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**BY**

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*Please note that the views expressed in the paper are my own,  
and are not necessarily those of the FFC*

# LOWER TIER GOVERNMENT REVENUE SOURCES IN SOUTH AFRICA

## A transition to fiscal federalism

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### Important notice

*Although the author is a member of the South African Financial and Fiscal Commission, the views expressed in this article are his own, and should not be taken to be the official views of the Commission.*

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### Summary

South Africa has long had a fiscal system characterised by strong centralisation. The new Interim Constitution provides for a move towards a degree of fiscal federalism.

Constitutional principles provide that the national, provincial governments and local governments shall have defined fiscal powers and functions, and that each level of government shall have a constitutional right to an equitable share of revenues collected nationally so as to ensure that provinces and local governments are able to provide basic services and execute the functions allocated to them.

These principles will be retained in the new Constitution that is in the process of being formulated, so providing continuity between the two sets of legislation.

The Interim Constitution (referred to below as the Constitution) itself provides that each province is entitled to an equitable share of revenue collected nationally in order to enable it to provide services and to exercise and perform its powers and functions. This equitable share comprises three elements, namely (a) a percentage of nationally collected individual income taxes, value-added taxes, sales taxes and fuel levies, (b) transfer duties collected within provinces, and (c) allocations (conditional or unconditional) out of national revenue.

It is provided that all transfers of revenue share and allocations should be effected expeditiously, and without deduction therefrom. This ensures that the national government should act promptly in distributing the full sum of each province's entitlement.

The Constitution gives provincial legislatures the competence to raise taxes, levies and duties with three exceptions, namely income tax, value-added tax and sales tax. In addition, they are given the competence to impose surcharges on taxes. In all cases, the province must receive authorisation by an Act of Parliament after taking into consideration the FFC's recommendations. Discrimination against non-residents of a province who are South African citizens is prohibited.

Provincial legislatures are also given exclusive competence within their provinces to impose taxes, levies or duties (excluding individual income tax, value-added tax

or sales tax) on casinos, gambling, wagering, lotteries and betting.

There is an overriding proviso (which applies to all of the matters discussed under this heading) that a provincial legislature is not entitled to levy taxes that detrimentally affect national economic policies, inter-provincial commerce or the national mobility of goods, services, capital and labour.

Provincial legislatures are given Constitutional competence to enact legislation authorising the imposition of user charges, subject to provisos similar to those relating to their taxing powers.

Local governments are Constitutionally competent to raise property rates, levies, fees, taxes and tariffs as may be necessary to exercise their powers and perform its functions. These competencies are subject to such conditions as may be prescribed by law of a competent legislature after taking into account recommendations of the FFC. Furthermore, within each local government area of jurisdiction such rates, levies, fees, taxes and tariffs must be based on a uniform structure. They are further entitled to an equitable allocation of funds by the provincial government - the FFC is charged with making recommendations regarding criteria for such allocations.

The concept of equity in revenue sharing as used in the Constitution can only be understood in terms of the requirement that provinces and local government provide and execute their defined services and functions. This, in turn, is affected by two principle variables, namely the extent to which the relevant powers and functions are devolved to the lower tiers of government; and the level at which the services are to be provided and the functions executed.

Besides access to revenues, lower-tier governments require access to borrowings. The related Constitutional provisions are discussed in the text.

The Financial and Fiscal Commission's overall tasks are then analysed in the light of the discussion above.

Finally, potential revenue sources for lower-tier governments are analysed in some detail. Theoretical discussion and a definition section are followed by an analysis of South Africa's existing revenue sources on an item-by-item basis. The analysis is made in the context of practicality as well as Constitutional requirements

## 1. Introduction

1.1 South Africa has long had a fiscal system characterised by strong centralisation. The Interim Constitution which has been in force since the successful democratic elections in April 1994 provides for a move towards a degree of federalism, and, of pertinence to this paper, a degree of fiscal federalism. Before examining this move, it is useful first to examine the relevant Constitutional principles.

