

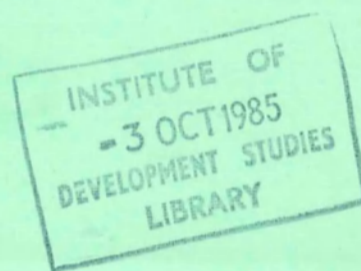
TOWARDS A TAX EXPENDITURE BUDGET
FOR SOUTH AFRICA

by

J. VAN DER S. HEYNS

OCCASIONAL PAPER NO. 15

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_(a) Economic Research Unit
University of Natal

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1. INTRODUCTION

This paper is concerned with the presentation of the South African budget. Its special focus is the tax expenditure budget.

Background

The South African tax laws contain many special concessions and incentives designed to achieve social and economic objectives beyond simply collecting revenue in accordance with the standard tax policy goals of simplicity, equity and neutrality. A listing of these special provisions and their tax costs, or so-called tax expenditures, should form part of the Finance Minister's annual budget presentation. The budget's present inadequate exposure of this dimension of budgetary policy is one of its major shortcomings.

The idea of a tax expenditure budget was first developed in the United States (US) in the 1960s. It is widely considered to be the brainchild of Stanley S. Surrey, who was Assistant Secretary for Tax Policy in the US Treasury at that time. Surrey first used the term 'tax expenditure' in a speech delivered in 1967.

The growing interest shown in tax expenditures in many countries, including South Africa, derives from the fact that these special tax provisions constitute an important part of the central government's economic and social policy, and therefore represent an important dimension of the annual budget. The need for fiscal discipline in inflation-prone economies has also encouraged many governments to re-examine the scope and scale of special tax provisions that absorb scarce government resources.

Tax expenditures are not a new phenomenon in South Africa. Indeed, some of the concessions embodied in our income tax laws have been in existence for many years. However, tax expenditures have hitherto not been given the attention that they deserve, mainly because they are recorded in the budget as revenue losses and therefore enjoy low visibility. In general, there seems to be a lack of public awareness and understanding in South Africa of the extent to which extraneous, indirect expenditure programs have already intruded into especially the income tax system and become identified with its essential structure.

This state of affairs is encouraged by the dearth of relevant data in the budgetary documents concerning tax expenditures. The innovative step taken in the 1984 budget to quantify some of the major tax incentives embodied in our income tax law (see Sections 7 and 8 below), does not go far enough, and seems merely to scratch the surface of what is obviously a much broader budgetary issue.

Objectives

This paper has two overriding objectives. The first one is to examine the scope and scale of the tax expenditures embodied in South Africa's income tax laws. The paper thus provides a tentative listing of the special provisions embodied in the normal tax levied in terms of the Income Tax Act (No. 58 of 1962, as amended). For reasons of time and space, it has not been possible also to cover the other taxes imposed in terms of the Income Tax Act. Costing of normal income tax losses is provided where possible, but the statistical picture is far from complete.

The second overriding objective is to provide some international perspectives against which tax expenditure budgeting

in South Africa can be considered. The study therefore (a) sketches the international evolution of the concept of tax expenditure budgeting, and (b) discusses some of the operational problems associated with the concept, in the light of experience with this type of budgeting in selected overseas countries.

The international perspectives are obtained from four major sources, namely the United States, the United Kingdom, Australia and Canada. These countries were selected mainly because of the relative ease and timeousness with which information about their budgets could be obtained.

It is also worth mentioning what the paper does not do. Firstly, in view of its focus on the budgeting concept, no attempt is made to evaluate individual special provisions. Although the regular scrutiny and evaluation of the special provisions of the tax law are undoubtedly the *raison d'etre* of tax expenditure budgeting, the subject is regarded as beyond the scope of the present paper.

Secondly, apart from some brief comments on the subject, mainly with reference to overseas experience, no specific consideration is given to ways in which a tax expenditure budget could be integrated into the actual decision-making process in South Africa. In our view this latter aspect might form part of a separate study of the budgetary process and the determination of government expenditure priorities in South Africa.

Study Outline

The study is divided into ten main sections. After this introduction, Section 2 briefly focuses on the concept of tax

expenditures. Section 3 sketches the international evolution of the concept, whilst Section 4 examines the advantages of tax expenditure budgeting. Sections 5 and 6 analyse the two main operational problems. These are, respectively, the identification and measurement of tax expenditures.

The next two sections focus on South Africa in particular. Section 7 first sketches the development of the concept of tax expenditures in South Africa since the late 1970s, whilst Section 8 contains a tentative listing of all normal income tax expenditures. This latter section also provides some international perspectives on aspects such as the coverage of the different taxes and the classification of tax expenditures into functional categories.

Section 9 provides further international background on the presentational aspects of tax expenditure budgeting, and the main conclusions of the study are summarised and drawn together in Section 10.

2. THE TAX EXPENDITURE CONCEPT

Tax Expenditures

A tax expenditure is a government revenue loss attributable to a special provision of the tax laws which is not part of the essential structure of the particular tax, but has been introduced for a non-tax purpose. Since such special provisions benefiting particular classes of taxpayers can in most cases be replaced with direct expenditure programs having an identical effect on the budget and taxpayers, the revenue losses resulting from them have come to be called tax expenditures to emphasise their dual role in the budget.

Normally most attention is paid to income tax expenditures; however, the concept can be extended to the entire tax system. As already mentioned, the present study focuses on income tax expenditures in South Africa with particular reference to the personal and company income tax.

Most tax expenditure provisions are created to provide a subsidy or incentive for those engaged in a particular kind of activity, or to give special or selective tax relief to those taxpayers who are in special circumstances. Willis and Hardwick noted that tax expenditure provisions may also be created to simplify the administration of a particular tax.⁽¹⁾ Examples of the latter in the income tax laws of South Africa might include (a) the so-called standard deduction, and (b) the recent raising of the married women's allowance (see also Section 8 below).

Tax Expenditure Budgeting

Tax expenditure budgeting, on the other hand, involves the identification and quantification of all the aforementioned

special provisions, for purposes of internal fiscal management and public information. Its ultimate object is to extend the traditional controls over government spending to indirect spending undertaken through the tax system. However, in practice tax expenditure listings are often provided in the budget for informational purposes alone.

A number of major countries have already either published a tax expenditure budget or appointed commissions or study groups to examine its practical implications. The international evolution of tax expenditure budgeting is examined in Section 3 below.

Income Tax Expenditures

Preferential tax treatment resulting in income tax expenditures typically involves exclusions from income, specific exemptions, special deductions and allowances, concessionary tax rates, tax credits (rebates) and deferrals of tax liability e.g., accelerated depreciation allowances for business fixed assets. A common outcome of all such provisions is that the liability for tax is reduced for certain favoured taxpayers or groups of taxpayers, and that the government therefore foregoes tax revenues during the year in question.

Income tax expenditures may include not only specific income exemptions "but also gaps in the charge as a result of which receipts or benefits which represent or are equivalent to income are not subjected to tax".⁽²⁾ The identification of income tax expenditures therefore typically involves questions relating to the proper definition and measurement of income. These issues are discussed in Section 5 below.

Tax expenditures may serve a variety of purposes. For

example, amongst activities encouraged in South Africa by special income tax provisions are savings, investment, regional government, housing, education, decentralised economic development, shipbuilding, small businesses, etc. The deductibility of medical expenses, child rebates, and personal reliefs for persons over 60 and 70, the disabled, etc., are again examples of the adjustment of tax liabilities to meet the special circumstances of tax payers.

Implications for Government Finances

Tax expenditures are equivalent to direct expenditures in terms of revenue foregone. That is to say, when a special provision in the tax system result in revenue losses to the government, the latter is effectively making an indirect expenditure through the tax system.

Tax expenditures are therefore composed of two separate processes: first the government collects the amounts involved (an imputed tax receipt) by imposing the tax on a comprehensive basis; and then it makes an outright grant (or a loan in the case of a tax deferral) to the person or persons benefiting from the special provision. In essence, it is merely a matter of timing as to whether assistance will be granted to the tax payer by failing to collect tax otherwise payable, or by disbursement of the tax revenue after it has been collected.

The effect of tax expenditures on the government's budget deficit should be apparent. Like direct spending, government spending through the tax system absorbs scarce resources. The creation of a new tax expenditure, or the extension of an existing one, would therefore have broadly the same impact on the government's borrowing requirement as a corresponding increase in government spending, and vice versa. In other words, the

expansion of tax expenditures should lower revenues and thus raise the level of the government's borrowing requirement, and the elimination of a tax expenditures will increase revenues and thus reduce the size of the borrowing requirement.

