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Chapter 1

A background for wealth tax in South Africa

1.1 Background

Treasury is investigating many sources to fund the deficit in the country's budget. Most recently, we saw an increase in the VAT rate.¹ Another avenue being explored is the introduction of a possible wealth tax. A wealth tax is a tax levied on personal capital and forms the main focus of this mini-dissertation. Currently, the transfer of wealth is taxed by capital gains tax, estate duty or donations tax.² The wealth tax discussed in this dissertation differs in that a transfer or disposal does not trigger it.

The idea of a wealth tax in South Africa, although it has been called many other names, is a notion that has been contentious since attaining democracy in 1994. Holistically, one cannot sever its political and emotional roots from its legal and economic components.³ The primary reasoning for a wealth tax lies in the vastness of South Africa's inequality. Looking at South Africa's Gini coefficient, which is a statistical tool used to depict the disparity in earnings/wealth between a country's residents,⁴ South Africa ranks very high in comparison to other countries.⁵ An economist⁶ advances the argument that the capitalistic economic system that Apartheid⁷ left behind is maintaining the inequality problem. We are therefore faced with a dilemma: is the South African economy in a

¹ SARS 'Types of Tax: Value Added Tax' <http://www.sars.gov.za/TaxTypes/VAT/Pages/default.aspx> accessed 24 March 2018.

² E Muller 'A framework for wealth transfer taxation in South Africa' unpublished thesis 2010 124.

³ K Lefko-Everett 'New wealth tax?' (2011) <https://bit.ly/2P9PyYo> accessed 20 October 2018.

⁴ C Gini 'Concentration and dependency ratios' (1909) (in Italian) English translation in *Rivista di Politica Economica*, 87 (1997) 769–789.

⁵ T Claassens 'Financial Inequality in South Africa Have Government's policies failed? Are we better off than 15 years ago?:marker perspective' 2009 17 *Civil Engineering* 47.

⁶ Piketty *Capital in the Twentieth Century* 2003.

⁷ An institutionalised discriminatory regime of racial exclusion that lasted from 1948 to 1994. The majority of Apartheid legislation was codified in the Population Registration Act of 1950. In terms of this Act, each inhabitant of South Africa had to be classified and registered according to their racial characteristics. Social rights, political rights, educational opportunities, and economic status were largely determined by the group to which an individual belonged.

position to self-correct and progress on its own? Alternatively, is state involvement necessary, and if so, how and to what extent?⁸

During the Truth and Reconciliation Commission's hearings in the 1990s, when Archbishop Tutu voiced the imposition of a once-off wealth levy, it was purported only to apply to White South Africans.⁹ This levy would then have served as a kind of reparation for the damage caused during the Apartheid era.¹⁰ This call never realised, but the notion did not cease to exist.

In 2011, Tutu again repeated his original statement. However, the more recently discussed wealth tax was considered as a revenue-raising tool for the fiscus. This tax gives the impression of being more economically driven, not acting as damages which is compensatory in nature, but as a contribution (in a taxation sense). Whereas the wealth levy would have been payable directly to the victims of Apartheid, the wealth tax would be utilised by the government in financing public expenditure. Although the wealth tax as discussed in 2018 looks entirely different from the levy discussed in the '90s, its parallelism cannot be diminished. This history becomes relevant when considering the purpose of this tax and who should be liable for the payment thereof. Are only Apartheid beneficiaries liable? Alternatively, will some victims also be considered? Is it only natural persons who are liable or can the tax be extended to include companies and trusts?

In 1997 Terreblanche¹¹ testified before the Truth and Reconciliation Commission's (TRC) hearings on the role of business and labour under apartheid, where he suggested the imposition of a wealth tax. He suggested that the proceeds could be used to set up a reparation fund to help reduce the most severe poverty in South Africa. The proposal evoked strong objection. Ann Bernstein from Anglo American contended: "Corporations are not institutions for moral purposes... They are not institutions designed to promote some or other form of morality in the world. Other institutions exist to fulfil these

⁸ J Shingler 'The Economic Legacy of Apartheid' (1997) *World Economic Affairs* 49 54.

⁹ Caucasian South Africans of European ancestry. See <https://bit.ly/2Pg9fO6> accessed 20 October 2018.

¹⁰ M Williams 'Tutu calls for wealth tax on whites' (2011) <https://bit.ly/2OArIGr> accessed 30 October 2018 .

¹¹ Terreblanche was a South African academic economist and writer, author of numerous books and was most famous for his *History of Inequality in South Africa, 1652-2002*.

purposes.” However, Bernstein acknowledged corporate monetary sustenance for what was regarded as a crime against humanity: “Life is not a morality play. There are very few people who give up everything for their beliefs and ideas. Business in South Africa accommodated itself to the apartheid system” This leans in favour of a wealth tax also applying to companies.

1.2 Introduction

The research problem of this mini-dissertation is whether the imposition of wealth tax is a viable solution in alleviating the gap in income and wealth between the rich and the poor in South Africa. Firstly, the rationale and need for a wealth tax in South Africa will be identified. This Chapter provides an introduction and context to the current research in this area of law.

After that, examining the advantages, disadvantages, and effects of a wealth tax will take place in Chapter Two. Herein, a practical approach will be followed to construct what a statutory wealth tax may look like. Finally, consideration of the role of taxation as a social mechanism for wealth redistribution is considered.

In the Third Chapter, the constitutionality of a wealth tax is assessed. Furthermore, the administrative burdens and implementation are evaluated.

Chapter Four provides recommendations as to the way forward and possible legislative amendments required to address the issues identified in the preceding chapters. It aims to provide a construction where a wealth tax could function optimally. Additionally, it also suggests alternatives to a wealth tax. This chapter concludes the mini-dissertation by briefly summarising and weighing up the findings made in light of the research question and objectives.

1.3 The effects of Apartheid

The system of white political supremacy, racial capitalism, and the mutually beneficial relationship between them brought about empowerment and enrichment of white South Africans and disempowerment and impoverishment of Africans. Terreblanche elaborates on the detrimental effects Africans suffered at the hand of the power structures that Apartheid put into place.¹²

Africans were dispossessed of sizeable parts of land on which they had run successful traditional farming for centuries. They were paid exploitative wages in all spheres of the economy, but particularly in gold mining and agriculture. The fact that Africans were politically powerless and economically unorganised made them easy targets. The discriminatory legislation did not only rob Africans of the opportunity to obtain skills, but it also compelled and disgraced them to do dull unskilled work at meagre wages. Their legal right to own property and to carry on business was sharply confined and deprived them of the chance to accumulate property and to develop entrepreneurial and professional capabilities. Individuals were not the only ones that had been impoverished and ruined by the racist systems, but also African societies, while it also prevented the South African people from becoming a society.¹³

1.4 Application

The fundamental difference between income and wealth tax lies in asset ownership. Broadly speaking, a wealth tax is a tax charged on the sum value of personal assets. It is payable on the market value of owned assets, either annually or at determined intervals. It is irrelevant if such assets generate income, and therefore constitutes a tax on potential / unrealised income.¹⁴ The purported assets that would be susceptible to a wealth tax, include, but are not limited to, the following:¹⁵

¹² S Terreblanche 'A wealth tax for South Africa' *SCIS Working Paper* University of Witwatersrand January 2018 16.

¹³ S Terreblanche 'A wealth tax for South Africa' *SCIS Working Paper* 18.

¹⁴ C Gers 'A "wealth tax" for South Africa? - industry insights' (2017) 30 *Tax Professional* 11.

¹⁵ EN Wolff 'Time for a Wealth Tax' (1996) <http://bostonreview.net/archives/BR21.1/wolff.html> (accessed 24 March 2018)

- Bank deposits;
- Property consisting of land or buildings (in addition to municipal rates);¹⁶
- Intangible assets;
- Assets in insurance and pension plans;
- Ownership of unincorporated entities (sole proprietorships, partnerships);
- Financial securities.

Whether a wealth tax would pass constitutional muster is questionable. It remains a point of contention precisely what is included under property in section 25(1) of the Constitution,¹⁷ and whether such tax could unreasonably and unjustifiably infringe the equality clause in the Bill of Rights.¹⁸

Another constitutional issue may arise when considering s 25(2),¹⁹ being the critical question of whether the charging of a (wealth) tax would amount to the 'expropriation' of property. If it is found to be the case, the second tier of the section needs to be considered, namely, whether the tax meets the conditions contained in s 25(2) (a) and (b). These sections consider whether the law that imposed the tax was 'for a public purpose and in the public interest' and was subject to compensation agreed to by those affected or approved by a court and which meets the further criteria laid down in s 25(3)(a) to (e).

In *First National Bank of SA Ltd t/a Wesbank v C: SARS*²⁰ Conradie J, *obiter dictum* in the court *a quo*, was of the opinion that "taxation does not amount to a deprivation of property. Nor is there anything which is expropriated", but added a reservation, "it may be different where the impugned tax is oppressive or partial or unequal in its operations".²¹

¹⁶ C Gers 'A "wealth tax" for South Africa? - industry insights' (2017) 30 *Tax Professional* 11.

¹⁷ Constitution of the Republic of South Africa, 1996.

¹⁸ S 9 of the Constitution.

¹⁹ Constitution.