1.2 Constitutional principle XXV provides that the national and provincial governments shall have fiscal powers and functions that will be defined in the Constitution, and that, similarly, such powers and functions for local government will be provided for in the portion of the Constitution dealing with the framework for local government.

1.3 In turn, constitutional principle XXVI provides that each level of government shall have a constitutional right to an equitable share of revenues collected nationally so as to ensure that provinces and local governments are able to provide basic services and execute the functions allocated to them.

1.4 Interpretation in this paper is guided by the Constitutional principles, since these principles will be retained in the new Constitution which is in the process of being formulated, so providing continuity between the two sets of legislation.

## 2. Provincial revenues and the constitution

### 2.1 General

2.1.1 Consequent upon the abovementioned constitutional principles, the Constitution itself provides for provincial government revenues in sections 155 and 156. These specify that each province is entitled to an equitable share of revenue collected nationally in order to enable it to provide services and to exercise and perform its powers and functions. The term "revenue collected nationally" is interpreted in this document to mean revenue collected at the national level, rather than revenue collected in the nation as a whole.

This equitable share of revenue comprises three elements, namely:

- a percentage of nationally collected individual income taxes, value-added taxes, sales taxes, fuel levies;
- nationally collected transfer duty;<sup>1</sup> and
- allocations (conditional or unconditional) out of national revenue.

<sup>1</sup> Of these three revenue sources, only transfer duties have a geographical restriction, as the provincial entitlement in this case comprises transfer duty on property situated within each particular province.

2.1.2 In all cases, with the exception of transfer duty, an Act of Parliament<sup>2</sup> is required, which must take into account the national interest and the recommendations of the FFC.

2.1.3 In the case of the conditional and unconditional allocations,<sup>3</sup> a number of further factors must also be taken into account, namely:

- provision for repayment of the national debt
- the legitimate needs and interests of the national government
- provincial fiscal capacities
- provincial fiscal performance and their efficiency of revenue utilisation
- provincial needs (including developmental needs) and economic disparities
- provincial administrative responsibilities
- other legitimate provincial interests, and
- other objective criteria identified by the FFC.

2.1.4 It is provided that all transfers of revenue shares and allocations should be effected expeditiously, and without deduction therefrom. This ensures that the national government should act promptly in distributing the full sum of each province's entitlement.

## 2.2 Provincial taxing powers

2.2.1 Provincial taxing powers are provided for in section 156, which gives provincial legislatures the competence to raise taxes, levies and duties with three exceptions, namely income tax, value-added tax and sales tax.<sup>4</sup> In addition, they are given the competence to impose surcharges on taxes.<sup>5</sup> In all cases, the following provisos apply:

- the province must receive authorisation by an Act of Parliament<sup>6</sup> passed after the consideration by Parliament of the FFC's recommendations on the Act's draft text, and
- there must be no discrimination against non-residents of a province who are South African citizens.

2.2.2 Provincial legislatures are also given exclusive competence within their provinces to impose taxes, levies or duties (excluding individual income tax, value-

added tax or sales tax) on casinos, gambling, wagering, lotteries and betting. The provisos discussed immediately are not applicable in these cases.

2.2.3 There is an overriding proviso (which applies to all of the matters discussed under this heading) that a provincial legislature is not entitled to levy taxes that detrimentally affect national economic policies, inter-provincial commerce or the national mobility of goods, services, capital and labour.

## 2.3 Provincial user charges

2.3.1 Section 156 also provides that provincial legislatures shall be competent to enact legislation authorising the imposition of user charges, subject to the following:

- the legislation may only be enacted after the provincial legislature has considered the recommendations of the FFC concerning the criteria according to which such charges should be determined, and
- there must be no discrimination against non-residents of a province who are South African citizens.