Why Tax Expenditures are Used

Special tax expenditure provisions often serve objectives which are similar in nature to those served by direct government outlays in the form of outright grants, subsidies or loans. Many tax expenditure provisions could also be replaced with direct expenditure programs. Why, then, are tax expenditures used?

A recent report on tax expenditures by the Australian House of Representatives Standing Committee on Expenditure listed a number of reasons that have been advanced as to why taxation expenditures have become a regular feature of budgets:

"Firstly, they are undoubtedly popular with individuals and industry. Secondly, they are a convenient way of helping governments to stay within their expenditure limits because they are recorded as revenue losses rather than as expenditure increases. Thirdly, lack of visibility of taxation expenditures has also been given as a principal reason for their use. Another reason is that of stability, for taxation expenditures may be less likely to be changed, because of a lack of scrutiny at budget time. For all these reasons, taxation expenditures are a politically attractive alternative to direct expenditure".⁽³⁾

It should also be noted that the tax system provides a government with a very handy device to effect both the apportionment and disbursement of government assistance programs, in a largely impersonal manner. By comparison, the replacement of major tax expenditures with direct subsidy programs would

almost certainly require the setting up of an expensive and complicated administrative apparatus. Because of its visibility, the administration of direct programs is likely to be subjected to much closer public scrutiny than the largely automatic working of a system of tax forgiveness.

Negative Tax Expenditures

Some special tax provisions are designed to discourage rather than encourage certain activities. That is to say, exceptions to the essential structure of a particular tax may have the effect of increasing rather than reducing tax liabilities for certain groups of taxpayers. Such provisions therefore give rise to so-called negative tax expenditures or tax penalties.

South Africa's income tax laws are relatively free of penalty clauses. To illustrate the concept, the following examples are quoted from the United States: (1) the non-deductibility of gambling losses in excess of gambling gains where gambling is engaged in for profit; (2) the non-deductibility of the costs associated with the demolition of certain historic buildings; and (3) the denial of certain normal tax treatment for taxpayers who co-operate with or participate in an international boycott.⁽⁴⁾

Apart from some brief comments regarding the negative tax aspects that possibly exist in connection with the taxation of capital receipts (see p.57), and the separate taxing of Blacks (see p.59), there will be no further consideration of this aspect of the South African tax system.

3. INTERNATIONAL DEVELOPMENTS

As already mentioned, the tax expenditure concept originated in the United States. It is recognised as largely the brainchild of Stanley S. Surrey, whose major work Pathways to Tax Reform⁽⁵⁾ is regarded as the most influential on the subject. The term 'tax expenditure' was first used by Surrey in a speech delivered in November 1967, when he was Assistant Secretary for Tax Policy in the US Treasury.

Although the Federal Republic of Germany was the first country to provide a comprehensive listing of tax subsidies in its official documents, after a 1967 law required biennial reports on direct and indirect tax subsidies, the West German listing did not form part of the federal budget presentation.⁽⁷⁾ The United States therefore provides the first example of a tax expenditure budget.

The United States of America

The first major effort to systematically record tax expenditures in the United States, using the conceptual framework of the budget, appeared in the Annual Report of the Secretary of the Treasury for 1968.⁽⁸⁾ The analysis in question was subsequently extended to cover the tax expenditures implicit in the fiscal 1970 budget, in the testimony of the Secretary of the Treasury before the Joint Economic Committee, January 17, 1969.⁽⁹⁾

The position in the US at present is that the Congressional Budget Act of 1974 requires the listing of tax expenditure in the Administration's annual budget submission to Congress. This listing is currently incorporated in the budget document as a so-called Special Analysis.⁽¹⁰⁾ The Congressional Budget

Act of 1974 also requires the Congressional Budget Office to issue a report annually that projects tax expenditures for each of the next five fiscal years.⁽¹¹⁾ In addition, estimates of tax expenditures are also prepared annually by the Joint Committee on Taxation.⁽¹²⁾

An Overview

Most other governments that publish tax expenditure listings became interested in the concept only in the late 1970s. The following quotation sketches the current situation in a number of countries.

"Austria has published an annual report on direct and tax subsidies similar to the German report since 1978. Canada, the United Kingdom, France, Spain, and Australia first published tax expenditure lists (or more general lists of tax reliefs and incentives) in 1979 and 1980. In Japan estimates of 'Special tax provisions' (mainly tax expenditures) are now usually provided to the legislature at budget time, even though they are not required by law. Government tax analysts have also begun to develop tax expenditure lists in Sweden, the Netherlands, New Zealand, Ireland, and Belgium".⁽¹³⁾

Canada

The first Government of Canada Tax Expenditure Account was released by the federal government in December 1979.⁽¹⁴⁾ This account was updated in 1980.⁽¹⁵⁾ In addition to the two formal tax expenditure listings, the Department of Finance tabled a further study with the November 1981 budget on federal tax expenditures for individuals.⁽¹⁶⁾ This latter study analysed the distribution of benefits from personal income tax expenditures

among various groups of individuals. Another update of the Government of Canada Tax Expenditure Account is also currently being prepared.⁽¹⁷⁾ According to information received from the Department of Finance, the updated Account is expected to be published shortly.

Australia

In Australia, the regular review of some major tax incentives has been a feature of the federal budget presentation for a number of years. The 1968/69 Budget Papers contained a special statement on Assistance Given to Industry Through the Taxation System. This latter section was transferred to a special appendix on so-called Taxation Expenditures in the 1980/81 budget.⁽¹⁸⁾ This appendix contained the first official 'list' of tax expenditures. It provided revenue loss estimates for eight tax expenditure provisions that provided relief to individuals and for six tax preferences that provided aid to industry. The practice of treating taxation expenditures separately was continued in the 1981/82, 1982/83 and 1983/84 budget papers.

In August 1982 the House of Representatives Standing Committee on Expenditure published a Report on Tax Expenditures. This latter report contained important recommendations regarding the publication of a comprehensive tax expenditure budget "within three years from the tabling of this report".⁽¹⁹⁾ In addition, the Budget Statements for fiscal year 1982-83 contained an expanded section on taxation expenditures. This latter section also incorporated the text of a 26-page Treasury submission on taxation expenditures to the aforementioned House of Representatives Standing Committee on Expenditure, listing 113 income and sales tax expenditures by functional category.⁽²⁰⁾

According to information received from the Australian

Treasury, there has as yet been no government response to the aforementioned Report, mainly because of the change in government in March 1983. However, the Report is regarded as 'sound' and the new government is expected to accept its recommendations, according to Treasury sources.

The United Kingdom

The British government currently publishes a list of 'Direct Tax Allowances and Reliefs' in its annual White Paper on expenditure.⁽²¹⁾ The first such listing was published in the budget document for fiscal year 1979-80.⁽²²⁾

The idea that an annual tax expenditure account be produced initially received an unenthusiastic reception from the British Treasury. In October 1977 the latter put its case as follows: "The construction of a tax-expenditure budget of the kind compiled in the United States would represent a substantial diversion of effort; and it would only be justified if a comprehensive list of this kind was of significantly greater value as an analytical tool for the appraisal of policy than the provision of particular estimates when specific areas of policy are studied".⁽²³⁾

The UK Treasury thus initially favoured supplying estimates of tax expenditures on an ad hoc basis rather than annually. However, in a technical note appended to the aforementioned memo, it did provide an updated version of a list of certain tax allowances and reliefs which had originally been provided in the Fourth Report from the Expenditure Committee, Session 1975-76.⁽²⁴⁾

As noted above, the government's Expenditure Plans now contain a list of special provisions, mainly in response to

Parliamentary pressure for such a listing. However this listing of Direct Tax Allowances and Reliefs is for informational purposes alone, and it does not distinguish between so-called structural and non-structural reliefs.

Other Countries

As noted on p.11 a number of other countries are also working on tax expenditures. In the Netherlands the Minister of the Treasury established a working committee of Treasury officials and academics in 1977 to study the concept of tax expenditures. An interim report on the subject is expected to be completed in 1984.⁽²⁵⁾

In Belgium also, the Finance Minister charged the Superior Council on Finance (an official government commission) in 1983 to examine the various operational issues and to work on completing a tax expenditure list.⁽²⁶⁾

Tax expenditure budgeting is also being considered in New Zealand. In July 1981 the government appointed a Task Force to undertake a thorough and systematic review of all aspects of central government taxation. The Task Force reported to the government in April 1982, and Chapter 4 of its report dealt with income tax concessions and incentives. On the subject of tax expenditure budgeting, the Task Force expressed itself as follows: "To meet the fundamental objectives of government accountability and efficient and effective management, requires as a first step, more explicit accounting of the cost of tax expenditures and their allocation (where possible) to the government's economic and social programmes".⁽²⁷⁾ The 1982 Report accordingly recommended "that there be more explicit accounting of tax expenditures for management purposes and preferably also for public information".⁽²⁸⁾ This, and other

recommendations regarding tax expenditures, are currently being considered by the New Zealand government. According to information received from the Inland Revenue Department, Wellington, there has been no public indication yet whether the recommendations of the Task Force will be acted upon.

