeper who cared for his/her dependent child, student (less than 21 years old), invalid relative or invalid spouse.

Maximum tax offset available:

- AUD1,919 per annum - Where the taxpayer has no other dependent children.
- AUD2,299 per annum - Where the taxpayer has other dependent children.

Limitations:

- This offset is not available to taxpayers with a taxable income (this taxable income calculation includes that off the taxpayer's spouse, if applicable) exceeding AUD150,000 for the 2011-2012 tax year. This offset is thus not intended for the wealthy.

Conclusion:

This offset adheres to the ability to pay tax principle as it recognises that taxpayers with a housekeeper have a lower ability to pay taxes than those taxpayers who do not as these taxpayers pay some form of remuneration to such a housekeeper.

It further seems to be focussed only on the taxpayers who are not very wealthy as it is only available to those who earn less than AUD150,000 of taxable income in a year. This is also an indication that it adheres to the first tax canon principle.

**A.3:** The **child-housekeeper offset** is available to taxpayers whose child kept house for him/her on a full time basis.

Maximum annual tax offset available:

- AUD1,919 - Where the taxpayer has no other dependent children.
- AUD2,299 - Where the taxpayer has other dependent children.

Limitations:

- This offset is not available to taxpayers with a taxable income exceeding AUD150,000 for the 2011-2012 tax year. This offset is thus not intended for the very wealthy.
- The offset is not available where the spouse's taxable income exceed AUD9,702 for the 2011-2012 tax year.

Conclusion:

This offset adheres to the ability to pay tax principle as it recognises that those taxpayers who use their child as a full time housekeeper have a lower ability to pay taxes than those taxpayers who do not as these taxpayers necessities-of-life expenses will increase due to the additional expenses of maintaining this child as he/she does not earn any income.

It further seems to be focussed only on the taxpayers who are not very wealthy as it is only available to those who earn less than AUD150,000 of taxable income in a year. This is also an indication that it adheres to the first tax canon principle.

**B.1: The invalid spouse offset** is a rebate available to taxpayers who maintain a spouse who is or was disabled and is unable to work.

Maximum tax offset available:

- AUD2,355 per annum.

Limitations:

- This offset is not available to taxpayers with a taxable income exceeding AUD150,000 for the 2011-2012 tax year. This offset is thus not intended for the very wealthy.
- The offset is not available where the spouse's taxable income exceed AUD9,702 for the 2011-2012 tax year.

### Conclusion:

This offset adheres to the ability to pay tax principle as it acknowledges that a taxpayers with disabled or medically boarded spouse have a lower ability to pay taxes than a taxpayer without such a spouse as these taxpayers only have the ability to earn one income stream and have higher necessities-of-life expenses due to the additional maintenance and medical expenses.

This is validated by the fact that it is not available in the event where the invalid spouse earns more than AUD9,702 for the 2011-2012 year. The government is thus of the opinion that this additional income is sufficient for the household to pay for the additional maintenance and medical expenses.

**B.2: The carer spouse offset** is a rebate available to a taxpayer's whose spouse is taking care on a full time basis for a disabled or medically boarded relative of the spouse or taxpayer.

### Maximum tax offset available:

- AUD2,355 per annum.

### Limitations:

- This offset is not available to taxpayers with a taxable income (this taxable income calculation includes that off the taxpayer's spouse, if applicable) exceeding AUD150,000 for the 2011-2012 tax year. This is offset is thus not intended for the very wealthy.
- The offset is not available where:
  - the invalid relative's taxable income exceed AUD3,738 for the 2011-2012 tax year; or
  - the invalid parent of the taxpayer or spouse taxable income exceed AUD7,186 for the 2011-2012 tax year.

### Conclusion:

This offset adheres to the ability to pay tax principle as it accepts that a taxpayer maintaining a disabled relative have a lower ability to pay taxes than a taxpayer without

such a relative. This lower ability is mainly due to an increase in maintenance and medical expenses.