## 3. Local revenues and the constitution

3.1 The Constitution provides for local government revenues in section 178 that requires that such governments should render efficient services to persons within their jurisdictions. In this context, the section provides that such governments shall:

- be competent to levy and recover such property rates, levies, fees, taxes and tariffs as may be necessary to exercise its powers and perform its functions - these competencies are subject to such conditions as may be prescribed by law of a competent legislature after taking into account recommendations of the FFC - furthermore, within each local government area of jurisdiction such rates, levies, fees, taxes and tariffs must be based on a uniform structure; and
- be entitled to an equitable allocation of funds by the provincial government - the FFC is charged with making recommendations regarding criteria for such allocations, taking into account the

<sup>2</sup> The provisions of sections 59(2) and 60 of the Constitution (which, inter alia, restrict the power of the Senate with regard to the passing of Bills) do not apply to these particular Acts of Parliament. These Acts must be passed by the National Assembly and the Senate sitting separately.

<sup>3</sup> The question could be posed as to whether these factors should not also have applied to the percentage shares discussed above.

<sup>4</sup> This implies that provinces may not levy a tax similar to the RSC "establishment levy" on turnover, but leaves the matter open as far as local governments are concerned.

<sup>5</sup> Since the reference is to tax alone, this implies that surcharges on levies and duties are precluded.

<sup>6</sup> The provisions of sections 59(2) and 60 of the Constitution (which, inter alia, restrict the power of the Senate with regard to the passing of Bills) do not apply to these particular Acts of Parliament. These Acts must be passed by the National Assembly and the Senate sitting separately.

metropolitan, urban and rural categories of local government.

3.2 In the context of the discussion above, the potential revenue sources (taxing powers) of the different levels of government are analysed in 6. below. But before doing so, it may be of interest to examine the way in which the above factors fit within the overall fiscal framework in the Constitution and then to take note of the basic task of the Financial and Fiscal Commission.

#### 4. The Constitutional framework

4.1 The concept of an "equitable share of revenues collected nationally" as set out above relates directly to the requirement to "ensure that provinces and local government are able to provide basic services and execute the functions allocated to them." It is thus clear that the concept of equity in revenue sharing can only be understood in terms of the requirement that provinces and local government provide and execute the aforementioned services and functions.

4.2 This requirement is affected by two principle variables, namely :

- the extent to which the relevant powers and functions are devolved to the lower tiers of government; and
- the level at which the services are to be provided and the functions executed.

4.3 The first variable is governed directly by the Constitution in that Constitutional principle XVI provides that Government shall be structured at national, provincial and local levels, while principle XX provides that each of these levels shall have appropriate and adequate legislative and executive powers and functions to enable them to function effectively. This principle requires the allocation of powers between the levels of government to be made on a basis conducive to financial viability at each of these levels, and to effective public administration, recognising the need for and promoting national unity and legitimate provincial autonomy, acknowledging cultural diversity. Various other principles relate to aspects of this issue, and these are conditioned by principle XXII which provides that national government shall not exercise its powers (exclusive or concurrent) so as to encroach on the geographical, functional or institutional integrity of the provinces. The Constitution itself then provides specifically for the allocation of powers and functions. The FFC has no direct role with regard to this allocation, except in relation to the allocation of certain fiscal powers and functions, as discussed under 1.2 above.

4.4 The second variable is governed only indirectly by the Constitutional principles, in that principle XXI refers to equality of opportunity or access to a government service, and principle XXVI refers to provincial and

local governments being enabled financially to provide basic services.

The Constitution itself refers in section 126 to Acts of Parliament taking precedent over provincial laws in relation to concurrent provincial legislative competencies in certain circumstances. These circumstances include, amongst others, where the Act of Parliament:

- deals with a matter that, to be performed effectively, requires to be regulated or co-ordinated by uniform norms or standards that apply generally throughout the Republic;
- is necessary to set minimum standards across the nation for the rendering of public services; or
- is necessary for the maintenance of economic unity, the protection of the environment, the promotion of inter-provincial commerce, the protection of the common market in respect of the mobility of goods, services, capital and labour, or the maintenance of public security.

4.5 Clearly, to the extent that the powers and functions are devolved to lower tiers of government, and to the extent that national government imposes related expenditure requirements on lower tiers of government by means of national legislation, these lower tiers have a right to an equitable share of national revenues in order to enable them to exercise these powers and fulfil these functions.