International Organisations

The subject of tax expenditures has also received attention from a number of international organisations.

At one time the OECD took an interest in tax expenditures "with a view to correcting the ratio of tax to GNP so as to allow for the fact that some countries rely more on tax 'aids' and cash transfers and vice versa".⁽²⁹⁾ However, a number of difficulties were apparently encountered, which forced the organisation to abandon its original objectives.

The subject of tax expenditures was a principal subject of discussion at the 1976 Congress of the International Fiscal Association. The Association's 549-page Report on "Tax Incentives as an Instrument for Achievement of Government Goals" included a General Report and 17 separate reports on countries such as Germany, Australia, the Netherlands, Israel, etc.⁽³⁰⁾

Private Studies

In addition, a number of private studies have been undertaken. In 1978 the London-based Institute for Fiscal Studies published the study, already referred to above, by Willis and Hardwick entitled Tax Expenditures in the United Kingdom⁽³¹⁾ And in 1979 the Canadian Tax Foundation published a work by Roger S. Smith on Canadian income tax expenditures.⁽³²⁾

4. ADVANTAGES OF TAX EXPENDITURE BUDGETING

There are strong arguments in favour of the listing and quantification of tax expenditures as part of the regular budget presentation.

Budget Comprehensiveness

Since budget revenues embody indirect subsidies and incentives in the form of revenues not collected, the scope of the government's involvement in the economy "cannot be properly measured or adequately presented for public debate by employing solely conventional definitions of public expenditure".⁽³³⁾ Consequently, a full and comprehensive accounting of the government's fiscal efforts in the economy must catalogue disbursements through the tax system in addition to those that involve conventional direct outlays.

More particularly, if the annual budget is to convey a true picture of the absorption of resources by the government and the allocation of resources amongst programs, it should contain a listing of direct outlays as well as their indirect equivalents.

Expenditure Priorities

Tax concessions or reliefs involve just as much a disbursement of government revenues as direct expenditures. Since tax expenditures are thus equivalent to direct expenditure, it is entirely logical that the nature and cost of each concession should be known and reviewed when direct expenditures are considered.

By focusing attention on tax preferences built into the tax system, the tax expenditure budget both facilitates (by making relevant data available), and encourages the regular examination of: (a) the need for the many government assistance programs and incentives undertaken through the tax system; (b) the method used to provide such assistance; (c) the effectiveness of the particular incentives in terms of the outlay involved; and (d) the appropriate size of the programs.

By advancing the objective of budget comprehensiveness, tax expenditure accounting thus also assists more efficient decision-making and resource allocation. Willis and Hardwick have noted that it is especially important that "where both tax relief and direct expenditures figure in a particular area of government activity, both should be taken into account in any consideration of the policies to be followed in that area".⁽³⁴⁾ If a tax expenditure budget is published the relative importance of different budgetary objectives can be more carefully weighed against all the budget resources used for those objectives.

Tax Planning

If the amount of revenue that would have been collected in the absence of special provisions is also shown in the budget, the latter would provide a more realistic picture of the revenue producing capacity of the tax system. Tax planning and the management of the government's revenues would thus also be assisted by tax expenditure budgeting.

Expenditure Control

Unless all special tax provisions resulting in tax expenditures are exposed on a permanent basis, there is the

danger that particular indirect spending programs will be pushed into the background once they have been legislated into the tax system. Indirect aid programs may also come to be regarded as part of the permanent structure of the tax system, and thus escape regular scrutiny.

A situation may then arise in which the authorities might be completely unaware of the cost to the Exchequer of programs which have been in existence for a number of years, or of the benefits bestowed on particular classes of taxpayers in this fashion. When this happens Parliament and the Cabinet would have abandoned control over the government's spending. By contrast, a tax expenditure budget would keep all special provisions and their costs in the public eye, and help to educate Parliament and the public to a higher level of awareness of the cost to the government of special provisions built into the tax system.

It follows from the foregoing that tax expenditure budgeting should be an essential element of any system of control over the government's expenditure and borrowing requirement. For once it is realised that tax expenditures are in most respects merely direct expenditures in disguise, the imposition of either formal or informal limitations on the latter alone becomes largely meaningless. The reason is that increases in direct spending can be avoided quite easily by granting new concessions or expanding existing concessions to special interest groups of taxpayers at times when it might be politically difficult to expand outlays in the form of direct subsidies or grants.

The regular and systematic public exposure of indirect spending should discourage or make impossible such direct expenditure avoidance. At the same time, a tax expenditure budget would encourage and facilitate a review of both direct

and indirect expenditure programs at times when large budget deficits need to be curtailed. In particular, the publication of a tax expenditure budget should drive home forcefully the fact that there are other ways to cut a budget deficit than to reduce budget outlays or to raise tax rates which, incidentally, have the effect of raising the value of some tax concessions (see Section 6 below).

Budget Flexibility

Tax expenditure budgeting would also enhance the objective of budget flexibility. This is because the encouragement that a listing of special provisions gives to the regular examination of individual items would serve as a constant reminder to everyone concerned that the provisions in question are not only concessionary but also non-permanent. Focussing on the non-permanent nature of all special provisions may make it easier in the long run to reduce or abandon particular concessions when it is necessary to do so in the interests of macro-economic policy. Ironically, fiscal planners might also be encouraged to introduce new concessions if they have the assurance that the particular provisions can be abandoned with ease if they are no longer in the general public interest.

Improved Perspectives

In principle, a fuller accounting of the source and application of government funds, comprising also monies disbursed through the tax system, would affect important aspects of the picture presented by the annual budget. These include, inter alia, the functional allocation of outlays, the contribution made by the different forms of taxation to the financing of the Exchequer, the important division between direct and indirect taxes, the levels of budgetary revenues and outlays and the

percentage contribution of the latter to the Gross National Product. Some adjustments would also have to be made to the national accounts, if indirect subsidies are brought into account.⁽³⁵⁾ Indeed, if all the necessary adjustments are made the government's budget may assume a completely different appearance. In practice, however, the application of tax expenditure data has been confined mostly to the area of public expenditure appraisal.

Conclusion

Enthusiasm for tax expenditure budgeting is often dampened by problems of identification and measurement (see Sections 5 and 6 below). However, the implications of not listing tax expenditures should not be lightly dismissed. Surrey and McDaniel have put it as follows:

"(A) moments thought should indicate how serious are the consequences of asserting that taxation expenditures cannot be identified or, if identified, that their costs cannot be ascertained. At bottom, this would be an assertion that the fiscal experts of a country do not know what is contained in their income tax or how much particular programs cost the government... (T)he assertion would be an admission that the country has lost control of both its tax policy and its budget policy".⁽³⁶⁾

It is now fairly widely accepted that the operational problems associated with tax expenditure budgeting should not stand in the way of more explicit accounting of tax concessions and reliefs.

5. THE IDENTIFICATION OF TAX EXPENDITURES

Tax expenditure budgeting is not without its controversies. The reason for this is that the concept confronts a number of operational difficulties. In the main, the latter relate to the identification, costing and functional grouping of special tax provisions resulting in tax expenditures. The present section examines the identification of income tax expenditure, with particular reference to the international background. Problems of measuring the tax costs of special provisions are discussed in Section 6 below, whilst the classification of tax expenditures into functional categories are considered rather more briefly in Section 8.

The identification of tax expenditures is a complicated business involving some intricate theoretical tax considerations. The many insights and perspectives that are to be gained in the course of researching the various concepts applied in several different countries cannot, therefore, be conveyed fully in the space of a few pages. The discussion below must therefore be seen as an attempt to survey and also draw attention to different approaches, rather than to come to any definite conclusions based on critical analysis.

The particular approach adopted for the purposes of identifying South African income tax expenditures is described in Section 8 below.