This is validated by the fact that it is not available in the event where the invalid relative earns more than the amounts set out in the limitations above. The government is thus of the opinion that such additional income is sufficient to pay for the additional maintenance and medical expenses.

**B.3:** The **invalid relative offset** is a rebate available to a taxpayer's who is maintaining his/her child, parent, brother or sister or that of his/her spouse, who is older than 16 years and is disabled or medically boarded.

Maximum tax offset available:

- AUD1,726 per annum - For each parent.
- AUD864 per annum -For each invalid relative.

Limitations:

- This offset is not available to taxpayers with a taxable income (this taxable income calculation includes that off the taxpayer's spouse, if applicable) exceeding AUD150,000 for the 2011-2012 tax year. This is offset is thus not intended for the very wealthy.
- The offset is not available where:
  - the invalid relative's taxable income exceed AUD3,738 for the 2011-2012 tax year; or
  - the invalid parent of the taxpayer or spouse taxable income exceed AUD7,186 for the 2011-2012 tax year.

Conclusion:

This offset also adheres to the ability to pay tax principle as it recognises the decrease in a taxpayer's ability to pay tax as a result of the increase in maintenance and medical expenses.

This is validated by the fact that it is not available in the event where the invalid relative earns more than the amounts set out in the limitations above. The government is thus of

the opinion that such additional income is sufficient to pay for the additional maintenance and medical expenses.

ii. **Low income earner tax offset (Australian Tax Office, 2012b):**

This rebate is available to low income earners only. It is intended to reduce a taxpayer's tax liability as low income earners have a lower ability to pay tax.

Maximum tax offset available:

AUD1,500 per annum.

Limitations:

This offset reduces gradually from AUD1,500 to AUD0 between a taxable income of AUD30,000 and AUD67,500.

Conclusion:

This rebate adheres to the ability to pay tax principle as it considers a taxpayer's ability to pay tax and is only available to those lower income earners who have a lessened ability.

What is more unique about this rebate is its gradual decrease to AUD0 with the increase in a taxpayer's earnings.

iii. **Family tax benefit (FTB) Part A and Part B (Australian Tax Office, 2012b Australia Government Department of Human Services, 2012a):**

The FTB is a payment that is meant to assist citizens in covering the cost of raising children (Australia Government Department of Human Services, 2012a). This benefit is paid out to citizens who are eligible. The benefit of a pay-out method is that a citizen will still receive income in cases where he/she has no taxable income. A tax offset/rebate on the other hand is always limited to zero where a taxpayer has no taxable income.

The benefit is split in two categories, namely FTB: Part A and FTB: Part B. Both these categories are discussed below.

### FTB: Part A: A studying dependent child

This benefit is paid for each child. The value of the benefit is dependent on each family's circumstance.

Citizens may be eligible if he/she has:

- has a dependent child under 16 years of age; or
- a dependent child aged of 16 to 20 who is studying full-time; or
- a dependent full-time student aged of 21 to 24.

### Maximum benefit available:

This benefit is paid out fortnightly and not annually. The maximum benefit value differs depending on a family's income, the amount of children and how old the children are.

However from a high level the maximum benefit ranges between AUD54.32 and AUD169.68 per fortnight per family.

### Limitations:

- Child income: A family will no longer be eligible for this FTB: Part A if the child earns AUD13,775 or more in a year and is:
  - Aged 5 to 15 and not studying on a full-time basis; or
  - Aged 16 to 19 and not in full-time secondary study; or
  - Aged over 19.
- Parent income level: This benefit reduces gradually from the maximum benefit to AUD0 between a family's earning taxable income between AUD47,815 and AUD94,316 (this maximum is increased by an amount of AUD3,796 for each additional child over and above the first child).

### Conclusion:

This benefit adheres to the ability to pay tax principle as it considers a taxpayers ability to pay tax and compensate him/her for child maintenance necessities.