4.6 As has been seen, lower tiers of government are entitled to three principal revenue sources, namely :

- an equitable share of revenue collected nationally comprising, first, percentage shares of certain nationally collected taxes and levies, second, transfer duty collected within their provincial boundaries, and, third, allocations out of national revenue
- own taxing powers (covering a range of taxes, surcharges, levies and duties); and
- user charges.

4.7 As has been noted in 1.3, Constitutional principle XXVI only uses the "equity" concept in the context of the first category, namely the equitable share of revenue. This is echoed in the Constitution itself in relation to both provincial government (sections 155 and 156) and local government (section 178). However, unlike provincial government, local government is given the competency to raise property rates, levies, fees and tariffs as are necessary to exercise its powers and perform its functions.

4.8 It is possible that the latter is, to a degree, at odds with principle XXVI (see 1.3 above) which entitles each level of government to an equitable share of revenues collected nationally, to enable them to provide basic

services and execute their functions. This possible paradox can be reconciled by accepting that local governments who, despite strong tax effort and fiscal efficiency, are not able to provide basic services and execute their functions, have an automatic right to a share of national revenues (via their province) to enable them to do so.

4.9 Interestingly, despite the equity sharing principle applying to the sum of all revenues collected nationally, the Constitution itself only refers in detail to criteria relating to equity (see 2.1.1 and 2.1.3) in the context of a subcategory of such shared revenue, that is, allocations out of national revenues. This leaves open the question as to whether the equity criteria apply to the other subcategory of shared revenue, namely, the percentage shares of certain nationally collected revenues, comprising taxes, levies and duties. Notwithstanding this inconsistency in the Constitution, it is considered that the provisions of Constitutional principle XXVI strongly imply that these criteria must have a broader application to the sum of all shared revenues, since the concept of an equitable revenue share applies to this sum.

4.10 Since the FFC cannot render advice and make recommendations without considering these criteria, it is essential that these criteria be:

- clearly defined;
- continually measured and recorded; and
- continually re-evaluated.

4.11 Besides access to revenues, lower-tier governments require access to borrowings. There is a generally accepted principle that borrowings should only be used to finance capital expenditure. In the context of provinces this finds expression in section 157 of the Constitution, which prohibits provinces from raising loans for current expenditure. The only exception to this is in the case of bridging finance, provided that such loans are redeemed in the same fiscal year, and are subject to such further conditions as may be prescribed by an Act of Parliament passed after recommendations of the FFC in relation to the draft text thereof have been considered by Parliament.

4.12 Provinces are entitled to raise borrowings for capital expenditure, provided that they do so within a framework of norms and conditions prescribed by an Act of Parliament passed after recommendations of the FFC in relation to the draft text thereof have been considered by Parliament.

4.13 The same section of the Constitution provides that provinces may not guarantee loans (presumably loans by local governments within their geographical areas, or loans by agencies or corporations of the provincial government) unless:

- the FFC has verified the need for a guarantee and recommended that it be given; and

- the giving of the guarantee has been approved by a resolution of Parliament.

4.14 Similarly, section 188 of the Constitution provides that the national government may not guarantee any provincial or local government loan unless:

- the guarantee complies with the norms and conditions for such a guarantee as set out in an Act of Parliament; and
- the FFC has made a recommendation concerning compliance of the guarantee concerned with such norms and conditions.

4.15 The Constitution contains no direct reference to the borrowing powers of local governments, other than that mentioned in 4.14. This reference, together with the indirect reference referred to in 4.13, implies that local governments are entitled to borrow. It is logical to assume that it was intended that the restrictions on provincial government borrowings discussed above should apply equally to local governments, with appropriate adjustments, and the new Constitution should deal specifically with this aspect.