²⁰ *First National Bank of SA Ltd t/a Wesbank v C: SARS* 2001 (3) SA 310 (C), 63 SATC 432.

²¹ *First National Bank of SA Ltd t/a Wesbank v C: SARS* 2001 449-450.

The Constitutional Court on appeal neglected to give its opinion on this statement but stated that expropriation is a subcategory of deprivation.²²

Whether taxation qualifies as “expropriation” in terms of s 25 of the Constitution is an open question. It is challenging to see how the preconditions for the constitutionality of expropriation set out in s 25(3) (amongst others, that it must be subject to “compensation” as agreed by “those affected” or by a court) can be applicable to a tax. It may be argued that the supplying of goods and services by the state serves as “compensation” for the exacted tax and the passing of the tax legislation by a democratic parliament can be said to constitute agreement “by those affected”.

The Davis Tax Committee (DTC hereafter) on 25 April 2017 requested written submissions on the establishment of a possible wealth tax in South Africa. On 21 August 2017, Davis²³ indicated his approval of a wealth tax, describing it as a significant representative progression to confront inequality. In elaborating, he explained, “it is well established that economic inequality inhibits economic growth and undermines social, economic and political stability”.²⁴ He admitted that despite the difficult times we are in, especially considering corruption and state capture, he could not allow immense wealth to go untaxed.²⁵ However, tax scholars are of the opinion that the additional revenue generated by this tax would be rather small when considering the growing budget shortfall. Davis conceded that a South African wealth tax would be of particular difficulty to apply since it would be imposed on an extremely limited base.

1.5 Conclusion

Why might a wealth tax be of relevance in South Africa? That is the main question this Chapter aims to address. It deals with the question by considering the socio-economic background of South Africa, the effect that Apartheid had on the labour market, and the

²² *First National Bank of SA Ltd t/a Wesbank v C: SARS* 2002 (4) SA 768 (CC) para 57.

²³ Judge Dennis Davis, Chair of the Davis Tax Committee.

²⁴ C Gers ‘A “wealth tax” for South Africa? - industry insights’ (2017) 30 *Tax Professional* 11.

²⁵ M Isa ‘Wealth tax: Good idea or not?’ (2017) <https://www.fin24.com/Finweek/Featured/wealth-tax-good-idea-or-not-20170913> (accessed 15 March 2018).

application of a possible wealth tax. Terreblanche makes the suggestion that an adequate degree of systemic justice can be reached by introducing a wealth tax (of say 0.5 per cent annually) for 10 or 20 on all persons with net assets of more than R2 million and use the produce of this levy for the upliftment of, say, the lower 40 per cent. This tax would then predominantly apply to wealth accumulated during the Apartheid era when the structures of white political supremacy and racial capitalism enriched a relatively small white elite to the detriment of the oppressed majority.²⁶ However, the current discourse available on wealth tax in South Africa is limited, and a wealth tax may be difficult to establish. A balanced and objective approach is required to consider its feasibility.

²⁶ S Terreblanche 'A wealth tax for South Africa' *SCIS Working Paper* 19.

Chapter 2

The practical considerations of a wealth tax

2.1 Introduction

The notion of a wealth tax has not evaded political rhetoric.¹ This has unfortunately resulted in public misconceptions about who would be liable for the payment of a wealth tax and its reasoning, its calculation, and how it would be put to use. Therefore, the aim of this chapter is to consider the practical effects of a wealth tax. As with any piece of legislation passed by Parliament, clear definitions would need to be provided before even considering its substantive part. The meaning of wealth, the tax base of a wealth tax, the difference between income and wealth, and Piketty's contributions to the wealth tax discourse will be discussed.

2.2 The meaning of wealth

Defining wealth (and by extension a net wealth tax) in terms of income tax for purposes of this dissertation is essential.

In some instances, a broad approach is followed when defining wealth and includes financial, physical, natural, and human² capital.³ Financial capital includes savings accounts, bonds and stocks. Physical capital comprises of machinery and immovable

¹ F Vawda 'A wealth tax smacks of hypocrisy' Daily Maverick 22 June 2017 available at <https://bit.ly/2CKFzSQ> accessed on 28 October 2018.

² C Goldin 'Human capital' in C Diebolt & M Hauptert (eds) *Handbook of cliometrics* (2014) 55-86. Human capital is seen as the collection of knowledge, education, experience, skills, personal and social attributes, that is of economic value and can result in financial benefit. However, human capital is seldom included when wealth inequality is under discussion.

³ The words *assets*, *capital*, and *resources* are used interchangeably throughout this dissertation.

property such as houses, while land, minerals, and energy resources are considered natural capital.⁴

The wealth a person holds is determined in relation to the wealth of another person in the community. Inequality comes into existence when there is a difference between the two wealth holders. The existence of a shortage is imperative as a potential for wealth.⁵ When a person owns a useful item that is in short supply, they will enjoy a greater prospective for wealth. A person holding an item which is plentifully available will not enjoy the same prospective for wealth; if any. The benefits associated with holding a significant amount of wealth are extensive. Wealthy individuals tend to possess power, and their elevated social status helps them to influence decisions that might affect their well-being.

Therefore, by accurately defining wealth tax, uncertainties are reduced. Firstly, it is vital to position it among the three distinct tax base categories found in South Africa. This avoids confusion by placing the tax in perspective with the other categories and highlights the difference between the three. Secondly, there is a direct link between its definition and the motivation for its existence. Here, it should be demonstrated that the general meaning associated with wealth, being affluence or opulence is inaccurate and should be clearly distinguished from income.

2.3 The tax base of a wealth tax

“The tax base is the amount on which tax is imposed and requires a determination of what is taxable”.⁶ By introducing a wealth tax, the government would be trying to broaden the tax base. This might be a problematic situation when the wealth tax’s primary aim is to collect more revenue because the base in itself might not provide adequate opportunity

⁴ ‘The real wealth of nations’ *The Economist* <https://econ.st/2xbIgvv> accessed on 26 May 2018.

⁵ Y Farzin ‘The time path of scarcity rent in the theory of exhaustible resources’ (1992) 102 *The Economic Journal* 813.

⁶ E Bronkhorst ‘Principles of Tax Policy Design’ in M Stiglitz (ed) *Silke: South African income tax* (2016) 1193.

for growth.⁷ Requiring people to pay wealth tax might only generate limited revenue as only a specific number of people are wealth owners.

South Africa broadly distinguishes between three categories of tax bases. The income tax base category is made up of income earned or profits generated by taxpayers during a year of assessment.⁸ This includes personal income tax, corporate income tax, turnover tax, and dividends tax and is contained in the Income Tax Act.⁹ The consumption tax base includes the amount spent by taxpayers on goods and services. This encompasses value-added tax, fuel levies, international air passenger departure tax, plastic bag levies, incandescent light bulb levies, customs tax, and excise duty¹⁰ and can be found in the Value-Added Tax Act¹¹ and the Customs and Excise Act.¹²

The third tax base category, and the base of relevance for this dissertation, is the wealth tax base. It encompasses the value of assets or property of a taxpayer.¹³ Wealth confers certain advantages over and above the rate of return that it produces and therefore wealth is a tax base in its own right.¹⁴ This category contains five separate types of taxes. Donations tax¹⁵ (value of a property disposed of by way of a donation), capital gains tax¹⁶ (taxable capital gain of assets disposed of), transfer duty¹⁷ (value of property acquired or property value enhancement via renunciation of rights), estate duty¹⁸ (dutiab amount of estate) and securities transfer tax¹⁹ (taxable amount of transferred security).²⁰

The wealth tax mentioned in this dissertation is different from the five types of wealth tax discussed above in that it is not triggered by a movement/transfer or disposal of assets. Any person who has a real right (ownership) over an asset would be liable for this tax on

⁷ E Bronkhorst 1193.

⁸ E Bronkhorst 1194.

⁹ Income Tax Act 58 of 1962.

¹⁰ E Bronkhorst 1195.

¹¹ 89 of 1991.

¹² 91 of 1964.

¹³ E Bronkhorst 1194.

¹⁴ Davis Tax Committee *Report on feasibility of a wealth tax in South Africa* March 2018 8.

¹⁵ Sections 54-64 of the Income Tax Act.

¹⁶ Eight Schedule of the Income Tax Act.

¹⁷ Transfer Duty Act 40 of 1949.

¹⁸ Estate Duty Act 45 of 1955.

¹⁹ Securities Transfer Tax Act 25 of 2007.

²⁰ E Bronkhorst 1195.

a recurring basis. In order to determine what is taxable, the concept of net wealth becomes relevant. Net wealth is the difference between gross wealth (assets) and total debt (liabilities).²¹ A net wealth tax would thus be imposed on a person's net wealth. Should a country have a narrow wealth tax base, a wealth tax will only give rise to considerable revenue if the tax rate is high.²² Nevertheless, a high tax rate places a substantial economic burden on taxpayers, especially in South Africa where the top 1% of taxpayers pay 61% of the total income tax collected.²³ Those taxpayers who cannot afford expert tax advice will be hit hardest by this burden, as affluent taxpayers can afford expert advice and will have access to professional tax planning.²⁴

2.4 Considerations

When deciding on whether to impose a tax rate, the Laffer curve should enjoy consideration. This curve is a theoretical representation of the correlation between the rate of taxation and the consequential government revenue raised.²⁵ The consequence of this curve is that increasing tax rates above a specific level will have the opposite effect and actually result in less tax revenue being collected.²⁶ On the one extreme of the curve where the tax rate is 0%, people can retain 100% of what they make. Production will be maximised and "the output of the money economy is limited only by the desire of workers for leisure."²⁷ Seeing that the tax rate is 0%, the government's revenue will be zero and will lead to a total absence of government and result in anarchy. On the other hand, where the tax rate is 100%, all production will come to an end. People will have no impetus to work if the government seizes all their earnings. Since there is no production, there is nothing to impound so the government would collect zero revenue once again.²⁸

²¹ Davis Tax Committee 12.