Distinguishing between Structural and Non-Structural Provisions

The essential identification problem is to distinguish special concessions offered for non-tax purposes from revenue off-sets which must reasonably be accepted in the course of defining the revenue (in this case - income) base or adjusting

a person's tax liability in accordance with his ability to pay the tax. In other words, the following key question needs to be answered:

"which income rules are special provisions representing Government expenditures made through the income tax system to achieve various objectives apart from that tax, and which income tax rules constitute the basic tax structure of the income tax itself and hence are integral to having such a tax at all?"⁽³⁷⁾

The practical implementation of the distinction between the structural and non-structural elements of a tax is fraught with difficulties. This is because in order to provide a basis for the identification of special provisions, it is necessary first to define the so-called basic or benchmark structure. The latter is a normative concept based on what the tax structure would be in the absence of all tax expenditures. Since it is not defined in the tax laws, disagreements about its definition are unavoidable. "Since the benchmark tax structure is an abstraction, there will always be room for legitimate disagreement about its nature and, thus, about whether certain tax provisions are properly characterised as tax expenditures".⁽³⁸⁾

Defining the Benchmark Tax Structure

It would be appealing to start with a theoretically pure income tax base, and use for this purpose the economist's definition of income as the market value of the individual's consumption (inclusive of imputed in-kind consumption), plus or minus the increase or decrease in his (accrued or imputed) net wealth over the year (the so-called Haig-Simons definition of income). Those tax expenditures arising from income

exclusions, exemptions or special deductions and allowances, could then be identified as the result of departures from the theoretically pure base.

Unfortunately, it would not always be possible or practical to make the imputations that would be necessary for such a listing. For a pure base would include items which are seldom taxed as income, such as gifts, legacies and unrealised capital gains. It would also include the imputed rental value of unrealised owner-occupied housing and imputed income from other durable consumer goods and in-kind consumption, such as the consumption by farmers of their own produce. Consequently, a tax expenditure listing based on departures from a pure income base is likely to deviate quite substantially from what would be regarded as normal in most countries.

Moreover, although a theoretically pure income base could perhaps be specified, the specification of a 'pure' rate structure would be impractical. Indeed, according to the US fiscal administration "there is no theoretical foundation upon which to support any particular degree of progressivity in the individual income tax rate structure or any particular company income tax rate".⁽³⁹⁾

In 1976 the International Fiscal Association gave recognition to these identification problems by adopting the following guidelines for the purpose of distinguishing special tax expenditure provisions from the essential structure of the income tax:

"(a) the economists' definition (in some countries) of personal income as 'the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in value of the store of property rights between the beginning and end of the period in question' (Haig-

Simons definition);

(b) standards of business accounting;

(c) the generally accepted structure of an income tax that would exist in the absence of the use of tax incentives or tax reliefs".⁽⁴⁰⁾

In case of conflict in a particular national milieu the 'generally accepted' criterion was to prevail. That is, "where there are differences between (a) and (c) guidelines, then for the purposes of tax expenditure classification the (c) guideline is to predominate".⁽⁴¹⁾

However, Willis and Hardwick noted that even the generally accepted criterion does not always provide clear-cut answers when it is desired to determine whether a particular provision is special or part of the essential structure, "since there is no strictly defined frontier between the structural and non-structural features of a tax".⁽⁴²⁾ Consequently, additional pragmatic guidelines are often adopted and relatively arbitrary decisions seem unavoidable at times.

To complete this part of the present section, Surrey's analysis of the distinction between the structural and non-structural elements of the income tax should be noted. His analysis is of special interest because it draws a distinction between (a) provisions which are part of a normative income tax, and (b) those which are not part of a normative tax but are still essential to the operation of the tax. Both sets of provisions, according to Surrey, form part of the benchmark structure. In view of its relevance to any examination of the South African income tax (see Section 8 on Identification), the particular section from Surrey's work is quoted in full:

"The building of an income tax requires two types of pro-

visions that collectively perform the following two functions: **First**, they provide the answers to those aspects of the above, and similar, questions that would essentially be treated in much the same way by any group of tax experts building the structure of an income tax and being governed in that task by all the requirements implicit in such a tax because it is an income tax. These answers then become the structural provisions which shape a normative income tax. As an illustration, in this first category fall matters relating to the measurement of net income and the time periods for inclusion of that income. **Second**, they provide the answers to those aspects of the above, and similar, questions that likewise are necessary to building an income tax but could, in the view of such a group of tax experts, conceivably be treated differently from country to country depending on the views and policies shaped by other goals in the particular society, rather than by factors special to an income tax. These answers, in view of these possible differences, are not part of a normative income tax. However, these answers, once they are determined, do become structural parts of an income tax - and essential to the operation of that tax - and therefore are not tax expenditures. For example, as the Treasury analysis indicates, the treatment of the family - e.g., the tax burden on married couples in relation to single persons - is not part of a normative income tax. There is no preordained method of treatment that follows from the decision to adopt an income tax. Countries properly differ in the treatment depending on their attitudes toward marriage or women in the labor force and other such social and economic questions. The levels of personal exemptions and tax rates, and the degree of rate progressivity, are other examples mentioned in the Treasury analysis that would fall in this second category. The treatment of the

corporation - as a separate entity or its income integrated with that of the shareholders in some fashion - is still another example. The provisions incorporating the decisions in these areas are not tax expenditures. But the decisions have to be made before the structure of the income tax is complete and the tax is ready to be applied. As a consequence, this set of provisions, while necessary to the construction of an income tax, is shaped by processes different in character from the processes determining the provisions in the first category, also relating to the inherent structure of an income tax. The tax expenditure provisions are, then, the provisions that may be found in an income tax law but that do not serve the two functions set forth above"⁽⁴³⁾.

The balance of this section briefly examines the approaches adopted in a number of countries to identify tax expenditures. The survey begins with the evolution of the US approach from the time that the concept first gained prominence in the late 1960s.

The United States

The US Treasury's first (1968) analysis (see p. 10 of this study), listed: "...the major respects in which the current income tax bases deviate from widely accepted definitions of income and standards of business accounting and from the generally accepted structure of an income tax".⁽⁴⁴⁾ The 1968 listing did not therefore attempt to list all tax provisions which departed from a strict definition of net income. Its pragmatic approach is demonstrated by the omission of some items from the listing, for one or more of several practical reasons:⁽⁴⁵⁾ (a) where there was no available indication of the precise magnitudes of the implicit subsidy; (b) where the case for the inclusion of a particular item in the income base relied on relatively

technical or theoretical tax arguments; and (c) where particular items had relatively small quantitative importance.

The US Treasury's first analysis further noted the influence of the overriding objective of the listing:

"It must be recognised that these exclusions are to some extent arbitrary and some may prefer to add items that we have omitted or to omit items that we have included. The immediate objective, however, of the study is to provide a list of items that would be generally recognised as more or less intended use of the tax system to achieve results commonly obtained by government expenditures. The design of the list seemed best served by constructing what seemed a minimum list rather than including highly complicated or controversial items that would becloud the utility of this special analysis".⁽⁴⁶⁾

As a further step in the development of the concept in the United States, the Congressional Budget Act of 1974 defines tax expenditures as: "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax or a deferral of tax liability".⁽⁴⁷⁾

Since 1974 the concept has gained further operational meaning in terms of a so-called normal structure. Thus Special Analysis F for Fiscal year 1978, noted that: "Income tax provisions which result in tax expenditures are further defined in the legislative history of the Congressional Budget Act as departures from the 'normal structure' of the individual and corporation income tax".⁽⁴⁸⁾ However, the normal structure is not defined in the US tax laws, but "has evolved in recent years from various

congressional and public reviews of the US tax system focussing on the definition of the income tax base and the rates applied to that base".⁽⁴⁹⁾ In practice, the US Administration, as well as the Congressional Budget Office and the Joint Committee on Taxation, used a concept of the 'normal' tax which "was a variant of a theoretically comprehensive income tax, albeit with several major exceptions".⁽⁵⁰⁾

Until recently there were therefore only a few differences between the Administration and Joint Committee on Taxation/Congressional Budget office listings. However, in their 1983 and 1984 budgetary presentations, the Administration revised their usual identification procedures. Under the revised rules, two conditions were necessary for a provision to qualify as a tax expenditure: (1) it was necessary that the tax laws provided general rules to enable a taxpayer to determine his income due and payable (these rules were called the 'reference law'), and (2) it was necessary that the special provisions applied to a sufficiently narrow class of transactions or transactors to permit the specification of a program objective".⁽⁵¹⁾

According to the 1983 Congressional Budget Office Report: "These conditions obviate the need to define the base of a conventional income tax. Various provisions are compared to the set of general rules currently in the tax code in order to determine whether they are 'special'".⁽⁵²⁾

Following these revisions, the Congressional Budget Office/Joint Committee on Taxation tax expenditure listing contained 13 provisions not included in the Administration's list.⁽⁵³⁾ These discrepancies arose mainly because the first mentioned listing used a broader definition of income than the Administration's. However, the Congressional Budget Office seemed

unconcerned about this discrepancy in view of the informational character of its listings. It noted: "As long as the tax expenditure budget is simply an information document, as it is now, there is usually little objection to including items about which there is some uncertainty".⁽⁵⁴⁾ It would have been different if a tax expenditure budget was integrated with the main budget: "If actual legislative decisions are to turn on whether an item is included or not, however, more strains may be placed on the classification process. If a budget resolution ceiling were to be placed on total tax expenditures, for example, questions could conceivably be raised about whether each item in the present tax expenditure budget is properly classified".⁽⁵⁵⁾