## 5. The Financial and Fiscal Commission's tasks

5.1 The Financial and Fiscal Commission's overall tasks are embodied in two measures. The first is to recommend equitable fiscal and financial allocations to the provincial and local governments from revenue collected nationally, after taking into account the national interest, economic disparities between the provinces as well as the population and developmental needs, administrative responsibilities and other legitimate interests of each of the provinces (Constitutional principle XXVII).

5.2 The second is to render advice and make recommendations to legislative authorities regarding the financial and fiscal requirements of all three tiers of government (Constitution, section 199).

## 6. Potential revenue sources

### 6.1 Introduction

Different tiers of government may obtain revenues from various sources, individually or in combination. These sources are own taxes, overlapping taxes, shared taxes, non-tax revenues, general purpose grants and specific grants. Each of these terms is defined below.

The share of total national revenue which provincial and local governments (generally referred to below as lower tier governments) may need from these sources depends on the extent to which legislative and executive competencies have been given to them. The more extensive these competencies, the higher the required revenue share to fulfil these competencies.

Furthermore, this required revenue share will also be influenced by the degree to which the national government sets standards that affect the level and type of services lower tier governments are expected to provide.

## 6.2 Revenue sources

6.2.1 To begin with the fairly obvious: the revenues of lower tier government usually flow from two sources, namely those which are completely or partially under their control and those over which they exercise no control at all.

6.2.2 Controlled revenues comprise revenues generated through a mechanism over which provinces and local governments have some control. These include tax as well as nontax revenues. The tax revenues may be divided into own taxes, overlapping taxes and directly attributable shared taxes - these terms are all explained in 6.3 below.

6.2.3 Revenue pools may be shared with lower tier governments in two ways. The first is through a percentage allocation method. The second is by means of allocations (also known as grants). Such pools are typically funded from centrally collected (and centrally controlled) revenues. The necessity for revenue sharing usually has an inverse relationship to the strength of the flow of lower tier government controlled revenues - the higher the latter, the lesser the need for the former, and vice versa.

6.2.4 Allocations can be divided into two categories namely:

- conditional allocations (also known as tied or specific purpose grants) - an example would be an allocation to build a hospital in accordance with predetermined specifications; and
- unconditional allocations (also known as untied or general purpose grants) - an example would be an unconditional allocation of a fixed sum to allow a province to balance its budget.

As a rule, the greater the degree of financial competence displayed by a lower tier government, the higher the likely level of unconditional allocations, and the lower the level of conditional allocations, and vice versa.

## 6.3 Definitions

6.3.1 The definitions in this section are adapted from *Local government, an international perspective*, edited by J P Owens and S Panella, North Holland 1991, as reproduced in *Tax Policy in OECD Countries*, by K C Messere, IBFD Publications, 1993.

*Own taxes* : these are taxes where both the tax base and the tax rate are under lower tier government control -

such taxes may be collected by these lower tiers, or by national government as an agent for lower tiers, where the lower tiers do not have the capacity to cost-effectively collect the taxes on their own behalf.

*Overlapping taxes* : these have a nationwide tax base, but the rates are completely or partially under lower tier control.

*Shared taxes* : these taxes have a nationwide base and nationwide rates, but with the lower tier able to exert such influence on the proportion of revenues attributed to it; these taxes may be either directly or indirectly attributed to the lower tier. This concept should be distinguished from the term *Revenue sharing*.

*Non-tax revenues* : in the case of these revenues the lower tier government is able to determine the fee to be charged, although national government may specify whether such a charge can be levied as well as the provisions that have to govern the calculation of such a charge; such revenues include user charges.

*Revenue sharing*: in the Constitutional context this term refers to the equitable sharing of nationally-collected revenues by all three tiers of government. Such sharing is to be achieved by allowing lower tier governments shares in certain national taxes, as well as by making *allocations* (conditional and unconditional) from national revenues.

*Unconditional allocations* : the lower tier government's share of such allocations or grants is fixed by national government (usually with a re-distributive element) subject to constitutional and legislative safeguards, but the lower tier is free to determine how the funds should be spent.

*Conditional allocations* : the amount of a conditional allocation or grant may be determined by national government or may depend on the spending decisions of lower tier government, but in either case national government specifies how the funds should be spent.