²² Davis Tax Committee 50.

²³ 'This is who is paying South Africa's tax' *Business Tech* <https://bit.ly/2GVLnXQ> accessed on 27 May 2018.

²⁴ Davis Tax Committee 50-51.

²⁵ A Laffer "The Laffer curve: Past, present, and future." (2004) 1765 *Backgrounder* 1-16.

²⁶ J Wanniski 'Taxes, revenues, and the Laffer curve' (1978) 50 *The Public Interest* 3-4.

²⁷ Wanniski 4.

²⁸ Wanniski 4.

The most effective tax rate, where both revenue and production is maximised, lies somewhere between 0% and 100%. According to some tax scholars, revenue is said to maximise at a tax rate between 65%²⁹ and 70%.³⁰ Other are of the opinion that it is impossible to stipulate a fixed rate that would be a one-size-fits-all for every countries and type of economy because various factors influence the relationship between the tax rate and tax revenue.³¹ The formation of the curve may also be influenced by policy decisions such as the availability of tax loopholes.³² If these loopholes are utilised, the stage at which revenue starts to decline with increased taxation will probably turn out to be lower. Usually, those with considerable wealth will actively pursue ways of preserving and protecting their wealth. This means aggressive tax planning, avoidance, and resorting to measures such as tax migration.

At present, the maximum tax rate in South Africa is levied at 45% and applies to those earning more than R1.5 m per annum. The effective capital gains tax rate of 18% upon emigration, when a taxpayer is deemed to dispose³³ of their assets at market value, therefore gives the impression to be a price worth paying for an affluent group of South Africans. This resembles what happened in France, where capital was exiting the country due to the country's wealth tax.³⁴ It is clear that the risk of capital flight associated with a wealth tax will significantly narrow the existing tax base.

Another factor to consider is which assets will fall within the scope of a net wealth tax. Logically, in order to maximise the revenue generated from a wealth tax, one must look at how wealth is comprised. South Africa differs from most countries in this regard. Whereas "housing assets" account for the more significant part of other countries' wealth,³⁵ it

²⁹ P Pecorino 'Tax rates and tax revenues in a model of growth through human capital accumulation' (1995) 36(3) *Journal of Monetary Economics* 527-539.

³⁰ D Fullerton 'Laffer curve' in K Arrow et al *The new Palgrave dictionary of economics* (2008) 1-4.

³¹ E Feige et al "Sweden's Laffer Curve: Taxation and the Unobserved Economy" (1983) 85(4) *The Scandinavian Journal of Economics* 499-519.

³² K Amadeo 'Laffer curve explanation- Why tax cuts not longer work' <https://bit.ly/2LBdTSj> accessed on 28 May 2018.

³³ S9H(2) of Eight Schedule of the Income Tax Act.

³⁴ C Astarita 2015 'Taxing Wealth: Past, Present, Future-Workshop Proceedings' (2015) *Discussion paper 003 Directorate General Economic and Financial Affairs European Commission* 35.

³⁵ Economic survey of South Africa (2015) OECD. See also Davis Tax Committee 20 <https://bit.ly/2JVNmjD>

makes up only about 25% of total private assets in South Africa.³⁶ The remaining 75% is found in financial assets and specifically interests in retirement funds and long-term insurance.³⁷ It follows that significant attention should be given to retirement funds as this is where one finds the bulk of South African wealth.

However, the line of reasoning that favours a tax on immovable property is much stronger than the argument for taxing retirement funds. From an economic perspective, the recurrent taxation of immovable property is possibly one of the most productive forms of taxation, as it does not distort labour supply decisions.³⁸ Furthermore, it is difficult to circumvent, as ownership of land is usually easy to establish. As the tax would be imposed regardless of what the owner is using the land for, it encourages the efficient and productive utilisation of the land.³⁹

Nevertheless, the disadvantages of taxing land are hefty. Firstly, liquidity and the ability to pay are problematic. Considering how impractical it would be to sell off a small piece of land or a house to pay the tax, the taxpayer would have to resort to their income for its payment. This would bring about difficulties when it comes to farmers (including those previously disadvantaged individuals who were benefitted from land redistribution policies), retired persons with restricted incomes and the problem of determining ownership when it comes to tribal land. Moreover, a tax on land singles out only one constituent of wealth and disproportionately affect those who hold more of their wealth in immovable property as opposed to, for example, annuities or shares.⁴⁰

A wealth tax on retirement funds will undoubtedly be coupled with immense administrative complications except if it carries a fixed rate on the gross assets of retirement funds. Hereby all pension fund members will be treated the same, without having regard to their economic situations. This is problematic bearing in mind that the lower income earners' wealth in South Africa are primarily made up of their retirement

³⁶ A Orthofer 'Private wealth in a developing country: A South African perspective on Piketty' (2015) *Economic Research Southern Africa Working Paper* 564.

³⁷ Davis Tax Committee 20.

³⁸ Davis Tax Committee 60.

³⁹ Davis Tax Committee 61.

⁴⁰ Davis Tax Committee 62.

funds.⁴¹ With South Africa's overall life anticipated to rise to 70 by 2030, taxing the elderly on their retirement funding might prove unwise in the long run as it will increase government's burden to provide for their livelihood. This will be the case if the elderly are expected to pay tax on money they allocated to live off during their retirement, leaving them less financially independent and thereby more dependent on government to provide for shortfalls by way of social grants. It is well known that South Africa has a poor savings culture,⁴² and it is irreconcilable to advocate for savings incentives in the form of retirement funds, interest exemptions and tax-free savings accounts if they end up being subject to wealth tax.⁴³

A further challenge is the valuation of assets to determine their net worth for wealth tax purposes. Valuation can take the form of the open market valuation method or by making use of expert valuation.⁴⁴ The open market valuation method stipulates that the value at which the asset was bought at or sold for will be its market price. This method becomes troublesome when dealing with assets acquired a long time ago and where sufficient accounting records lack. This hurdle may be overcome by comparing these assets to the market value of other homogenous assets with accurate existing records.⁴⁵

Expert valuation becomes relevant when dealing with particular assets, such as artwork. In this case, an expert values the asset by roughly judging its selling price in an open market. Expert valuations essentially remain a subjective and costly exercise.⁴⁶

2.5 Income v wealth

The well-known fruit-tree principle⁴⁷ as found in the *Visser* case can be used to illustrate the difference between income and wealth in a simple manner. The income (fruit) derived

⁴¹ Davis Tax Committee 58.

⁴² R Grobler 'Snapshot of SA's saving culture' Investec Specialist Bank <https://bit.ly/2GWamug> accessed on 28 May 2018.

⁴³ Davis Tax Committee 54-55.

⁴⁴ D Trotman-Dickenson *Economics of the public sector* (1996) 223-224.

⁴⁵ Davis Tax Committee 32.

⁴⁶ Davis Tax Committee 32.

⁴⁷ *CIR v Visser* 1937 TPD 77 Maritz at 276: " 'Income' is what 'capital' produces, or is something in the nature of interest or fruit as opposed to principal or tree. This economic distinction is a useful guide in matters of income tax, but its application is very often a matter of great difficulty, for what is principal or

from owning assets/ wealth (tree) is taxed through the income tax system. The wealth itself is taxed through the wealth tax system. Consequently, a tax on wealth is not a tax on the wealthy.⁴⁸ A person earning a big salary can live a seemingly luxurious lifestyle, without being the owner of any wealth. Wealth refers to the *amassing* of resources but whether these resources are copious or not is irrelevant. The passing of time is thus a key factor connected to wealth. Due to the immense growth of monetary globalisation, successfully taxing capital and investment returns has become a difficult task because of the upsurge in “both legal and illegal international capital mobility”.⁴⁹ This results in the continuous worldwide decline of revenue from taxes collected on capital income, shifting the tax obligation from capital income to labour income. Labour income, therefore, carries a disproportionate tax burden when compared to capital income.⁵⁰ In South Africa, this is evident when comparing the wealth and income Gini coefficients. While our income inequality coefficient is at 0.67⁵¹, new evidence shows that our wealth inequality is even more severe with a coefficient of 0.9.⁵²

2.6 Piketty

Piketty⁵³ advances that wealth inequality is increasing⁵⁴ and necessitates intervention by the government through imposing a net wealth tax.⁵⁵ He states that this increase of inequality is not as a result of mere coincidence, but by what he calls “patrimonial

tree in the hands of one man may be interest or fruit in the hands of another.” Law books in the hands of a lawyer are a capital asset; in the hands of a bookseller they are a trade asset.

⁴⁸ Davis Tax Committee 8.