It should be noted in conclusion that Special Analysis C for Budget 1985, noting that some people have found confusing the different definitions used recently by the several agencies, have reverted to listing a number of tax expenditures in addition to those that meet the narrower tests used in the 1983 and 1984 budgets.⁽⁵⁶⁾

Canada

The Government of Canada Tax Expenditure Account (1979) chose the criterion of neutrality for the purpose of distinguishing special tax provisions from the benchmark structure: "the benchmark tax structure is one that provides no preferential treatment to taxpayers on the basis of demographic characteristics, sources or uses of income, geographic location, or any other special circumstances applicable only to a given taxpayer or to a particular group of taxpayers".⁽⁵⁸⁾

However, in view of the fact that the criterion of neutrality "may not provide sufficient guidance in some cases as to whether or not a given provision should be classified as a tax

expenditure",⁽⁵⁹⁾ and since "a strict adherence to this criterion may lead to a benchmark tax structure that bears no resemblance to the actual tax structure in place",⁽⁶⁰⁾ and "in keeping with the informational purposes of this tax expenditure account",⁽⁶¹⁾ additional criteria were used to draw up the initial and subsequent Canadian listings. These criteria comprised the following:⁽⁶²⁾ the definition of the benchmark tax structure should not deviate dramatically from the public's perception of the current tax system; whenever there is uncertainty or disagreement about the classification of, or given special provision, the analysis should err on the side of comprehensiveness; a tax provision which may be neutral for all taxpayers while at the same time clearly being functionally equivalent to a direct spending program should be classified as a tax expenditure; and partial or ad hoc provisions should be viewed as tax expenditures although the same provisions, comprehensively applied, could be part of the benchmark tax system.

In practice the criteria of 'general acceptance' and 'neutrality' would produce broadly similar but not identical listings, because although some provision may be generally accepted, they may not be neutral or non-discriminatory.⁽⁶³⁾

Australia

In comparison with Canada and the US, the criteria employed to identify so-called taxation expenditures in Australia have received much less public exposure.

The budget for tax year 1980/81 defined tax expenditures as "financial benefits from taxation concessions of various kinds which reduce the tax liabilities of particular groups of taxpayers",⁽⁶⁴⁾ whilst the 1982/83 and 1983/84 budgets merely

referred to the financial benefits that individuals and businesses derive from taxation concessions of various kinds.⁽⁶⁵⁾ Although the precise criteria employed to distinguish between the benchmark tax structure, on the one hand, and tax expenditures, on the other, are therefore not spelled out in the budget papers, both the 1981/82 and 1982/83 budgets focussed on the equivalence of tax expenditures and direct expenditure programs; for example, the 1982/83 budget noted that:

"The inclusion of an item in the Appendix does not necessarily indicate that it is considered a departure from an equitable tax distribution. Rather, it implies no more than that the item confers a benefit on recipients and could conceivably be regarded as an alternative to direct expenditure in the same way that family allowances confer a benefit comparable with that conferred by the dependent child rebates which they replaced in 1976. It would be possible to replace most of the tax provisions mentioned below with a direct expenditure program having an almost identical impact on both Budget and taxpayer".⁽⁶⁶⁾

The Australian Treasury's pragmatic approach to the identification problem, and their emphasis on tax expenditures as alternatives to direct expenditure, are further underlined by the following quotation from their 1982 submission on tax expenditures to the House of Representatives Standing Committee on Expenditure: "In line with the view adopted in Canada and the USA, it is considered that the aim of identifying tax expenditures should be to include in the budget-making process and documentation the cost of special tax provisions which can, in most cases, be considered as alternatives to direct expenditures programs rather than to attempt to define some ideal taxation system and show deviation from it".⁽⁶⁷⁾

On the subject of the comprehensiveness of tax expenditure listing, the House of Representatives Standing Committee on Expenditure endorsed the view of the Canadian Government and the Australian Treasury: "The Canadian government decided that their taxation expenditure list should be more comprehensive than restrictive. Adopting this approach means that users can select or reject specific items at their own discretion. This view is endorsed by the Expenditure Committee and also forms the basis of the Treasury listing in Attachment A of their submission to the Committee. Treasury has said that 'we have approached it on the basis that we have tried to include everything'". (68)

The United Kingdom

Little text accompanies the current listing of Direct Tax Allowances and Reliefs in the UK's The Government's Expenditures Plans. The usual form of the presentation makes in addition no attempt to distinguish genuine tax expenditures from those reliefs and allowances which can be regarded as part of the structure of the tax system. The philosophy behind this approach was summarised as follows:

"..this (the tax expenditure) approach can be useful in relation to some tax reliefs, but there is no agreement as to the criteria governing its application and the field within which it can be applied. In the circumstances the government have decided that the most helpful course is to publish a list of direct tax reliefs, giving costs where they are available. This will enable Parliament and the public to form their own views as to which tax reliefs should most appropriately be considered in the context of public expenditure". (69)

6. MEASURING TAX EXPENDITURES

Tax expenditures are usually costed on a tax foregone basis. Income tax losses will occur as either a simple reduction of tax liability, as with tax-exempt interest on investments in government securities, or a deferral of tax liability, as in the case of an accelerated depreciation allowance.

In general, if the hypothetical withdrawal of a particular relief or incentive would raise the taxable income of the taxpayer, the tax expenditure equals the product of the relevant marginal personal or company tax rate and the income increment. The value of the tax concession or incentive can therefore be expanded or reduced by altering either the terms of the special concession or the tax rates, or both. On the other hand, if the hypothetical abolition of a tax concession would result in a tax credit or rebate not being available any longer, the tax expenditure would equal the actual rebate claimed by the taxpayer and the tax rates would not enter into the calculation at all.

Measurement Problems

The measurement of tax expenditures is not without its problems. Some of these problems are mentioned below.

It is usual for the revenue loss associated with each special tax provision to be estimated separately. This is done by comparing the revenue actually raised under existing tax laws with the revenue that would have been raised if the particular provision had never existed, assuming that (a) all other tax provisions, including the tax rates and other tax incentives and concessions, are kept in place, and (b) taxpayer behaviour and economic conditions are unaffected by the repeal of the

particular provision.

The separate costing of tax expenditure provisions on the basis of this ceteris paribus assumption is a simple solution which provides a reasonable approximation of the revenue costs of such provisions. However, it is recognised that the costs of some provisions is affected by inter-relationships with other features of the tax system, and that there are so-called second-order economic effects. For example, if major tax expenditures are withdrawn, some features of the income tax, such as the rate structure or personal exemptions, may be changed so that the marginal tax rates used in making the estimates would no longer apply. The additional revenues accruing to the government following the withdrawal of a particular concession may also be channelled back into the economy through a reduction in tax rates, so that the value of all other tax expenditures would be influenced.

Taxpayer behaviour and general economic conditions are also unlikely to remain unaffected by the withdrawal of major tax incentives. For example, to the extent that a tax expenditure that was introduced to encourage certain activities has been successful, its elimination would presumably induce taxpayers to re-adjust their behaviour accordingly. The collection of additional revenues following the withdrawal of major tax concessions may also affect general economic conditions and hence government revenues from other sources.

Because of the difficulties involved in the estimation of such remote consequences, tax expenditure costing is generally confined to relatively crude 'first level' figures. The UK Treasury remarked that: "In practice, a crude tax foregone assumption seems essential if tax expenditures are to be presented at all".⁽⁷⁰⁾

Another problem is that the amount of revenue that the government does not collect because of the existence of a particular tax expenditure provision can never be directly observed; the revenue losses can only be estimated. The US Congressional Budget Office has put this particular problem as follows:

"The amount of revenue the government collects under existing law can be observed directly; the amount of revenue that would be collected under some different law can never be observed and can only be estimated. The future effects of spending programs and general tax rules must also be estimated, of course, but eventually there are actual outlays and tax collections against which to compare the estimates. Since a tax system without tax expenditures is an abstraction, the revenue yield of such a system cannot be observed and, therefore, can only be estimated imprecisely".⁽⁷¹⁾

For a further discussion of some measurement problems in the South African context, see Section 8 below.

Problems of Aggregation

Tax expenditure estimates are not cumulative. In other words, individual tax expenditures cannot be added arithmetically like direct expenditures, to form totals for functional areas or to obtain a grand total.