6.3.2 In practice most of these revenue sources tend to be subject to fairly detailed controls by national government, even in strongly federalist countries; for example, own taxes are seldom exclusively under the control of provinces; they are frequently subject to constraints on the tax base and rates, and the value of general purpose grants received by provincial authorities sometimes depends upon the rates fixed for provincial own taxes.

## 6.4 Discussion of options

6.4.1 For any given share of total national revenue which the lower tier levels of government may need, the mix of possible revenue options depends on the degree to which the devolution of taxing powers may be cost-effective, on the distribution of tax bases between geographical areas represented by lower tiers, and on the extent to which the national government is willing



(within constitutional constraints) to relinquish control over revenue-gathering and expenditure powers.

6.4.2 For example, revenue-gathering and expenditure powers may be kept entirely under national control, with expenditure powers either completely devolved by distributing revenues as unconditional allocations or completely centralised by means of conditional allocations. On the other hand, there is an automatic effect in that the greater the extent of the devolution of revenue-gathering powers, the greater the devolution of expenditure powers for the simple reason that it is near-impossible for a national government to prescribe to a lower tier government how it should spend its own taxes.

### 6.5 Discussion of specific taxes

This discussion examines the technical feasibility of current South African tax sources being adapted to become lower tier own taxes, overlapping taxes or shared taxes, in whole or in part, in the light of the constitution. The discussion assumes that such adaptation does not in itself increase or decrease the overall level of each particular tax as a percentage of Gross Domestic Product. The author has drawn in part from work done by him in 1993 for a project of the Consultative Business Movement, in which considerable valuable input was given by other project members, most notably Mr Colin Donian of the Department of Finance.

#### a. *Personal income tax*

This source of tax is invariably a major source of a country's tax revenues and is consequently a major tool for redistribution of revenues. Internationally, personal income tax systems have been somewhat complex, and the South African system is no exception. The collection and administration of such tax is thus necessarily complex and, in the context of South Africa's limited tax gathering infrastructure, it should thus preferably be centralised. As a consequence personal income tax is not particularly suitable to be used as an own tax. The Constitution recognises this by retaining it for the exclusive use of national government.

It is technically possible for personal income tax to be in part an overlapping tax - for example, provincial or local governments could be given the option of imposing a surcharge on personal income tax paid within their provinces, subject to national constraints. Such a surcharge could be collected by a centralised tax administration for onward distribution to provinces. This method has a shortcoming as, in order to keep the administration reasonable, it would have to be based on the place of residence of the taxpayer, rather than the place where the taxpayer's business activities are carried out.

It is also possible, and substantially simpler, for personal income taxes to be a shared tax - for example, each provincial government could be irrevocably entitled to a fixed percentage of the personal income tax collected in

its particular area, or the provincial government level as a whole could be entitled to a fixed percentage of total personal income tax collections, with the allocation between provinces determined on the basis of an approved formula. Such a course of action is provided for in the constitution.

#### b. *Company income tax*

The collection and administration of corporate tax is complex and should preferably remain centralised - as a consequence it cannot easily be an own tax. The constitution recognises this by retaining it for the exclusive use of national government.

It is also inappropriate to attempt to make this tax an overlapping tax as it is technically very complex to attribute a company's taxable income to particular geographic areas. For the same reason, a shared tax system that entitles lower tiers of government to a proportion of tax relating to their particular geographic areas is problematic.

It is possible for company income tax to be a shared tax in the sense that the provincial government level as a whole could be entitled to a fixed percentage of the total company income tax collection, and, similarly to individual tax, the allocation between provinces would be determined on the basis of an approved formula. However, unlike the case of personal income tax, such a course of action is not provided for in the constitution.

#### c. *Value Added Tax*

The collection and administration of VAT is also fairly complex. Furthermore, it does not easily lend itself to being levied on a provincial basis. It cannot easily be levied as an own tax. For these reasons it is most effectively levied on a national basis. The constitution recognises this by retaining it for the exclusive use of national government.