South Africa has a similar child support grant system (refer to figure 17), but what makes the Australian system superior is the fact that the calculation of this benefit is ultimately driven from citizens' tax return and the fact that the maximum benefit (AUD169.32 every 14 days which amounts to AUD362 in a 30 day month. This translates to approximately R2,900 assuming a 8:1 AUD:ZAR exchange rate) is almost 10 times more than the maximum child support grant of South Africa, which amount to R280 per month per child (South Africa Government Services, 2012).

*FTB: Part B: A dependent child in a household with one income stream*

The purpose of this benefit is to assist single parents or families with a single income stream to compensate for the cost of raising children.

Citizens may be eligible if he/she:

- has a dependent child of no older than 16 years; or
- has a full time secondary student of no older than 18 years.

Maximum benefit available:

This benefit is paid out fortnightly and not annually. The maximum benefit value differs depending on the age of the citizen's youngest child. The maximum 2012-2013 annual benefit per family amounts to:

- Youngest child younger than 5 years old = AUD4,117.20 per annum
- Youngest child between 5 and 18 years old = AUD2,978.40 per annum

Limitations:

This offset is not available to taxpayers with a taxable income exceeding AUD150,000 for the 2011-2012 tax year. This is offset is thus not intended for the very wealthy.

Conclusion:

This benefit adheres to the ability to pay tax principle as it recognises that citizens with children have a lower ability to pay taxes than those taxpayers who have no children. It further is only focussed on the citizens who are not very wealthy as it is only available to

those who earn less than AUD150,000 of taxable income in a year. This is also an indication that it adheres to the first tax canon principle.

Other family benefits:

A number of other benefits are available to compensate for additional expenses of dependent children. These have been listed below (the maximum benefit/rebate available for the 2011-2012 has been set out below next to each):

- Baby Bonus = AUD5,000 per annum per eligible baby
- Child Care Benefit = AUD195 per week per eligible child
- Child Care Rebate = AUD7,500 per annum per eligible child
- Double Orphan Pension = AUD57.20 per fortnight
- Parental Leave Pay = 18 weeks of government-funded Parental Leave Pay
- Parenting Payment = AUD 648.50 per fortnight
- Rent Assistance = AUD121 per fortnight with no children  
= AUD160.44 per fortnight with children
- Teen Dental = AUD163.05 per annum per family

**iv. Education Tax Refund (ETR) or Schoolkids Bonus (Australian Tax Office, 2012; Australia Government Department of Human Services, 2012b):**

The Schoolkids Bonus system replaced the ETR from the 2012-2013 tax year. The ETR however was phased out by the end of the 2010-2011 tax year. Some transitional arrangements were available for the 2011-2012 tax period but this paper will only cover the current rebate (i.e. the Schoolkids Bonus).

The Schoolkids Bonus is intended to reduce a taxpayers' tax liability to compensate for the payments made by him/her towards primary and secondary education for his/her children. This bonus is a benefit which is paid out to eligible citizens who are incurring educational expenses.

Maximum tax benefit available:

- AUD410 per annum per child in primary education.

- AUD820 per annum per child in secondary education.

Limitations:

- Only parents or caretakers who receive a FTB: Part A for a dependent child who is less than 18 years of age and in primary or secondary education on a full-time basis qualifies for this bonus scheme.
- Students between the age of 16 and 18, in full-time secondary education, are also eligible to receive this benefit.

Conclusion:

This benefit adheres to the ability to pay tax principle as it recognises that citizens who pay for the children's education have a lower ability to pay taxes than those taxpayers who do not have such expenses.

### **3.2.2.2 Brazil**

The Brazilian tax system is a far less evolved system with regards to taxation rebates/deductions than that of Australia. This tax system operates similar to the South Africa system. Instead of rebates, such as that of Australia, Brazilian taxpayers have certain allowed deductions/allowances which reduce a person's taxable income and ultimately his/her tax liability.