⁴⁹ P Profeta et al ‘Wealth transfer taxation: an empirical investigation’ (2014) 21(4) *International Tax and Public Finance* 740. See also Davis Tax Committee 12.

⁵⁰ L Ndikumana ‘Better global governance for a stronger Africa: a new era, a new strategy’ in E Zedillo et al (ed) *Africa at a fork in the road: taking off or disappointment once again?* (2015) 8. See also Davis Tax Committee 12.

⁵¹ A Finn & M Leibbrandt ‘Mobility and inequality in the first three waves of NIDS’ (2013) *SALDRU Working paper no.120/ NIDS Discussion paper 2013/2*.

⁵² A Orthofer ‘Wealth inequality in South Africa: Evidence from survey and tax data’ (2016) *SALDRU Working paper no. 15*

⁵³ Piketty is a Professor of Economics at the Paris School of Economics and at the School for Advanced Studies in the Social Sciences) in Paris. For the past 15 years, his works have focused on understanding the accumulation and distribution of global income and wealth.

⁵⁴ T Piketty *Capital in the twenty-first century* 2014 15-26.

⁵⁵ Davis Tax Committee 14.

capitalism."⁵⁶ This means that the economic elite mostly achieves their affluence through inheritance or bequest, as opposed to their own innovative entrepreneurial efforts. Inequality is, therefore, an attribute of capitalism.⁵⁷

One of Piketty's most important contributions to the wealth tax discourse is his analysis of the relationship between the rate of return (r) and the rate of economic growth (g). Included under (r), one finds dividends, interest, profits, and rental. On the other hand, (g) is solely computed in terms of income and output. This model states that there is a propensity for the rate of return on capital (r) to materially surpass the rate of economic growth (g), allowing inherited wealth to multiply much faster than income and output.⁵⁸ "For example, if r is 5% and g is 1%, wealth holders only need to invest one-fifth of their capital income to ensure that their wealth grows as fast as the size of the economy."⁵⁹ The wealth owners have the resources to make investments in newly constructed sources of wealth or to leverage the amassing of wealth, thereby securing even more wealth for themselves. Given the "propensity of wealth to perpetuate itself,"⁶⁰ the wealthy elite fortify their economic superiority. He concedes that the relationship between the rate of return on capital and economic growth is not the most important or the only consideration when evaluating wealth and income inequality.⁶¹ Moreover, the relationship between r and g is intricate as it is contingent on elements that are challenging to anticipate such as technology and savings behaviour.⁶²

Piketty scrutinises inherited wealth from the position of the same model. Inherited wealth and capital income are both factors causing an increase in inequality. Should the return on capital outweigh the rate of growth, the inequality gap will only get bigger, resulting in wealth concentration amid the rich. In these circumstances, Piketty contends that inherited wealth will overshadow (by a wide margin) the wealth collected from a lifetime's labour and the further concentration of wealth vesting in the elite. Accordingly, he

⁵⁶ T Piketty 'Capital in the Twenty-First Century: a multidimensional approach to the history of capital and social classes' (2014) 65(4) *The British journal of sociology* 736-747.

⁵⁷ R Cooper *Why everyone is talking about Thomas Piketty's Capital in the twenty-first century* <https://bit.ly/2IJTLQd> accessed on 26 May 2018.

⁵⁸ Davis Tax Committee 15.

⁵⁹ Davis Tax Committee 15.

⁶⁰ 'Bigger than Marx' *The Economist* <https://econ.st/2INsyIb> accessed on 26 May 2018.

⁶¹ T Piketty 'About capital in the twenty-first century' (2015) 105(5) *American Economic Review* 48.

⁶² Davis Tax Committee 17.

disagrees with the argument that economic growth will invariably reduce inequality. This poses the serious threat of “weakening democratic standards”.⁶³ The current wealth tax systems underestimate the gravity of inheritance inequality’s role.⁶⁴ This is also specifically applicable to South Africa, where a large part of accumulated white wealth can be traced back directly or indirectly to Apartheid.⁶⁵

Piketty recommends that governments worldwide should work jointly towards the establishment of a global wealth tax. Motivating this statement, his recommendation opines that this tax will restrain the issues accompanying tax migration and also diminish tax secrecy laws.⁶⁶ Noteworthy is the amount of wealth held in tax havens.⁶⁷ Although accurate statistics are unattainable due to secrecy, it is estimated that between \$ 24 and \$36 trillion worth of assets (8% of global wealth) are held in tax havens.⁶⁸ Bearing in mind the endless difficulties that transpire in the international tax environment, it is unimaginable to develop a universal tax base ,for this reason the need for international tax treaties.⁶⁹ He also admits that the imposition of worldwide taxation is “politically impossible.”⁷⁰

With a specific focus on South Africa, Piketty proposed⁷¹ the creation of a progressive annual net individual wealth tax. He considers this to be “important” and also “absolutely

⁶³ Davis Tax Committee 16.

⁶⁴ T Piketty & E Saez ‘A theory of optimal inheritance taxation’ (2013) 81(5) *Econometrica* 1851.

⁶⁵ See the discussion of *The effects of Apartheid* for Apartheid’s role in the accumulation of wealth by White South Africans in Chapter 1.

⁶⁶ Edited transcript of economist Professor Thomas Piketty’s address to the 13th Nelson Mandela Annual Lecture, which took place at the University of Johannesburg’s Soweto campus on 3 October 2015 available at <https://bit.ly/1QSm3RI> accessed on 26 May 2018.

⁶⁷ See ‘What is a secrecy jurisdiction?’ *Tax justice network* <https://bit.ly/2sfHE2b> accessed on 26 May 2018 (author unknown). A tax haven can be described as an independent jurisdiction that does not impose any tax or alternatively charges a low rate. In addition it provides banking confidentiality, which allows foreign persons to obscure assets or earnings to circumvent or minimize taxes in their home jurisdiction.

⁶⁸ ‘Tax havens’ *Tax justice network* <https://bit.ly/2s811uC> accessed on 26 May 2018.

⁶⁹ In terms of s 2 (1) (a) of the Vienna Convention of the Law of Treaties, a treaty is a written international agreement negotiated between States. A tax treaty would thus amount to a written agreement related to taxation.

⁷⁰ ‘Bigger than Marx’ published 3 May 2014 *The Economist* available at <https://econ.st/2GSRb4s> accessed on 28 October 2018.

⁷¹ Edited transcript of economist Professor Thomas Piketty’s address to the 13th Nelson Mandela Annual Lecture, which took place at the University of Johannesburg’s Soweto campus on 3 October 2015 available at <https://bit.ly/1QSm3RI> accessed on 26 May 2018.

possible.” At first, this tax should be imposed at a low rate and will create some degree of transparency. Additionally, it will serve to ascertain which assets are owned and the owners of those assets are.⁷² One can view it as a sort of fixed asset register for SARS. This directly correlates to what the Davis Tax Committee ends up suggesting in their report’s recommendations chapter.⁷³

2.7 Conclusion

It has become clear at this point that the formulation of an effective wealth tax is challenging. The fact that South African taxpayers are already overburdened further complicates matters. Due consideration is needed in identifying the appropriate tax base and determining its scope. Considering all the aforementioned problems, it seems that Piketty’s enthusiasm might be premature as the imposition of a wealth tax in South Africa is impractical in the short term. However, there are small steps that might pave the way for a longer term plan.

⁷² Davis Tax Committee 18.

⁷³ Davis Tax Committee 67-68.

Chapter 3

The constitutionality of a wealth tax

3.1 Introduction

When considering a proposed wealth tax, the question of which class or group of persons will be liable to pay this tax arises. As referred to earlier,¹ Tutu called for a prosperity tax on white South African as a gesture of reconciliation. The FW de Klerk Foundation² subsequently rejected this type of tax:³

“One of the principles [on which the post-apartheid society is based] is non-racialism and the idea that we should no longer adopt laws that are aimed at one or another racial group. It would accordingly be unconstitutional to impose a wealth tax only on one of South Africa’s racial groups. It would require the reintroduction of racial classification and of many of the other demeaning racial distinctions that were associated with apartheid. It would also be unfair. Would whites who opposed apartheid be expected to pay the same as those who supported it? Would there be different tax scales for whites who supported the ANC, the DP and the old National Party? And what about the many blacks who held well-paid positions in homeland governments? To be constitutional, a wealth tax would have to be applied to all South Africans regardless of their race.”

Furthermore, there is uncertainty whether this type of tax would satisfy the well-established principles (or canons) of taxation.⁴ This entails the principles of equity,

¹ See *1.1 Background* chapter 1.

² A nonpartisan organisation that was established in 2000 by former South African President Frederik Willem de Klerk. According to their website, the organisation “aims to promote peace in multi-community states” and is of the opinion that “the foundation is well positioned to play a catalytic role in South Africa, Africa and the world in working for harmonious relations between ethnic, cultural, linguistic and religious communities in multi-community societies.” <https://bit.ly/2O7AKGr> accessed 22 July 2018.

³ P De Vos Constitutionally Speaking 15 August 2011 <https://bit.ly/2uMSgXy> accessed 18 July 2018.