It is technically possible to make VAT an overlapping tax, for example by allowing each province to impose a surcharge on the national VAT rate, within certain constraints. However, there are two major problems with this course of action. The first is that VAT is not necessarily levied where the underlying business activities take place, as businesses have the option to centralise or decentralise VAT calculations. The second (and possibly more serious) problem is that, in the event of differential VAT rates between provinces, widespread evasion of VAT may result as a consequence of the absence of border controls between provinces. The first reason also militates against VAT being a shared tax allocated specifically to each individual province.

However, it is perfectly feasible for VAT to be a shared tax in the sense that the provincial government level as a whole (including local government) could be entitled to a fixed percentage of the total VAT collection. Such a course of action is provided for in the constitution.

Allocations to the different provinces would need to be on an objective basis, and, similarly to individual and corporate tax, the allocation between provinces would be determined on the basis of an approved formula.

#### d. Retail sales tax

A very low rate retail sales tax could be levied as an own tax by provinces, subject to certain constraints. This overcomes the first problem relating to the VAT surcharge, in that the tax is located at the retail outlet, but the second problem (the case of evasion due to non-existent border controls) still exists.

A further potential problem is that sales tax is a fairly difficult tax to administer and police, and it is debatable whether this task would be a cost-effective option for lower tier governments in South Africa.

The constitution has in any event precluded this option by prohibiting sales tax as a source of lower tier government revenue. However, should a national sales tax ever be reintroduced (an unlikely event while the national VAT continues to be levied) the constitution does allow provinces a potential percentage share thereof.

#### e. Excise Duty

Although the complexity of excise duty is such that it is most efficiently administered and collected centrally, it is technically possible for it to be treated as a lower tier government own tax or overlapping tax, based either on the full tax base, or perhaps only on defined luxury items. The system of allocating transactions to individual geographic areas will, of necessity, be somewhat complex.

#### f. Fuel levy

This levy is relatively easily capable of being treated as an overlapping tax, with a common tax base. For example each province or local authority might be given the power to levy a surcharge, subject to certain constraints - the obvious mobility of motor vehicles will be a natural check on abnormal variations in provincial surcharges. A uniform nationwide surcharge dedicated to provincial and/or local authorities is also feasible.

The constitution envisages that provincial participation in fuel levies should be on a percentage share basis. This does not preclude that, as an alternative, one of the above surcharge options could be applied, unless the implication mentioned in footnote 5 proves to be correct.

#### g. Transfer duty

Because transfer duty has no geographic mobility, it has substantial potential as a lower tier government own tax, particularly at the local level. Similarly to fuel levies, the constitution envisages that provincial participation in transfer duties should be on a percentage share basis, albeit that there is a geographical limitation. This does

not preclude that, as an alternative, one of the above surcharge options could be applied unless the implication mentioned in footnote 5 proves to be correct. Furthermore, the constitution is silent as to local government's possible role in relation to such duties. It is considered that local governments are not necessarily precluded from participating in their revenues, subject to the conditions discussed in 3.1.

#### h. Mining and Minerals tax

There is an argument that minerals tax in the form of a severance tax should be levied by provinces in which the mining is undertaken, on the basis that the province should earn some return on the depletion of the natural resources located within its boundaries, in order to bolster other economic activities in the area in anticipation of the ultimate closure of the mine. On the other hand, if such a tax adds to the cost of the mining operation, it effectively shrinks the quantum of the area's economically exploitable mineral reserves, to the ultimate detriment of the country as a whole.

As a consequence, the province could best be provided for by allowing it to share in the income taxes generated by the mines in its area, although this may involve some complexity in apportionment where a single company operates a number of mines. For the position where the province owns the mineral rights, see r. below.

#### i. Import surcharge

The current import surcharge is a temporary measure that is due to be abolished, and thus it is not dealt with in detail. If it was a permanent tax feature, it could probably be dealt with reasonably effectively a general shared tax.