These deductions were reviewed and the following deductions have been extracted as they are of relevance to this paper (Deloitte, 2012:3):

- i. The dependent allowance
- ii. Educational expense allowance
- iii. Alimony and child support deduction
- iv. The standard annual deduction

To simplify the deduction process two methods have been established namely the verde (green) method and azul (blue) method. Under the green method taxpayers only have one overall standard deduction (nr. iv of the deductions listed above). This is referred to as the

standard annual deduction (Deloitte, 2012:3; Brazil-help.com, 2012). On the contrary to this the blue method gives taxpayers the ability to claim specific allowed expenses (nrs. i, ii and iii of the deductions listed above).

The two methods are mutually excluded and accordingly a taxpayer may only select one of the methods. It is however his/her prerogative to choose the most beneficial method (Deloitte, 2012:3; Brazil-help.com, 2012).

Each of the allowances/deductions which are relevant to this paper has been discussed briefly below:

**i. Dependent allowance (Deloitte, 2012:3):**

This allowance is available to Brazilian citizens who maintained a person during the tax year. Its purpose is to compensate the taxpayer for the additional expenses incurred for such maintenance.

**Blue or green method allowance:**

This deduction forms part of the blue/itemised method. Where a taxpayer selects this method, he/she forfeits the right to the standard annual deduction which is set out below.

**Maximum annual deduction available:**

Brazilian Real (BRL) 144 per month per dependent.

**Limitations:**

- A taxpayer is eligible for this deduction if he/she maintains a dependent. There are no other limitations to this deduction.
- All the taxable income of a dependent must be included in the taxpayer's taxable income where a taxpayer claimed this allowance and a dependent earned taxable income.

**Conclusion:**

Even though this deduction is not packaged as a rebate it still adheres to the ability to pay principle as it considers each taxpayer's financial ability by allowing a deduction to the

extent the taxpayer has dependents. The increase in the necessities-of-life expenses matches the increase in this allowance. If a taxpayer for instance maintained 10 people during the year he/she will be eligible to 10 times the dependent allowance.

**ii. Educational expenses allowance (Deloitte, 2012:3):**

This allowance is available to Brazilian citizens who paid for educational expenses during a tax year. Its purpose is to compensate the taxpayer for the additional expenses incurred for such education.

Blue or green method allowance:

This deduction forms part of the blue/itemised method. Where a taxpayer selects this method, he/she forfeits the right to the standard annual deduction which is set out below.

Maximum annual deduction available:

BRL2,708 per annum per eligible student/pupil.

Limitations:

- The allowance is only available to a taxpayer to the extent which he/she has paid for other citizens' educational expenses in the year.
- Education includes all education from kindergarten to doctorate (v-brazil.com, 2012).
- Where the education expenses for year is less than the maximum allowable deduction, the deduction is limited to the actual expenses incurred.

Conclusion:

This allowance adheres to the ability to pay principle as it considers a taxpayer's financial ability by allowing a deduction to the extent the taxpayer has incurred educational expenses. The increase in the necessities-of-life expenses matches the increase in this allowance. If a taxpayer for instance pays the education expenses of 10 people during the year he/she will be eligible to 10 times the educational expense allowance.

### **iii. Alimony and child support deduction (Deloitte, 2012:3):**

This deduction is available to Brazilian citizens who paid alimony or child support under a court order during a tax year. Its purpose is to compensate the taxpayer for the additional expenses incurred for such maintenance.

#### **Blue or green method allowance:**

This deduction forms part of the blue/itemised method. Where a taxpayer selects this method, he/she forfeits the right to the standard annual deduction which is set out below.

#### **Maximum annual deduction available:**

The alimony deduction is unlimited (www.brazilirs.com, 2012). However note that the alimony payment is taxable in the hands of the receiver.

#### **Limitations:**

There is no limitation as long as the alimony is paid under court order.

#### **Conclusion:**

This deduction adheres to the ability to pay principle as it considers each taxpayer's financial ability by allowing a deduction to the extent the taxpayer pays alimony. The increase in the necessities-of-life expenses matches the increase in this deduction.