This particular problem arises mainly because of an interaction with other tax provisions, especially the progressive personal income tax rate structure. As already noted, the revenue loss attributable to one specific income exemption would be measured by multiplying the amount excluded under the provision by the relevant marginal rate. However, if several major tax

expenditures, which take the form of exemptions from income, were eliminated simultaneously, many more individuals would be pushed into higher marginal tax brackets than if only one exemption was withdrawn. Consequently, the revenue gain to the Exchequer would be greater than the arithmetic sum of the individual tax expenditures. Although it might still be possible to take these interactions into account when a small number of tax expenditures are examined, the estimation would become increasingly more complicated as more items are included in the analysis. Moreover, if several major tax expenditures are withdrawn simultaneously, the ceteris paribus assumption regarding taxpayer behaviour and economic conditions will become totally unrealistic.

The aforementioned difficulties and others are summarised in the following quotation:

"Including all tax expenditures and taking into account all of the interactions would require constructing a wholly new tax system without tax expenditures. The higher revenues that this would produce, assuming no other changes in the tax system and no effects on the economy from the tax increases, could be characterised as the total revenue loss from tax expenditures. Because these are not realistic assumptions, however, the resulting number would be an artificial one. Furthermore, it would no longer be a useful estimate of the revenue loss from each individual tax expenditure, since there would be no way to assign the differences between the total and the sum of the parts to any of the parts".⁽⁷²⁾

For these various reasons tax expenditure budgets do not usually show totals or sub-totals.

Outlay Equivalents

A recent innovation from the US is the inclusion in the

federal budget of a further set of estimates of tax expenditures, calculated according to the so-called outlay equivalent approach. The outlay equivalent of a tax loss is the amount of direct expenditure that needs to be undertaken to provide the same benefit to the taxpayer.

In essence, the difference between the revenue cost approach and the outlay equivalent approach is that the latter includes the extra income taxes payable by the recipients of the tax aid. The outlay equivalent approach therefore reflects the direct expenditure that would have to be made to raise the taxpayer's income after taxes by the amount of the benefits bestowed on him by the particular provision of the tax law. The US Administration decided to provide this additional information because: "...the outlay equivalent approach makes tax expenditure estimates more consistent with direct expenditure estimates, thus permitting comparison on a similar basis".⁽⁷³⁾

In Canada too, the Government of Canada Tax Expenditure Account (1980) drew attention, under the heading 'Net versus gross values', to the discrepancy that may exist between the estimates of tax foregone and the direct expenditure equivalents, because "government grants are generally taxable to the recipients".⁽⁷⁴⁾ However, the outlay equivalents were not actually published in the Account.

In view of the general lack of adequate data, no attempt will be made in this study to calculate the outlay equivalents of our own relatively crude tax foregone estimates.

7. DEVELOPMENTS IN SOUTH AFRICA

The South African tax system contains many special provisions resulting in revenue losses which benefit particular classes of taxpayers. These so-called tax expenditures are not a new phenomenon in South Africa. Indeed, some of the provisions have been in existence for a great many years. However, tax expenditures have hitherto not been given the attention they deserve, and there is a dearth of relevant data in the budgetary documents concerning them. The innovative steps taken in the 1984 budget to quantify some of the major tax incentives do not go far enough. The small number of incentives listed in the latest budget clearly form part of a much more comprehensive system of tax expenditures which needs to be exposed in toto for public scrutiny.

This section reviews developments in South Africa concerning the concept of tax expenditures.

Official Attitudes

There have been several references to the aforementioned shortcomings of the South African budget in recent years.

In 1970, the Franzsen Commission of Enquiry into Fiscal and Monetary Policy in South Africa drew attention to the understatement of subsidies in the government's accounts and the budget, and noted that: "A thorough-going study of the Treasury will be required if all the forms that subsidies have already adopted in South African public finance are to be identified. Only when the true figure has been determined will it become clear to Parliament and the public what a heavy burden this form of assistance provided to the private sector by the state already imposes on the annual budget".⁽⁷⁵⁾

In 1978, the Minister of Finance announced that the Standing Commission on Tax policy was "devoting its attention to the problem of tax expenditures."⁽⁷⁶⁾ The latter were referred to as "revenue losses enshrined in our tax laws which allow for special exemptions or reductions of income or deferrals of tax liability."⁽⁷⁷⁾ The Minister further observed that: "The existence of an ever-growing array of such concessions prevents a balanced judgement on priorities of expenditure, which is becoming more and more essential today. These concessions are not quantified annually and Parliament is therefore not in a position to review their relative importance or necessity from time to time."⁽⁷⁸⁾

More recently, in 1982, the Commissioner for Inland Revenue questioned the tax expenditure method of granting government assistance to the private sector, in an address to the Graduate School of Business of the University of Cape Town.⁽⁷⁹⁾ The Commissioner argued that: "Concessions, allowances, deductions, etc., which can be classified as tax expenditures should not form part of the income tax structure but should be the subject of departmental votes so that they can also be subjected to Parliamentary scrutiny and not hidden away as tax concessions."⁽⁸⁰⁾ It is interesting that the Commissioner chose to criticise the tax expenditure method of granting government assistance, in the interest of improved Parliamentary control over expenditures, but failed to consider the option of publishing a tax expenditure budget as part of the central government's annual budget presentation.

The Exchequer's revenue needs are presently compelling our fiscal planners to consider all means available to

them to exercise fiscal restraint. This was also reflected in the 1984 budget speech, which once again focused on the scope of indirect spending through the income tax system. In one reference to the level that government subsidies have already reached in South Africa, the Minister of Finance emphasised the cost of special provisions in terms of revenue foregone. He said: "In 1983-84 the direct subsidies by..... reached over R1 300 million, while indirect subsidies, especially by way of tax concessions - or so-called tax expenditures - were well over R1 000 million. I suspect that ever-increasing subsidies have come to be accepted as a way of life".⁽⁸¹⁾ Unfortunately, the Minister failed to intimate how the estimated figure of 'well over R1 000 million' was calculated or what items it included.

The 1984 budget speech touched on another important aspect of the tax expenditure concept in South Africa. This is the open-endedness of some tax expenditures and the fact that these special provisions often become a convenient means to avoid tax on a large scale. In this latter regard the Minister referred to "the selling of tax bases for the purpose of taking advantage of the concession involving incentive allowances to lessors".⁽⁸²⁾ This, he said, had resulted in a drain on revenue which "has become alarming".⁽⁸³⁾ Other disadvantages of these practices were also mentioned: "unrestricted tax expenditures of this kind have a distorting effect and militate against efforts to spread the tax burden more evenly".⁽⁸⁴⁾ As a result, the Minister announced a number of measures to close some of the loopholes associated with the particular special provision.⁽⁸⁵⁾

In a further reference to the uncontrolled growth of the tax losses, the Minister recognised that the quantum

of tax expenditures is also affected by the income tax rates, so that: "The value of the allowances has increased whenever the rate of (Company) tax has been increased".⁽⁸⁶⁾ As a result, he said, the rates of incentive allowances would have to be reconsidered in the light of the company tax rates and the revenue needs of the Exchequer.

As a further step in the evolution of the concept of tax expenditure budgeting in South Africa, the 1984 budget document contained an important innovation. That is, for the first time ever, the Statistical/Economic Review accompanying the budget contained a brief section dealing with "the provision of fiscal incentives through the income tax system".⁽⁸⁷⁾ The section in question lists eight major items; however, the estimates of the tax costs of the incentives are in respect of the 1980/81 tax year, and are therefore considerably out of date. There is also little text, and the Minister failed to refer to the new section in his budget speech. There is a further reference in the next sub-section to this particular section of the Statistical/Economic Review, and the accuracy of the estimates given therein is discussed in Section 8 below.

It is not clear at this stage whether the whole exercise of parading the tax costs of some of the major incentives in the latest budget represented a temporary ploy to overcome the Exchequer's current revenue difficulties, or whether it represented a modest but serious attempt to deal with the long-term problem of re-establishing control over both direct and indirect spending. Either way, it represented a policy advance. However, what is clear is that the whole concept of tax expenditure budgeting in South Africa is, from both a conceptual and presentational point of view, in its infancy.

The Budgetary Exposure of Tax Expenditures

It should by now be apparent that there is no systematic treatment of the body of tax expenditures in the South African budgetary documents. Whilst full information on direct spending is provided in the annual Estimate of Expenditure, the main budgetary sources of data on tax expenditures are the annual budget speeches presented to Parliament by the Minister of Finance. That is to say, data on special provisions resulting in tax losses are provided only at the time of the introduction of a particular provision or on the occasion of significant changes. On such occasions the Minister of Finance usually supplies an estimate of the tax foregone (or saved) for the forecast year, and for a full year if the provision is to come into effect during the coming year. After that, however, the budget loses track, so to speak, of the revenue losses incurred by the State. In other words, following the first full year after the introduction of a particular provision, the tax losses become hidden in the annual estimates of revenue and are consequently not at hand for internal fiscal management and public information.