⁴ E Bronkhorst ‘Principles of tax policy design’ in M Stiglingh (ed) *Silke: South African Income Tax* (2016) 1189 1199.

certainty, convenience, economic efficiency, administrative efficiency, and simplicity.⁵ These principles cannot be evaluated in isolation. Checks and balances are vitally important for the critical observation of tax drafts and for the passing of proper tax legislation that is in line with the constitutional principles and the established standards of fair taxation.

In essence, this chapter scrutinises whether a wealth tax would pass Constitutional muster.

3.2 Levying of tax and the Constitution

The Constitution does not explicitly empower the state to levy taxes. However, Section 214(1) of the Constitution states that an Act of Parliament must allow for “the equitable division of revenue raised nationally among the national, provincial & local spheres of government.” SARS is mandated to administer national tax legislation.⁶

The Constitution requires a careful and candid procedure to be followed upon the proposal of new legislation. The legislative procedure normally starts with the issuing of a Green Paper which entails a Government Department’s broad conception of the issue under consideration. The public is allowed to comment on the Green Paper. The applicable Government Department then evaluate any submitted public commentary and may decide to modify the Green Paper for these comments. The modified Green Paper is then issued in the form of a White Paper, which constitutes a more polished version of the Green Paper. This White Paper can also be put through additional deliberation and criticism before it being converted into a preliminary version of legislation known as a Draft Money Bill. As the basis of a wealth tax entails the imposition and payment of tax, Section 77 of the Constitution becomes relevant. This Draft Money Bill should be assembled and submitted by the National Treasury to the Minister of Finance. After receiving approval from Cabinet, the Draft Money Bill must be evaluated by the State Law Advisers to confirm that it is in line with the Constitution and other existing law and that it is free from any technical errors. Once approval from the State Law Advisers is obtained, the Draft Money

⁵ A Smith *The wealth of nations vol 2* (1947) 307-308.

⁶ Sections 2 & 3 of the South African Revenue Service Act 34 of 1997.

Bill is tabled by the Minister of Finance in Parliament to the National Assembly and the National Council of Provinces. After that, the Draft Money Bill is published in the *Government Gazette* for public consideration.⁷ After the Draft Money Bill has successfully passed through Parliament it will be presented for assent by the President. As soon as the President assents, the Money Bill becomes an Act of Parliament and becomes binding.⁸

It is clear that the procedural requirements of South Africa's legislative process are methodical and transparent, attempting to ensure that any problems are detected, addressed and resolved before the President assents a Bill. The public and various other stakeholders (for example the media) are provided with an opportunity to voice their concerns. Ideally, this will also ring true when it comes to the proposed wealth tax.

There are cases where the importance of public participation was emphasised. The lack of active public participation in the legislative process resulted in the case of *National Treasury and Others v Opposition to Urban Tolling Alliance and Others*,⁹ where the Constitutional Court dealt with the hostility from Gauteng residents over the implementation of electronic toll fees on the N1 highway throughout the Gauteng Province. These electronic toll fees were devised to fund a R20 billion Gauteng highway upgrade project.¹⁰ In July 2007 Cabinet accepted the implementation of the e-tolling for Gauteng and in October 2007 the then Minister of Transport officially issued a statement about the commencement of electronic toll collection.¹¹ Nonetheless, it was only when the Opposition to Urban Tolling Alliance (OUTA) became aware of the suggested toll tariffs published in the media that the public became perturbed. This was nearly five years after cabinet had approved the improvements of the N1 by utilising an electronic toll system. It begs the question of why the public's indignation only surfaced when the media announced the worrying news of the toll across television, newspapers, radio, and the internet. Both the media and the public ought to have vocalised their concerns back in 2007 when the provision was merely a Draft Money Bill, by collectively resisting the

⁷ S 77 of the Constitution.

⁸ Parliament of the Republic of South Africa *How a law is made* available at <https://bit.ly/2zXkFjr> accessed on 22 July 2018.

⁹ (6) SA 223 (CC).

¹⁰ *National Treasury and Others v Opposition to Urban Tolling Alliance and Others* para 5.

¹¹ What is e-tolling OUTA available at <https://bit.ly/2ziJoLN> accessed on 28 October 2018.

scheme. They ought to have placed political pressure on the Gauteng and National Government to terminate this project. The residents of Gauteng remained passive until the moment they realised they would feel it in their pockets. Upon realisation, they instantly approached the judiciary, even when it is not the judiciary's responsibility to halt unpopular policy decisions and to penalise a government for making unwanted determinations:¹²

“The main thrust of the respondents’ review is the alleged unreasonableness of the decision to proclaim the toll roads. But unreasonable compared to what? The premise of their unreasonableness argument is that funding by way of tolling is unreasonable because there are better funding alternatives available, particularly fuel levies. But that premise is fatally flawed. The South African National Roads Agency Limited has to make its decision within the framework of government policy. That policy excludes funding alternatives other than tolling. It is unchallenged on review. But the High Court order effectively went against it. Since the making of the policy falls within the proper preserve of the executive and was, on the papers before the court, perfectly lawful, the order undermining it was inappropriate. No fundamental rights of the respondents beyond that of just administrative action are at stake here. The courts of this country do not determine what kind of funding should be used for infrastructural funding of roads and who should bear the brunt of that cost. The remedy in that regard lies in the political process.”

The backlash received in the e-tolling case was severe, as Gauteng residents refused to pay their e-tolls, resulting in more than R 1 billion overdue e-toll fees.¹³ It illustrates that residents and the media play an active role in South Africa’s legislative process, and should participate in policy decisions even if it is initially unclear to what extent they will be affected. Active participation preserves South Africa’s constitutional democracy. The

¹² *National Treasury and Others v Opposition to Urban Tolling Alliance and Others* paras 94-95.

¹³ ‘E-toll defaulters’ bills exceed R1 billion’ *Sandton Chronicle* (author unknown) available at <https://bit.ly/2D9mDhG> accessed on 28 October 2018.

courts are not there to solve citizens' political problems. The case also highlights the separation of powers' principle, as the court was cautionary "not to attribute to itself superior wisdom in relation to matters entrusted to other branches of government".¹⁴ It is advisable that taxpayers learn from their mistakes in the e-tolling saga should the process of introducing a wealth tax into South African legislation commence.

The event may arise that wealth tax legislation is validly passed and those liable for its payment subsequently refuse to pay, for example the e-tolling case where residents were not buying e-tags and not paying their e-tolls when they were obliged to do so. There is uncertainty whether a wealth tax would infringe on any fundamental human rights. According to the FW de Klerk Foundation, it would transgress one of our Constitution's founding values, namely non-racialism.¹⁵

3.3 Non-racialism and wealth tax

At face value, the suggestion that (only) white people should pay a wealth tax might seem discriminatory. Upon legislative consideration, the equality clause and its provisions on affirmative action come into play. It reads: ¹⁶

"9.

(2) Equality includes the full and equal enjoyment of all rights and freedoms. To promote the achievement of equality, legislative and other measures designed to protect or advance persons, or categories of persons, disadvantaged by unfair discrimination may be taken."

The Constitutional Court in *Minister of Finance and Other v Van Heerden*¹⁷ had to decide whether a Parliamentary pension plan, which afforded better benefits to parliamentarians who first joined parliament during the new Constitutional dispensation, was

¹⁴ *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs and Tourism and Others* 2004 (4) SA 490 (CC) para 48.

¹⁵ Section 1(b) of the Constitution.

¹⁶ Section 9(2) of the Constitution.

¹⁷ *Minister of Finance and Other v Van Heerden* 2004 (6) SA 121 (CC).

constitutionally valid. Van Heerden, who was a member of Parliament under the previous regime, objected that the plan unfairly discriminated against whites because the overriding majority of new parliamentarians in 1994 were African and those who served during the Apartheid regime were predominantly white. Moseneke puts forward three principles to determine whether affirmative action measures may be taken in terms of Section 9(2).¹⁸ Firstly, does the measure target persons or categories of persons who have been previously disadvantaged by unfair discrimination; secondly, is the measure aimed at the protection or advancement of such persons or categories of persons, and thirdly does the measure promote the achievement of equality.

It was raised that the affirmative action plan might contravene section 9(2) because some white people also only became parliamentarians in 1994, entitling them to the plan's benefits. That means that these new white parliamentarians inevitably reap the benefits of an affirmative action plan, despite never forming part of a group that was disadvantaged by unfair discrimination. The court did not see this unintended gain as an issue but provided some guiding measure for these type of situations. The overwhelming majority of those benefiting from the plan must be from the disadvantaged group (black people) to meet the validity criteria.¹⁹ It follows that the inverse of the rule is also applicable: the overwhelming majority of those who are disadvantaged must be from the former or continuing privileged group (white people). Under Apartheid, white people were the sole privileged group while black people were the overriding majority of the disadvantaged group. As a result, a wealth tax on white people (earning a certain amount or those with a particular net worth) would meet the section 9(2) test. Over and above that, a wealth tax on all South Africans (earning a certain amount) regardless of race would also seem to satisfy section 9(2). This is because white people currently hold the majority of wealth in South Africa,²⁰ and it is argued that the majority of that wealth was amassed during and due to Apartheid.²¹ The overwhelming majority of those that are disadvantaged by a wealth tax would be from the former privileged group. It is unknown if the passage of

¹⁸ *Minister of Finance and Other v Van Heerden* para 37.

¹⁹ *Minister of Finance and Other v Van Heerden* para 40.