### **iv. Standard annual deduction (Deloitte, 2012:3):**

A taxpayer may opt to deduct a standard annual deduction instead of itemised or specific deductions.

#### **Blue or green method allowance:**

This deduction forms part of the green/itemised method. Where a taxpayer selects this method, he/she forfeits the right to all itemised deductions which includes the dependent, educational expense and alimony deductions set out above.

#### **Maximum annual deduction available:**

20% of taxable income to a maximum of BRL12,743

### Limitations:

- This deduction is limited to BRL12,743 for the 2012-2013 tax year.
- This method is only advisable to those taxpayers whose consolidated itemised deductions do not exceed this deduction.

### Conclusion:

This deduction does not adhere to the ability to pay tax principle as it only allows a deduction of 20% of the taxable income. This will create horizontal unfairness in for instance a case where there is one household with only one employed person and no dependents or spouse versus another household also with one employed person but also with 4 children and 1 spouse.

Both households will only be entitled to a 20% of taxable income deduction under this method. It is obvious that the household with 6 individuals will have a higher necessities-of-life expense than the household with only 1 individual. This deduction however does not reflect this.

But as the Brazilian tax system gives the taxpayer the option to select the green or blue method, this unfairness can be circumvented, because as we can assume that the necessities-of-life expenses are higher in the household of 6, we can make the same assumption that this household will select the blue (itemised) method as it will be more beneficial to them.

### **3.2.2.2.3 Comparison summary**

Table 4 summarises the rebates and offsets discussed in sections 3.3.2.2.1 and 3.3.2.2.2 above.

**Table 4: Adherence of the discussed rebate, deductions and benefits to the first tax canon**

Country	Reference / Description	Rebate/ Offset	Benefit/ Pay-out	Tax Deduction	Maximum benefit <i>* The limitations set out above under each of the matters are important to consider in line with these benefits.</i> <i>** Also note that these values are specific to the tax years set out under each benefit above.</i>	Adheres to the first tax canon
Australia	The dependent spouse offset	✓			1. AUD2,355 per annum	✓
	The housekeeper offset	✓			1. No children - AUD1,919 per annum 2. Children - AUD2,299 per annum	✓
	The child-housekeeper offset	✓			1. No children - AUD1,919 per annum 2. Children - AUD2,299 per annum	✓
	The invalid spouse offset	✓			1. AUD2,355 per annum	✓
	The carer spouse offset	✓			1. AUD2,355 per annum	✓
	The invalid relative offset	✓			1. Parent - AUD1,726 per annum per parent 2. Relative - AUD864 per annum per relative	✓
	Low income earner tax offset	✓			1. AUD1,500 per annum	✓
	Family tax benefit (FTB) Part A		✓		1. AUD169.68 per fortnight per family	✓
	Family tax benefit (FTB) Part B			✓	1. Youngest child < 5 years - AUD4,117.20 per annum per family 2. Youngest child between 5 and 18 years - AUD2,978.40 per annum per family	✓
	Schoolkids Bonus			✓	1. Primary education - AUD410 per annum per child 2. Secondary education - AUD820 per annum per child	✓
Brazil	The dependent allowance			✓	1. BRL144 per month per dependent	✓
	Educational expenses allowance			✓	1. BRL2,708 per annum month per student/pupil	✓
	Alimony and child support allowance			✓	1. Unlimited to the extent that alimony has been paid	✓
	Standard annual deduction			✓	1. BRL12,743 per annum	✗

Source: Self compiled from information set in section 3.3.3.1 and 3.3.3.2 above.