The tax expenditure data provided in the five most recent budget speeches are summarised in Appendix I to illustrate the scope of the budget's present coverage of this dimension of the government's finances and for purposes of comparison with the listing provided in Section 8 below.

Further evidence of the casual manner in which tax expenditures are treated in South Africa is the fact that changes in the system of tax expenditures are often incorporated in the annual income tax amendment Act later in the year without such changes having been mentioned

in the budget speech earlier on in the year, or the revenue implications ever being considered by Parliament. Also, tax proposals announced in the budget speech may later be withdrawn or modified before they reach the legislation stage.

In 1984, South Africa's budget acquired a new dimension from a presentational point of view. As already mentioned, the 1984 budget document supplied estimates of some of the major tax concessions embodied in the income tax. These estimates are based on statistics obtained from income tax assessments issued up to 31 December 1983, in respect of the 1980/81 tax year, and are therefore not comparable with the 1984 budgetary estimates of expenditure and revenues. According to the relevant table, the total amount of tax foregone in 1980/81 in respect of the several concessions, came to R997,1 million. This latter amount was made up as follows:⁽⁸⁸⁾

Table 1 Fiscal Incentives through the Income Tax System (Rm)

Allowance	Tax foregone
Machinery investment allowance	444,82
Machinery initial allowance	379,54
Industrial building investment allowance	18,56
2% industrial building allowance	14,71
Decentralisation benefits	9,24
Hotel grading allowance	5,04
Exporters' allowance	73,81
Training allowance	32,34
	977,07

Source: Republic of South Africa, Statistical/Economic Review 1984/85, W.P.B.-'84, p.30.

As already mentioned, the relevant section contains little text. More particularly, no mention is made of the usual estimating assumptions and the problems of aggregation. More is said in Section 8 below about the accuracy and usefulness of these estimates.

It is, finally, worth recording that Members of Parliament seldom, if ever, use Question Time in order to obtain information on the tax expenditures embodied in our tax laws. For example, a careful scrutiny of Hansard over the last five years has revealed that only one question was put to the Minister of Finance during this entire period, namely, a question on tax revenue lost as a result of tax concessions granted to decentralised or deconcentrated industries.⁽⁸⁹⁾ On this occasion the responsible Minister intimated that the information requested was not available. This contrasts sharply with the position in the UK, where written answers to Parliamentary Questions are a major source of statistical information on tax expenditures.⁽⁹⁰⁾

Previous Studies

The most comprehensive attempt to date to identify and quantify indirect government subsidies, including those that are embodied in our direct and indirect tax systems, is contained in a master's thesis by van Dyk.⁽⁹¹⁾

Van Dyk did pioneering work in his chosen field. However, the relevance of his work to the concept of tax expenditure budgeting in South Africa is diminished by the following. Firstly, the study is confined to subsidies alone. The latter are defined as: "... lopende oordragbetalings deur die owerheid aan sakeondernemings

in die vorm van...waarteenoor die ontvanger nie indirekte teenprestasie hoef te lewer nie maar as quid pro quo op 'n sekere manier, by voorbeeld die verhoging van produksie of die verlagings van pryse, via die markmeganisme moet optree".⁽⁹²⁾ Van Dyk therefore confined his study to indirect payments to business enterprises and this means that many other tax concessions involving income exemptions and deductions allowed to individuals were not considered. The tax expenditure concept is a broad one which penetrates much deeper into the realm of tax law than subsidies of the kind described above.

Secondly, van Dyk used the accrual approach of national accounting practice for the costing of the subsidies, as opposed to the budgetary or cash flow approach of the tax expenditure concept. In terms of the former method, the value of a particular subsidy is equal to the stream of benefits accruing to the particular class of taxpayers, discounted to the present at an appropriate discount rate. The national accounts would be adjusted accordingly to take account of the imputed subsidies calculated in the manner just described. For example, the value of a particular tax concession involving a tax deferral, as opposed to the elimination of a tax liability, would be measured as the present value of the interest foregone by the State on the assumed interest-free loan to the taxpayer which is repayable over a number of years. By contrast, the tax expenditure concept considers as relevant the actual amount of tax not collected by the government in a particular year as a result of the existence of a particular concession or incentive. In the above example, the amount of the loan itself is recorded as a tax expenditure rather than the discounted value of the interest foregone by the State.

That the particular type of concession is equivalent

to an interest-free government loan rather than an outright tax loss, is therefore relevant only in the sense that the taxes now foregone will be recovered in later years and that the benefit accruing to the taxpayer as a result of the non-payment of interest is tax free. Tax expenditure costing usually does not consider the latter aspect of the transaction. As regards the fact that the tax foregone now will be recovered later, this aspect will be dealt with in Section 8 below.

It follows from the foregoing that in some important respects the conceptual basis for both the identification and measurement of indirect government subsidies in van Dyk's study is different from that normally used for tax expenditures.

For the sake of completeness, it is also worth noting that van Dyk's costings are for 1977 and are therefore out of date. A useful aspect of the study is, however, that it identifies some important special provisions in South Africa's indirect tax system.⁽⁹³⁾ Indirect tax expenditures are, however, not covered in this study.

A recent report of the Standing Committee of Enquiry with regard to the Taxation Policy of the Republic, contains some estimates of tax foregone in respect of the initial and investment allowance in the manufacturing sector.⁽⁹⁴⁾ The Report quotes a Department of Inland Revenue special survey conducted in 1978, showing that "the amount of the tax foregone (in the 1976 tax year) as a result of the two allowances lay somewhere between R270 million and R500 million".⁽⁹⁵⁾ Further figures provided to the Commission by the Economic Department of the South African Reserve Bank, indicated that (a) the estimated revenue foregone

as a result of the investment allowances in respect of machinery and buildings in the manufacturing sector (private manufacturing and tax-paying public corporations) grew from R182 million in 1975 to R549 million in calendar year 1981; and (b) the estimated gross deductions allowed for purposes of the initial allowance in respect of machinery and in the manufacturing sector (again for private manufacturing and taxpaying public corporations) grew from R306 million in 1975 to R927 million in calendar year 1981.⁽⁹⁶⁾ Applying the company income tax rate of 42 per cent (tax year 1981/82) to the latter figure for 1981 would indicate that the Government failed to collect an amount of R389 million in that year. The total tax loss in 1981 is therefore estimated to be in the region of R928 million.

For the sake of completeness, we also quote below estimates of revenue foregone by the State during calendar year 1982, as supplied in a recent newspaper article.

Table 2 Tax Allowances

<u>Item</u>	<u>R(m)</u>
Plant and machinery	1 500
Mining capital expenditure	500
Buildings used for manufacture	100
Hotels	50
Leasehold improvements	100-150

Source: Sunday Times, 19 September 1983.

Sargeant's figures are apparently based on fairly rough estimates and, we guess, interviews with officials of large undertakings. Although the figures quoted above

may be 'guesstimates' in some instances, Sargeant's article has definitely helped to highlight the scope of indirect government spending embodied in the income tax system. The article has also drawn attention to the extent to which institutions have been able to take advantage of loopholes in the tax laws to claim incentive allowances. These loopholes have resulted in a serious erosion of the tax base.

8. A TENTATIVE INCOME TAX EXPENDITURE LISTING
FOR SOUTH AFRICA

The primary objective of this part of the study is to examine the scope and scale of the indirect spending programs of the government which are undertaken through the normal income tax system.

The actual listing of tax expenditures is preceded by an introductory discussion dealing with the following practical aspects of the drawing up of such a list: coverage, identification, functional grouping, the time focus, and measurement. Some international perspectives are also provided.

The Coverage of the Budget

It is apparent that both in theory and practice the tax expenditure concept is not confined to the income tax, but can be extended to a country's entire tax system. However, tax expenditure listings abroad vary greatly as far as their coverage of the various taxes imposed at central government level is concerned.

In the United States the Congressional Budget Act requires a listing in the budget of tax expenditures contained in the Federal tax laws. However, the Administration's budget submission is confined to the income tax on individuals and corporations. No account is therefore taken of tax expenditures that might be embodied in other major taxes imposed by the Federal Government, such as excise taxes, estate and gift taxes and customs duties and payroll taxes.