#### j. Customs duty

This tax cannot easily be dealt with as an own tax or an overlapping tax, due to the difficulty in determining the location of the ultimate usage of the imported item, where the importer's operations are geographically widespread. However, this tax could probably be reasonably effectively dealt with as a general shared tax.

#### k. Financial services levy

As currently constituted, the financial services levy, which is levied on certain financial enterprises instead of VAT, cannot easily be dealt with as an own tax or an overlapping tax. This is primarily due to the difficulty in apportioning the levy (which is alternately asset or interest-based) to the underlying activities of the affected financial institutions that, by their nature, are invariably geographically widespread. However, the tax could probably be reasonably effectively dealt with as a general shared tax.

### l. Marketable securities tax and stamp duties

These taxes could conceivably be levied as own taxes or overlapping taxes, based on the location of the ultimate client. However, due to the mobility of the transactions that are sought to be taxed, differential rates between provinces would ensure almost universal migration of business to the lowest tax jurisdiction. These taxes are thus most suitably levied at the national level.

It should be borne in mind that a reasonable case can be made for the proposition that these taxes are an impediment to financial activity and that they should be abolished, as has occurred in various other countries. As a consequence they cannot be relied upon as a long term source of lower tier government revenue.

### m. Capital transfer tax

Such taxes, in the form of estate duty and donations tax have a location profile similar (but not identical) to personal income tax, and the discussion under that heading thus also has substantial relevance here.

### n. Regional Services Councils levies

The current regional services councils levies on business turnover (the establishment levy) and employee remuneration (the services levy) are solely an own tax accruing to the local government level. They are potentially unwieldy from an administrative point of view. There are mixed views as to the cost effectiveness of these levies. There is a widespread view that they have, in the long term, a potential to dampen economic growth and employment generation.

In the short term, because of the current low rate of the levies, they probably need to be retained as a source of local government revenue. However, the constitutional position of the establishment levy needs to be clarified in the light of the prohibition against provinces levying sales taxes (see c. above).

### o. Betting taxes

Where betting activity falls under provincial jurisdiction, it is logical that the related tax should be an own tax for the relevant province. Where the betting activity falls under national government jurisdiction, for example, in the case of a national lottery, it is feasible for the related taxes or net revenues to be subject to general sharing with provinces.

### p. Property taxes

Property taxes, including rates on urban dwellings and commercial premises as well as land taxes traditionally fall under the jurisdiction of the local authorities in which the properties are located. There is no reason for this to change.

### q. Other new taxes

Various new taxes have been mooted in general discussions of future tax policy. Should any of these be implemented the potential for provincial participation will depend, as in the above cases, on the administrative complexity and the ease with which the underlying taxable event can be accurately located, amongst others.

For example, a capital gains tax would have a similar profile to personal income tax. As another example, should a property tax be levied on land that currently is not subject to property tax (for example, agricultural land), such a tax should be regulated and administered by and for the benefit of local government.

### r. Non-tax revenues

User charges, where a provincial or local government owns the asset concerned or has financed its erection or acquisition, should as a rule be levied by that level of government, and the rates should be under its control. Such non-tax revenues can be categorised as follows (*Bird and Wallich (1992)*):

**Service fees** - fees representing a cost reimbursement to provinces or local government for performing specific services; these include licence fees and registration fees.

**Public prices** - the revenues received by provincial or local governments from the sale of public goods and services, other than the abovementioned service fees; these include public utility charges, lease or rental fees for the use of provincial or local government-owned assets (this includes royalties or similar charges which would be levied on mines, where a province or local authority is the owner of the related mineral rights), and admission charges to recreational facilities. These revenues may be generated by charging users on a cost or a cost plus basis.

**Specific benefits taxes** - these relate to the specific benefits supposedly received by specific taxpayers and tend to relate more to local government than to provincial government; these include special assessments, land value increment taxes, improvement taxes, front footage levies, supplementary property taxes related to the provision of sewers or street lighting - usually such charges are imposed either on the assessed value of real property or some characteristic of that property, such as its area, frontage or location.