### **3.2.2.3 Conclusion on the dependency ratio and rebates in relation to the tax-free threshold**

South Africa compares poorly to Australia and Brazil with regards to the basis on which the tax-free threshold is based. From the comparison it is possible to conclude that South Africa tax-free threshold is the least fair and the most complex of the three countries as:

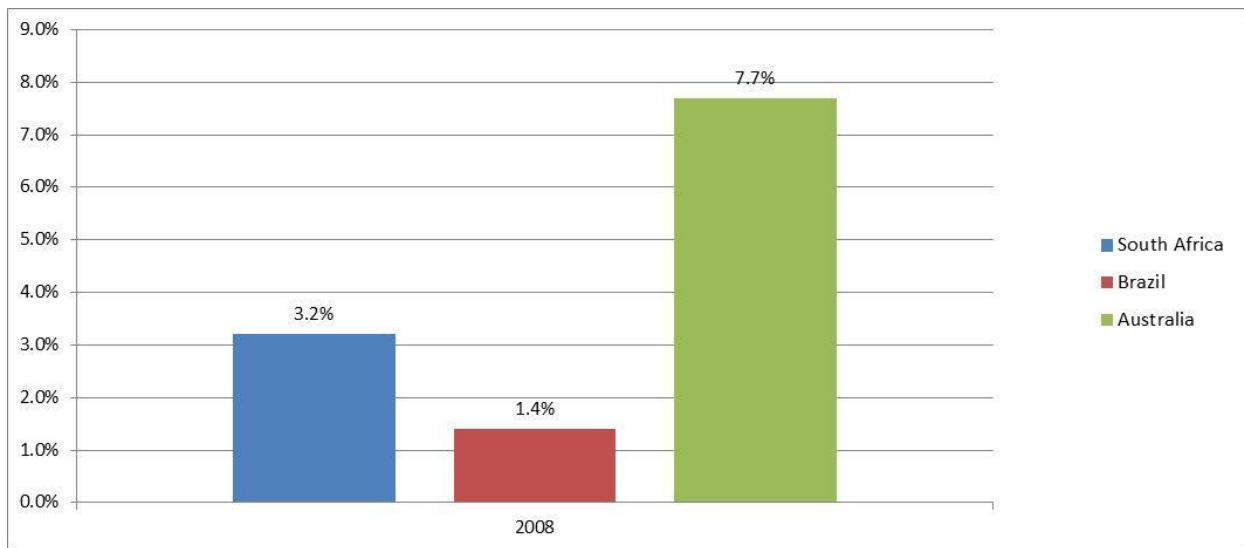
- i. South Africans are the poorest of all three countries with the highest dependency ratio. In such a scenario it is expected that South Africa has the highest tax-free threshold, but it actually has the lowest; and
- ii. Both Australia and Brazil have a number of rebates, benefits and/or deductions which establishes Smith's (1776:676) first tax canon fairness by decreasing taxpayer's (with lower financial abilities or higher necessities-of-life expenses') tax liability. Considering this in light of South Africa which only has a primary rebate available to the general taxpayer and is supposed to cover all the items reflected in table 12, one can only conclude that South Africa's unfairness created by the primary rebate system is uncommon, illogical and unhealthy.

### **3.2.3 COMPARISON OF THE SOCIAL GRANTS BETWEEN SELECTED COUNTRIES**

In Section 2.4 it was established that a social grant system, also known as a social assistance system, can compensate or even substitute Smith's (1776:676) first tax canon principle as the purpose of social grants is to redistribute funds to those individual's with survival needs which they themselves cannot fund (South African Government Services, Not dated).

The extent of a country's social assistance programs must thus be considered together with the tax-free threshold value to establish the fairness of it in relation to Smith's (1776:676) first tax canon. Figure 23 illustrates the social grants as a percentage of GDP of the countries compared.

**Figure 23: Social grants as a percentage of GDP as reported in 2008**



Source: World Social Security Report, 2011:75. Australian Bureau of Statistics, 2012.

The high level of social grants in Australia together with the value of the tax-free threshold, the low dependency ratio and high level of dependents rebates indicates that Australia has the fairest tax rebate system in relation to the first tax canon of Smith (1776:676) of the countries compared for purposes of this study.

South Africa's significantly higher social grant percentage to that of Brazil indicates that there may be corrections in the unfairness's identified in Section 3.3.1 and Section 3.3.2 due to the fact that necessities-of-life expenses are funded by grants instead of tax-free thresholds and dependent rebates.