²⁰ Davis Tax Committee 24-26.

²¹ S Terreblanche 'Armoede in Suid-Afrika' (2004) *Tydskrif vir Geesteswetenskappe* 44/ 2&3 218-219.

time might affect this criterion. The wealth accumulated by black people might one day surpass the wealth held by their white counterparts. It is therefore posited that Tutu's suggested wealth tax (as reparation) is time sensitive, but it is nearly impossible to estimate a time at which such a tax might become outdated.

The Court emphasised that equality and non-discrimination are goals yet to be attained in South Africa and that section 9 of the Constitution mandates all organs of state "to protect and promote the achievement of equality" by facilitating corrective steps aimed at those people who were (and still are) in a disadvantaged position due to the former regime's discrimination. The FW de Klerk Foundation's equality is formal equality, which is inapt with the circumstances in South Africa.²² In the minority judgment of *van Heerden*, Sachs eloquently describes the difference between formal and substantive equality and clarifies why South Africa is in need of the latter type:²³

"The whole thrust of section 9(2) is to ensure that equality be looked at from a contextual and substantive point of view, and not a purely formal one. As this Court has frequently stated, our Constitution rejects the notion of purely formal equality, which would require the same treatment for all who find themselves in similar situations. Formal equality is based on a status-quo-oriented conservative approach which is particularly suited to countries where a great degree of actual equality or substantive equality has already been achieved. It looks at social situations in a neutral, colour-blind and gender-blind way and requires compelling justification for any legal classification that takes account of race or gender. The substantive approach, on the other hand, requires that the test for constitutionality is not whether the measure concerned treats all affected by it in identical fashion. Rather it focuses on whether it serves to advance or retard the equal enjoyment in practice of the rights and freedoms that are promised by the Constitution but have not already been achieved. It roots itself in a transformative constitutional philosophy which acknowledges that there are patterns of systemic advantage and disadvantage based on race and gender that need expressly to be faced up to and

²² *Minister of Finance and Other v Van Heerden* para 142.

²³ *Minister of Finance and Other v Van Heerden* para 142.

overcome if equality is to be achieved. In this respect, the context in which the measure operates, the structures of advantage and disadvantage it deals with, the impact it has on those affected by it and its overall effect in helping to achieve a society based on equality, non-racialism and non-sexism, become the important signifiers.”

Accordingly, we cannot disregard or erase the factor of race in our law because doing so will maintain white privilege.²⁴ Sachs referred to the *Walker* case²⁵ where courts were alerted to situations where parties use inequality as a façade to mask their actual intention of perpetuating their privilege, as opposed to cases where there are sincere efforts to safeguard equality.²⁶ It is understood that the interests of white people will be affected should a wealth tax be introduced. This infringement needs to be considered in light of the third and final requirement that the measure “promotes the achievement of equality”:²⁷

“Determining whether a measure will, in the long run, promote the achievement of equality requires an appreciation of the effect of the measure in the context of our broader society. It must be accepted that the achievement of this goal may often come at a price for those who were previously advantaged. Action needs to be taken to advance the position of those who have suffered unfair discrimination in the past. As Ngcobo J observed in *Bato Star*:²⁸

²⁴ *Minister of Finance and Other v Van Heerden* para 150.

²⁵ *City Council of Pretoria v Walker* 1998 (2) SA 363 para 48.

²⁶ This might also apply to other civil rights organisations such as AfriForum, who have continually faced criticism as only catering to the interests of white wealth. Afriforum ‘defender of white privilege’ African National Congress Youth League *IOL* <https://bit.ly/2NOErOm> accessed on 28 July 2018. According to their website, AfriForum is a “non-governmental organisation, registered as a non-profit company, with the aim of protecting the rights of minorities. While the organisation functions on the internationally recognised principle of the protection of minorities, AfriForum has a specific focus on the rights of Afrikaners as a community living on the southern tip of the continent.” Available at <https://bit.ly/2vc2fGe> accessed on 28 July 2018.

²⁷ *Minister of Finance and Other v Van Heerden* para 44.

²⁸ *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs and Tourism and Others* 2004 (4) SA 490 (CC) para 76.

‘The measures that bring about transformation will inevitably affect some members of the society adversely, particularly those coming from the previously advantaged communities.’”

Despite that, the court clarifies that such conceivable adversity is not unfettered.²⁹ Our nation is ultimately aiming for a society that is free of racism and sexism, where each person will be accepted and treated as a human being of equal worth and dignity. Understanding that South Africa is a diverse nation, comprising of people of different races, language groups, religions and sexes, is vital to this long-term goal. The South African Constitution honours and protects this diversity. In evaluating therefore whether a measure will promote equality in the long-term, South Africans must not forget this constitutional vision. In particular, a measure should not amount to an abuse of power or result in such considerable and excessive harm to those excluded from its benefits that the long-term constitutional goal would be under threat.

The imposition of a wealth tax thus comes with a proviso: it should not amount to an abuse of power. Additionally, it should not cause such considerable and excessive damage to those liable for its payment that South Africa’s long-term constitutional aim will be jeopardised. A litigant wanting to oppose a wealth tax might rely on this caveat, although proving that a provision is a threat to our long-term constitutional goal might be extremely difficult.

When considering the nature of the previously advantaged group’s demographics, and the fact that one group should face adversity in order for the other to advance, Sachs perceives that the advantaged group may in a certain sense be vulnerable by referring to the *Walker* case:³⁰

²⁹ *Minister of Finance and Other v Van Heerden* para 44.

³⁰ *City Council of Pretoria v Walker* paras 47-48.

“The respondent belongs to a group that has not been disadvantaged by the racial policies and practices of the past. In an economic sense, his group is neither disadvantaged nor vulnerable, having been benefited rather than adversely affected by discrimination in the past. . . .The respondent does however belong to a racial minority which could, in a political sense, be regarded as vulnerable. It is precisely individuals who are members of such minorities who are vulnerable to discriminatory treatment and who, in a very special sense, must look to the Bill of Rights for protection. When that happens a Court has a clear duty to come to the assistance of the person affected.

. . .

No members of a racial group should be made to feel that they are not deserving of equal ‘concern, respect and consideration’ and that the law is likely to be used against them more harshly than others who belong to other race groups.”³¹

Finally, Sachs provided a holistic perspective when he elaborates on Apartheid’s widespread aftermath. A moral imperative can be deduced from this statement, showing that the payment of a wealth tax might also be advantageous to white South Africans. Despite how onerous some may experience the process, one must not lose sight of the fact the system of state-sponsored racial oppression not only inflicted harm and shame on those oppressed by it, it tarnished the whole of society and disgraced its beneficiaries. Rectifying the resultant injustices, albeit potentially unnerving for those who might be removed from the entrenched expectations (and relative prosperity and the pleasant lifestyle it secures) of inherent privilege, is essential to provide dignity to South Africa as a whole. For as long as the enormous inequalities created by Apartheid exist, the values upon which the Constitution is founded of a non-racial and a non-sexist society which exhibits and lauds our diversity in all ways can not be reached. Consequently, although some members of the advantaged group may be required to carry a more significant portion of the responsibility of transformation than others, they, like all other members of

³¹ *City Council of Pretoria v Walker* para 81.

society, benefit from the enduring nature, social harmony and mending of national dignity that the attainment of equality brings.³²

3.4 A retrospective or retroactive tax on wealth

As a large part of South African wealth accumulated before 1994 and was not subject to wealth taxation upon attainment, it might be asserted that the retrospective taxing of wealth is unconstitutional. Taxpayers might have spent their money on different assets or chose to invest their resources in different ways had they been aware it would be subject to tax in future. In the *Pienaar* case, the judge clearly stated:³³

“There is nothing in our Constitution which prohibits parliament from passing retroactive or retrospective legislation...Also, and more significantly, there is nothing internal in the Rule of Law which renders retrospective legislation per se unconstitutional.”

Instead, the judge in the *Pienaar* case is concerned about formulating a guideline by which the constitutionality of retrospective legislation is to be ascertained. While considering foreign law, he found that retrospective laws are allowed and that they are rife in countries that adhere to the rule of law. He subsequently supplied three criteria.³⁴

Firstly, the legislation must be rational, as all legislation ought to be in accordance with the rule of law established in section 1 (c) of the Constitution. This is a straightforward

³² *Minister of Finance and Other v Van Heerden* para 145.

³³ *Pienaar Brothers (Pty) Ltd v Commissioner for the South African Revenue Service and Another* [2017] ZAGPPHC 231 para 102.

³⁴ *Pienaar Brothers (Pty) Ltd v C: SARS* para 80.

question of whether there exists a rational link between the method employed and the desired outcome.³⁵

Secondly, the statutory requirement of reasonableness with regard to section 36(1) of the Constitution becomes relevant when a provision violates a fundamental right as contained in the Bill of Rights. Restricting such rights passes constitutional muster only if it would be reasonable and justifiable in an open and democratic society.

Thirdly, in the limited circumstances where the law allows for the deprivation of property as provided for in section 25(1) of the Constitution, the rule of sufficient reason becomes relevant. For a deprivation not to be arbitrary, it must be executed with practical reason.³⁶ This test is more onerous than the test contained in the first criteria.