To quantify the possible correction the grant per citizen was calculated and is depicted in Table 5.

**Table 5: Average annual social grant per South African and Brazilian citizen**

Country	Social grants as a percentage of GDP (2008)	GDP (2008)	Calculated social grants (2008)	Population size (2008)	Average annual grant per citizen (2008)
	<b>A</b>	<b>B</b>	<b>A x B = C</b>	<b>D</b>	<b>C/D</b>
South Africa	3.2%	273,870,092,686	8,763,842,966	48,793,022	179.61
Brazil	1.4%	1,652,817,559,097	23,139,445,827	191,543,237	120.81

Source: Figure 23. World Bank, 2011b and 2011c.

Table 5 indicates that there is a correction of the unfairness's of the South African primary rebate system as established in Section 3.3.1 and Section 3.3.2. The correction however is insignificant as South Africa's average grant per citizen is only \$58.80 higher per annum to that of Brazil. This minor correction is not sufficient to compensate for the unfairness's identified in Section 3.3.1 and Section 3.3.2.

### **3.3 CONCLUSION**

In this chapter a comparison was done between South Africa, Brazil and Australia on their tax-free thresholds, dependency ratios, dependent rebates and finally on the social grants available in these countries. This comparison has been done to meet the primary purpose of this study, which is to critically analyse and compare the fairness of the primary rebates in South Africa in relation to other countries.

Based on these comparisons it is possible to conclude that the unfairness of the unified South African primary rebate system is not present in Australia and Brazil. It was found that:

- South Africans are the poorest of the three countries compared as their GDP per capita value is the lowest. South Africans thus have the lowest ability to pay taxes.
- Australia and Brazil have higher tax-free thresholds than South Africa.
- Australia and Brazil have a lower dependency ratio than South Africa and accordingly have a lower necessities-of-life expense level per income earner.
- Australia and Brazil have various rebates and deductions which are intended to reduce a taxpayers who sustains dependents' tax liability whilst South Africa has none.
- Australia has a higher social grant percentage to GDP than South Africa, whilst Brazil's social grants percentage is the lowest. It was however concluded that South Africa only has an average of \$58.80 per citizen per annum higher grant than that of Brazil which is argued to be insufficient to compensate for the gap in fairness between South Africa's unified primary rebate system and that of Brazil.

## CHAPTER 4

### CONCLUSION

#### 4.1 INTRODUCTION

The main purpose of this study was to critically analyse and compare the fairness of the primary rebates of South Africa in relation to other countries, whilst the secondary purposes were:

- To clarify the theoretical constructs underpinning the fairness of primary rebates.
- To critically analyse the fairness of primary rebates from a South African viewpoint.
- To compare the primary rebates of South Africa in relation to other countries.

In Chapter 2 a detailed literature review has been set out with regards to the fairness principles which underpin the primary rebate together with a detailed analysis of the South African primary rebate and its history. A comparison of the principles identified in Chapter 2 has been conducted in Chapter 3 between South Africa, Brazil and Australia to conclude on the fairness of the South African primary rebate in relation to these countries.

#### 4.2 SUMMARY OF FINDINGS AND CONCLUSIONS

The fairness of taxation is principle based. These principles were well documented by Smith (1776:676-678) as follows (See Section 3.1.2):

- i. Taxes should be imposed in proportion to an individual's ability to pay tax (Smith, 1776:676).
- ii. The taxes levied on an individual should be definite and not random (Smith, 1776:676).
- iii. Taxes should be collected at the time which is most convenient for the taxpayer (Smith, 1776:677).
- iv. Each tax should be imposed in such a manner that it takes out and keeps out the minimum amount of money from taxpayers' pockets (Smith, 1776:678).

The primary rebate principle is based on the first tax principle set out above, also referred to as the first tax canon of Smith which determines that a taxpayer should only pay tax in proportion to his ability to pay it. The primary rebate thus reduces a taxpayer's tax liability to compensate for the necessities-of-life expenditure required to survive.

South Africa however changed from a multiple rebate system to a unified rebate system post-1994 based on the recommendations of the Katz Commission (Manual, 2002:2). This unified rebate system does not adhere to the first tax canon of Smith (1776:676) as it disregards the increase in an individual's necessities-of-life expenses due to dependents which he/she maintain. This disregard has significant impacts on South Africans due to the country's high dependency ratio, which has averaged at 1 income earner to every 3.85 people. This elevated dependency ratio is created by the high unemployment rate of South Africa. South African taxpayers thus have a high necessities-of-life expense level due to the financial burden placed by dependents with no income. These taxpayers however have no tax dependent rebates available to compensate for the decrease in their financial ability.

A substantial financial assistance program has however been implemented in South Africa which provides funding to those individuals who have dependents and have little or no ability to maintain them, but this program is not sufficient to compensate for unfairness created by the unified primary rebate system.

The comparison of the primary rebate or tax-free threshold, the dependency ratios, the dependent rebates and the social grant programs implemented in South Africa, Brazil and Australia yielded the following main findings:

- South Africans are the poorest of the three countries compared as their GDP per capita value is the lowest. South Africans thus have the lowest ability to pay taxes.
- Australia and Brazil have higher tax-free thresholds than South Africa.
- Australia and Brazil have a lower dependency ratio than South Africa and accordingly have a lower necessities-of-life expense level per income earner.
- Australia and Brazil have various rebates and deductions which are intended to reduce a taxpayers who sustains dependents' tax liability whilst South Africa has none.

- Australia has a higher social grant percentage to GDP than South Africa, whilst Brazil's social grants percentage is the lowest. It was however concluded that South Africa only has an average of \$58.80 per citizen per annum higher grant than that of Brazil which is argued to be insufficient to compensate for the gap in fairness between South Africa's unified primary rebate system and that of Brazil.

It is thus concluded that South Africa's unified primary rebate system creates significant unfairness's due its non-adherence to the first tax canon of Smith (1776:676) and the social grant program does not compensate for these unfairness's. The South African unified primary rebate system also compares poorly on an international basis. The unfairness perceptions highlighted by Oberholzer (2006) is thus valid and the risks of non-compliance identified by identified by Torgler (2002:1251) and Davidson (2005:3-7), as set out in Section 2.2.5, to this study very real.

#### **4.3 SUMMARY OF CONTRIBUTIONS OF STUDY**

The study has contributed to the field of fairness of taxation specifically with regards to the primary rebate system implemented in South Africa.

#### **4.4 LIMITATION OF THE PRESENT STUDY**

Critical reflection of the present study has exposed some limitations which could be supplemented and improved by future research as set out in Section 4.5

#### **4.5 FUTURE RESEARCH**

This study has pointed out that future research can be conducted the types of dependency rebates required in South Africa, the methods of administration of such rebates and the legislation required to regulate it.

## 4.6 CONCLUDING REMARKS

We find ourselves in a fast paced, ever changing world, where every technology company is trying to come up with the next best TV, computer or cellphone. More and more data is being shared, free of charge over various forms of telecommunication channels, such as the internet, blogs, Facebook, Twitter and so forth.

These changes do however not impact sound principles based on logic, such as the first tax canon of Smith (1776:676). Logical principles do not date, they are merely misinterpreted. The unfairness which is created by the unified primary rebate premise in South Africa is placing strain on an already fragile economy where the tax burden is high and employment is low.

Government should accept that the extent of the gap between the rebate system and the first tax canon in South Africa is unique from an international perspective. Even worse than this, the gap between the primary rebate and survival expenses is increasing.

We all should embrace change, but that does not mean that we should not retain sound taxation principles which have been proven effective over centuries and millenniums. Evolution can only take place where we learn from mistake and put in measures not to make it again. It is time Government reconsiders their decision to abolish the multiple rebate system and considers following the international trends.

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