When applying these tests to a possible wealth tax, the composition of such tax becomes important. When considering the first criteria, a rational link is in existence: the imposition of a wealth tax as a form of reparation, alternatively to increase revenue. Secondly, it has already been established that a wealth tax would not violate a fundamental right. When considering the third criteria, it is mainly dependent on which form the wealth tax might take. Should a taxpayer's property constitute the wealth and it subsequently be deprived as payment of the wealth tax, such deprivation should occur with adequate cause.

3.5 The maxims of taxation

As there is no single ideal tax policy, tax policy should be evaluated by comparing it with the standard maxims intrinsic to a good tax system. Checks and balances are vitally important for the critical observation of tax drafts and for the passing of proper tax legislation that is in line with the constitutional principles and the established standards of fair taxation. Adam Smith³⁷ provided the leading principles of taxation that had an

³⁵ H Botha & C Marupen 'Retrospective legislation: the Pienaar Brothers case' (2017) 8 (3) *Business Tax and Company Law Quarterly* 11.

³⁶ *Pienaar Brothers (Pty) Ltd v C: SARS* para 81.

³⁷ A Smith *An Inquiry into the Nature and Causes of the Wealth of Nations Vol 2* (1817).

enduring effect on tax policy design and are referred to most frequently. The Davis Tax Committee has raised concerns over whether a wealth tax would satisfy these criteria.

3.5.1 The Equity Principle

This principle is rooted in the idea that a tax should be impartial and just, without favouritism or discrimination. While a tax should not only be fair, it should also be perceived to be fair.³⁸ Should taxpayers deem a tax unfair, it will be reflected in their compliance behaviour. Non-compliance by taxpayers erodes the tax base.³⁹ Taxpayers in South Africa might feel that a wealth tax is unfair and subsequently not comply with its provisions, similarly to what happened with the e-tolling case. Determining what is fair and what is unfair is not readily ascertainable, as it is influenced by personal feelings, tastes, or opinions. Consequently, execution of the equity principle can be an onerous exercise. In terms of wealth tax, this might be the most crucial principle considering the policy's objective is equality.

Equity, as a benchmark of consideration when developing tax policy, is supported by two leading principles: the benefit principle and the ability-to-pay principle. The ability-to-pay principle entails that a taxpayer's economic capacity be considered when evaluating their tax liability.⁴⁰ In turn, the benefit principle is satisfied when a taxpayer pays tax in proportion to the benefit received from the Government in the form of tax revenue spending. "In practice, these two principles produce different policy recommendations and offer different measures of tax reform."⁴¹ In order to satisfy the equality principle, a taxpayer's willingness to pay should correspond to the benefits he or she will derive.⁴²

³⁸ A Smith 307-308.

³⁹ E Bronkhorst 'Principles of tax policy design' in Stiglingh 1199.

⁴⁰ A Smith 306-308.

⁴¹ Davis Tax Committee 33.

⁴² Davis Tax Committee 33.

The Davis Tax Committee draws attention to the practical complications associated with the benefit principle: ⁴³

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

The Davis Tax Committee further highlights the issues associated with the ability-to-pay principle⁴⁴ in that it utilises “stocks of wealth and income” to represent a person’s capacity to pay. These proxies provide an insufficient idea of actual welfare, but the tax payments also fail to account for the actual welfare losses. The ability-to-pay principle cannot be the only consideration for the formulation of a wealth tax. As an example, problems arise when individual A inherits wealth but does not have a job and relies on interest payments for consumption while Individual B is in a position of employment, due to his university education, but lacks wealth and savings. Simultaneously, introducing a wealth tax that exclusively taxes financial assets leaves A at a drawback because he will not be able to maintain the same degree of consumption after wealth taxation.

⁴³ Davis Tax Committee 33.

⁴⁴ Davis Tax Committee 33-34.

The Equity principle can further be classified as either being vertical or horizontal. Horizontal equity occurs when taxpayers with equal economic capacity carry an equal tax burden. It should be noted that a wealth tax that makes provision for exemptions on certain assets creates horizontal inequities.⁴⁵ Vertical equity takes place when a taxpayer with a greater ability-to-pay should be responsible for a more significant burden of tax than a taxpayer with lesser ability.⁴⁶ A person in possession of a greater amount of wealth would be responsible to pay a larger part of wealth tax than a person owning less wealth.

3.5.2 The Certainty Principle

A lack of certainty about how SARS will handle wealth taxation, or how and by when Parliament will introduce such legislation or amend existing legislation, may have an intense effect on South Africa's economy. Moreover, this principle can be undermined if taxpayers are doubtful about the amount of tax an asset will be subjected to and by when it is required to be paid. A wealth tax, just as any other tax, should be clear and definite. Unfortunately, this will not be the case since the determination of the tax liability is dependent on considerations such as when the valuation is done, death, changes in asset demand, valuation method or inflation rate that may further influence the valuation of assets.⁴⁷

3.5.3 The Convenience Principle

Taxpayers should be able to comply with tax legislation and settle their tax liabilities effortlessly. Bearing in mind that taxation is compulsory by nature, it is already stigmatised by some level of opposition and hostility. If a person is compelled to do something that

⁴⁵ Davis Tax Committee 34.

⁴⁶ E Bronkhorst 'Principles of tax policy design' in Stiglingh 1200.

⁴⁷ Davis Tax Committee 35.

one would not necessarily do out of free will, there is a more significant probability of tax evasion if it is harder for that person to adhere to tax legislation:⁴⁸

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

3.5.4 The Economic Efficiency Principle

A wealth tax will be considered economically efficient if it does not excessively affect a taxpayer's economic decision-making.⁴⁹ Should an economy wish to preserve their tax base, it should ensure that their taxes are functioning in a well-organised and competent manner.⁵⁰ If a tax is inefficient, taxpayers would be prompted to alter their behaviour in an attempt to circumvent paying that tax. For instance, should the wealth tax payable on owning immovable property be too high, some taxpayers might choose to instead lease a house as opposed to owning one. That would negate the whole purpose behind a wealth tax. The Davis Tax Committee have contended that imposing a wealth tax might improve economic efficiency, as it motivates taxpayers to pursue investments that are more efficient. On the other hand, taxing wealth threatens to reduce the income of an individual even before they actualise any capital income.

⁴⁸ Davis Tax Committee 36.

⁴⁹ A Smith 310.

⁵⁰ E Bronkhorst 'Principles of tax policy design' in Stiglingh 1202.

3.5.5 The Administrative Efficiency Principle

SARS should make it as easy as possible to pay taxes and the associated compliance burden should not be too burdensome. The complex nature of wealth taxation causes its compliance costs to be high, and this can bring about the unfair treatment of some taxpayers. Wealthy individuals are inclined to have access to resources that provide them with advice from tax specialists on how to minimise their tax burden or how to entirely circumvent wealth taxation. When this occurs, the onus of the tax falls on the less wealthy who do not have the resources to pursue costly tax advice. Moreover, the administrative costs related to tax collection can be high for wealth and wealth transfer taxes and collection costs are usually high because of the required inspection and valuation of assets. SARS will need a substantial number of internal controls to be in place to assess taxpayers' information, while also needing qualified personnel to ensure compliance with the wealth tax's provisions. There are arguments that a wealth tax system would cost more to implement and maintain than the tax revenue it would generate, which would result in the tax not meeting the principle of administrative efficiency.⁵¹

3.5.6 The Simplicity Principle

Simplicity eases adherence. Tax legislation and its workings should be straightforward enough so that a reasonably informed taxpayer would be capable of understanding and applying it.⁵² Complicated legislation may result in mistakes, which could eventually result in revenue losses for the government. Taxpayers may also accuse SARS officials of abusing their powers, as their level of tax expertise places them in a more powerful position in relation to that of the taxpayer as a layman. Whether or not this accusation is well founded, it would be challenging to handle this negative perception and this could

⁵¹ A Jeffery *Politicsweb* Why the proposed Wealth Taxes won't work <https://bit.ly/2NVSSST> accessed on 29 July 2018.

⁵² Business Dictionary *Taxation principles* (2018) <https://bit.ly/22QCchv> accessed on 29 July 2018.

prompt taxpayers to evade or avoid taxation.⁵³ The legislation governing wealth and wealth transfer taxes would have to be somewhat comprehensive due to avoid any ambiguity or inadequacy, and this inevitably diminishes the principle of a simple tax system.⁵⁴

4 Conclusion

This Chapter firstly examined the procedural aspects of how wealth tax legislation would be introduced, while also highlighting the importance of the various role players in the legislative process. The core of this Chapter rests on the Constitutional Court judgment of *Minister of Finance and Other v Van Heerden*, which provide a valuable framework for assessing the constitutionality of a race-specific legislative provision. The constitutional focus of this chapter culminates as a probe is made into the issue of retrospective tax legislation. Finally, a wealth tax was considered in light of the well-established principles of taxation. The priority of the application of these principles would depend on the policy objective to be achieved. All these principles operate like a “tax ecosystem”.⁵⁵ An isolated concentration on a single principle will result in policy failure. It has become clear in this Chapter that the imposition of a wealth tax face several practical challenges, while also raising various constitutional concerns. The challenges seem to outweigh the advantages.

⁵³ E Bronkhorst ‘Principles of tax policy design’ in Stiglingh 1203.

⁵⁴ Davis Tax Committee 36.

⁵⁵ E Bronkhorst ‘Principles of tax policy design’ in Stiglingh 1199.

Chapter 4 Conclusion

4.1 Introduction

The first chapter of this mini-dissertation provided the background of wealth taxation, with a specific focus on South Africa. The gist is to impose a tax on the value of personal assets, as opposed to income tax, where a person pays tax based on their income stream. Although this concept is not novel in South Africa, its motivations and manifestations have fluctuated. Initially, it emerged solely as a measure of restorative justice as suggested by Archbishop Tutu. During the Truth and Reconciliation Commission's hearing in the late 1990s he put forward that the beneficiaries of Apartheid (white people) pay a once-off amount to the victims of Apartheid (black people) as a kind of solatium for the pain they suffered under the regime. He repeated this idea in 2011. More recently, Treasury's evaluation of wealth tax as a revenue raising-tool eclipsed the restorative justice aspect. It seems as if the reasoning has shifted from being compensatory to just serving as another governmental income source. However, legal scholars are generally in agreement with the fact that South Africa's vast levels of inequality are the primary motivation behind the consideration of a wealth tax. In better understanding South Africa's inequality and how it reached such extremes, one has to examine the socio-economic history and the role of labour and commerce under Apartheid. As the South African commercial sphere assimilated with the Apartheid system, it is arguable that companies, and not just individuals, are liable for wealth tax.

In Chapter Two, the technicalities of a wealth tax was analysed by relying on the Davis Tax Committee's report on a wealth tax. Firstly, as a multitude of misconceptions exist as to what wealth means, the significance of accurately defining wealth enjoyed consideration. When used as an umbrella term, wealth includes financial, physical, natural and human capital or resources. However, taxing human capital might prove particularly challenging as it is hard to ascribe a monetary value to these types of attributes. Pivotal to this consideration is the determination of a tax base. The tax base is established by identifying what is taxable and then quantifying it by arriving at an amount on which to

impose the wealth tax. The introduction of a wealth tax would necessitate the broadening of the tax base. This tax is different from the already established forms of wealth tax, namely donations tax, capital gains tax, transfer duty, estate duty and securities transfer tax in that a movement, transfer or disposal does not prompt it. Any person who has the real right of ownership over an asset would be liable to this tax on a recurring basis. Making use of the well-known fruit-tree principle may aid in grasping the difference between income tax and wealth tax. The income received as the owner of an asset or wealth attract an income tax liability. This income is the “fruit” of the tree. The “tree” is the asset or wealth itself, triggering a wealth tax liability. This chapter drew to a close by incorporating the contributions of Piketty, who is of the opinion that wealth inequality will only worsen unless there is governmental interference. Because wealth breeds wealth, the wealthy can keep their wealth concentrated amongst themselves while maintaining their economic superiority. He encourages that governments across the globe should jointly work towards the establishment of a global wealth tax, as such a tax will restrict the difficulties associated with tax migration while additionally deprecating tax secrecy laws.

The crux of this mini-dissertation lies in Chapter Three. This chapter predominantly considered whether a wealth tax would pass Constitutional muster by using the case of *van Heerden*¹ as a framework. The question raised is which class or group of persons will be eligible to pay this tax. As race plays a central role in this regard, a law will be adopted to single out one racial group, being white people. The backlash from civil rights organisations such as AfriForum and the FW de Klerk Foundation could be significant and may in all probability result in legal proceedings. Furthermore, the canons of taxation namely equity, certainty, convenience, economic efficiency, administrative efficiency and simplicity also need to be satisfied, regardless of who will be liable to pay the tax. As this proposed tax is not part of the current law, the legislative process leading up to the enactment of such law is contemplated, with a specific focus on the role of the general public in this process. Regarding racialism and wealth tax, the Constitutional Court in *van Heerden* laid down three standards to ensure affirmative action measures are valid in terms of section 9(2). Firstly, the measure should target persons who have been

¹ *Minister of Finance and Other v Van Heerden* 2004 (6) SA 121 (CC).

disadvantaged by unfair discrimination. Secondly, the measure should be designed to protect or advance such persons. Finally, the measure should promote the achievement of equality. Resultantly, a wealth tax on white people with a particular net worth would meet the s 9(2) requirements. A wealth tax on all South Africans of particular net worth would also seem to satisfy s 9(2). When considering the maxims of taxation, each maxim's priority would depend on the policy objective to be reached. However, all these principles operate in an interconnected system; and isolating one principle will result in policy failure.

4.2 Recommendations

Conceptualizing the introduction of a wealth tax in South Africa is challenging, taking into account the various issues discussed in this mini-dissertation. At this point, legal scholars can only hypothesise on how the legislature could optimally implement such a tax.

4.2.1 Thomas Piketty

Piketty evaluated South African inequality and made various suggestions. He stated that it would be beneficial for South Africa to have a more accurate and transparent approach to ascertaining who the wealth holders are and what the extent of their wealth is. To a large extent, our inability to have constructive deliberation on the issues of wealth and inequality is due to the lack of reliable information available on wealth. Consider the South African estate duty tax for example, where there is a dutiable amount payable on a deceased estate. Despite this, it is challenging to establish how many taxpayers transmitted wealth between R1 million, R2 million or R10 million to R20 million, on an annual basis. Estate duty only becomes relevant at the time of the taxpayer's death, where the living's wealth might be of more relevance.

He continues to anticipate reluctance from the commercial sphere's roleplayers but highlights that transparency will also be beneficial to them and that those who have a problem with being transparent usually have something to hide. One should not underestimate the role of trust in a country, and transparency about wealth and income are vital to building such trust.

Finally, he moves towards the global arena and identifies the role of other countries. Wealthy South Africans can utilise tax havens and obscure their wealth because the tax laws of countries enable them to do so. The international community should encourage worldwide financial transparency and oppose tax havens. Europe is directly responsible for the Apartheid system, which was merely a severe extension of a colonial inequality present throughout the European colonial period in Africa. Africa is in need of an international legal system that empowers African countries to force multinational corporations and wealthy citizens to contribute their fair share of tax.²

4.2.2 Davis Tax Committee

The Davis Tax Committee is of the opinion that a taxation system that disregards the worrying levels of wealth inequality in South Africa will not satisfy the significant requirement that a tax system should be legitimate. The procedure of designing a wealth tax in South Africa as a tool to remedy the country's levels of inequality must initially contemplate a straightforward and explicit form of a yearly net wealth tax. The decisive factors to be considered before implementing a wealth tax are threefold. Firstly, the tax base needs to be identified. Secondly, extensive information on the configuration of wealth ownership is needed. Thirdly, there should be an assessment of whether the revenue received would outweigh the administrative and practical onus on the revenue service and taxpayers.

In order to improve the quality of taxpayer data mentioned in the second factor, the Committee advances that all taxpayers and holders of wealth(including trustees and trust beneficiaries) that are obliged to submit an income tax return should also be obliged to add the market value of all readily determinable wealth in an amended tax return for the 2020 year of assessment.³ Additionally, taxpayers should be obliged to disclose other forms of wealth they might hold, such as pension funds, private company shares,

² Edited transcript of economist Professor Thomas Piketty's address to the 13th Nelson Mandela Annual Lecture, which took place at the University of Johannesburg's Soweto campus on 3 October 2015 <https://bit.ly/1QSm3RI> accessed on 16 September 2018.

³ Davis Tax Committee *Report on feasibility of a wealth tax in South Africa* dated March 2018 67.

intellectual property, and assets above a specific value, even if these assets' market value is not readily ascertainable. The Committee then suggest an amendment of the non-disclosure penalties of the Tax Administration Act⁴ in that it should provide for considerable penalties in the event of taxpayers not disclosing their wealth. This proposed alignment with existing legislation is commendable, as it provides some measure of certainty and simplicity by not exclusively relying on new rules. It is also less disruptive and provides taxpayers with a benchmark in completing their tax return. Furthermore, this disclosure will improve income tax collections by reconciling whether the disclosed income is in correspondence with the taxpayer's underlying assets.⁵

When considering all these suggestions, it becomes evident that the establishment of a wealth tax cannot be executed in the short term. The DTC is in favour of utilising interim measures, that does not include a wealth tax, to address the problem of wealth inequality. They endorse the complete implementation of their First⁶ and Second⁷ estate duty reports. Therefore priority should initially be placed on increasing estate duty collections, as the needed administrative capacity is already firmly established.

Lastly, the DTC touches on the damaging effects of corruption and wastefulness, stating that the elimination of imprudent, corrupt, and unauthorised government expenditure and improved tax morality will aid in redressing South Africa's unsustainable inequality levels.⁸

Upon collection of such wealth taxes, it may be beneficial to earmark how such funds will be allocated. Ensuring that the money will serve a specific purpose or go to a specific cause will also increase taxpayer willingness and trust.

⁴ Tax Administration Act 28 of 2011.

⁵ Davis Tax Committee *Report on feasibility of a wealth tax in South Africa* dated March 2018 68.

⁶ Davis Tax Committee *First interim report on estate duty* dated January 2015.

⁷ Davis Tax Committee *Second and final report on estate duty* dated April 2016.

⁸ Davis Tax Committee *Report on feasibility of a wealth tax in South Africa* dated March 2018 68.

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