In Canada the first Government of Canada Tax Expenditure Account pointed out that: "This paper is concerned with the tax expenditures provided through the federal individual and corporate income taxes and the sales and excise taxes. It does not cover any tax expenditures that may be embodied in other federal legislation such as the customs tariff, social security taxes under the Canada Pension Plan or the Unemployment Insurance program, or tax expenditure embodied in various Canadian tax treaties with other countries".⁽⁹⁷⁾ The 1980 update of the Account used the same conceptual basis as the 1979 version, and had a similar coverage.⁽⁹⁸⁾ The 1981 study, however, analysed the distribution of benefits from personal income tax expenditure (only) among various groups of individuals.⁽⁹⁹⁾

Most discussion of taxation expenditures in the Australian budget papers has thus far been confined to government assistance granted to individuals and industry through the income tax on individuals and corporations. However, the Treasury's May 1982 submission on taxation expenditures to the House of Representatives Standing Committee on Expenditure covered the income tax as well as the sales tax, the Australian Capital Territory payroll tax and stamp duty, but not customs and excise duties which fall outside its principal responsibility.⁽¹⁰⁰⁾ With regard to customs duties the Treasury commented that: "customs duties as such are not generally levied for revenue raising purposes but for industry protective purposes with the exception of the 2 per cent revenue duty".⁽¹⁰¹⁾ The Standing Committee, however, included customs and excise duties in their own listing, commenting as follows: "in line with the view that a tax expenditure list should be comprehensive rather than restrictive, the Committee has incorporated customs and excise duties in the scope of such a list and

recommends that: The Treasurer consult with other Ministers to ensure that the listing covers taxation expenditures in areas outside the Treasurer's principal responsibility". (102)

In the United Kingdom the list of Direct Tax Allowances and Reliefs cover all Inland Revenue taxation. (103) In addition to the personal and corporation income tax, Inland Revenue taxes also include the petroleum revenue tax, the supplementary revenue duty, capital gains tax, development land tax, capital transfer tax and stamp duty. Indirect taxes are therefore excluded. This is in accordance with a decision taken by the British government. (104)

In South Africa most taxes imposed by the central government contain special provisions benefiting particular classes of taxpayers. To limit the study, these cannot all be dealt with. Consequently, the items listed below cover only the tax expenditures contained in the normal income tax levied in terms of the Income Tax Act (No.58 of 1962, as amended). Tax expenditures embodied in other taxes levied in terms of the Income Tax Act, i.e., the undistributed profits tax, the non-resident's shareholder's tax, the non-resident's tax on interest and the donations tax, are not covered. This section also does not cover any tax expenditures embodied in other taxes imposed by the central government, such as the general sales tax, sales duties, customs and excise tariffs, transfer duties, estate duties, the marketable securities tax or stamp duties. Neither does it cover any so-called social security taxes, such as compulsory contributions by employers and employees to the Unemployment Insurance Fund and the Workmen's Compensation Fund.

Identifying Normal Income Tax Expenditures

The problems associated with the definition of the essential structure of an income tax and the identification of income tax expenditures were discussed in an earlier section, where some international perspectives were also provided. This section examines the guidelines underlying the tax expenditure listing which is provided in this paper.

It should be said right away that, for the purposes of this study, a pragmatic approach to the identification of income tax expenditures has been adopted. Our decision to use a pragmatic definition, rather than a more theoretical one, is based on a practical consideration: to have credibility, especially at this stage of the development of the concept of tax expenditure budgeting, any listing of tax expenditures must enjoy broad acceptance from a conceptual point of view. By contrast, a list of tax expenditures for South Africa which is defined in relation to a theoretical or ideal benchmark tax system that deviates too far from the community's perception of the current income tax, would probably include some highly controversial items that might be regarded as too theoretical and perhaps even as farfetched at this stage. The inclusion of such items at this stage is likely to weaken the thrust of the main argument of the paper and thus impede rather than encourage progress towards a fuller accounting of tax expenditures in the South African budget.

For this reason the present study adopts the concept of 'general acceptability' for purposes of defining income tax expenditures. That is, income tax expenditures are defined as all special provisions in the income tax system which represent a departure or deviation from what is

generally accepted as the essential structure of the tax.

The generally accepted structure of the income tax is, however, not explicitly defined in the tax laws or budgetary conventions of South Africa. As we have seen, in the US the concept of the normal tax structure evolved over a number of years, but South Africa does not have similar budgetary conventions. How then is the essential structure of the income tax to be defined if there is no clearly identifiable view of what it is? Clearly, before the concept of the generally accepted structure can be used as a basis for distinguishing tax expenditures from the structural aspects of the income tax in South Africa, an operational definition of it needs to be found. In other words, can a practical working rule be found to distinguish between the structural and non-structural elements of the income tax, which is capable of being applied consistently, but at the same time does not seriously contradict existing attitudes towards income taxation?

In our view the answer to these questions lies in the income tax law itself. That is, in the absence of a conventional meaning of the essential structure, the latter could be defined as the set of general provisions of the current income tax laws. More specifically, the general provisions of the present income tax law regarding (a) the determination of the size of the revenue base (income) and (b) the taxable capacity of taxpayers (as reflected in the effective graduation of the tax), may be considered as indicative of what is commonly viewed as the normal or essential structure of the income tax that would have existed in the absence of all tax expenditures. Against this, all exceptions to these general provisions, i.e., all special provisions which apply to

particular taxpayers or classes of taxpayers, should be classified as tax expenditures which may be regarded as alternatives to direct expenditure programs.

The implementation of such a criterion is not likely to be without its controversies. In particular, distinguishing between general provisions of the law which are designed to take account of any special circumstances existing in particular sectors, on the one hand, and special provisions introduced into the tax system to favour particular classes of taxpayers in the pursuit of certain social or economic objectives, on the other, is not likely always to be clear cut. For the purposes of this study, therefore, whenever there is uncertainty about whether a particular provision in the tax law is general or special, the relevant provision is to be included rather than excluded. This is done mainly in order to avoid losing sight of the particular item. It is also in line with the basic dictum that if a tax expenditure budget is published, its essential function of providing better information would be best served if it is comprehensive rather than restrictive. Those budget users who do not wish to consider a particular item as a tax expenditure are free to omit the item from their analysis. Of course, if the tax expenditure account is to become a formal part of the decision-making process, it would obviously become essential to be more precise if fundamental difficulties are to be avoided.

It is believed that the general guidelines outlined above will produce a useful initial list of tax expenditures. Such a list should enjoy broad acceptance, and could serve as a starting point for further refinements of the concept of tax expenditures in South Africa.

Some specific aspects of the distinction between income tax expenditure and the structural elements of the income tax in South Africa are mentioned below.

The essential structure of the personal income tax is considered to include the following: (a) the personal income tax rate schedules, including the degree of progressivity of the rate structure and the separate rate schedules for single and married taxpayers; and (b) the single and married personal reliefs which are implemented through a system of single and married primary rebates (credits). The latter rebates are considered to be part of the effective graduation of the tax. Almost all other so-called personal reliefs and exemptions are classified as tax expenditures.

Excluded from the normal structure are therefore the standard deduction for single and married taxpayers, the minimum insurance and funds rebate for single and married taxpayers, and the basic interest exemption. All three devices were introduced in 1982 in order to facilitate the introduction of the final income tax deduction system for individuals. In the case of the standard deduction it is (partly) in lieu of four itemised deductions, three of which are themselves classified as tax expenditure items. The minimum insurance and funds deduction also refers to itemised tax expenditures and the basic interest exemption was introduced "...in order to encourage savings and not to deprive them (persons at relatively low income levels) of the benefits of the new tax system".⁽¹⁰⁵⁾

Child rebates and dependants' rebates are perhaps borderline cases. Some analysts may regard them as reliefs

whose role is to adjust tax liabilities so as to reflect more closely the taxable capacity and special circumstances of the individual taxpayers. However, because these allowances: (a) have social welfare connotations; (b) are often associated with direct expenditure serving basically the same purpose; and (c) could be replaced by a system of direct government grants to parents having an identical affect, they are listed here as tax expenditures (in the UK the child reliefs were recently replaced by a system of direct grants to parents).

The study regards the treatment of individuals and companies as separate taxpaying entities as part of the normal tax structure. Differential tax rates applicable to companies and individuals do not therefore give rise to tax expenditures. In a theoretically pure income tax the profits of companies would be apportioned to the shareholders and only the latter would be taxed to avoid the multiple taxation of particular kinds of income. In South Africa a system based on apportionment for private companies, was introduced in 1941, but abandoned in 1952. Although the treatment of companies and individuals as separate taxpaying units is therefore, after 32 years, an established feature of the tax system in South Africa, the Standing Commission on Taxation Policy is again looking into the matter and a change in the law is therefore possible. (106)

The combination of husband and wife as a taxpaying unit is also regarded as an element of the generally accepted structure of the tax system. The allowable deductions from married women's earnings are therefore classified as a tax expenditure. This approach is perhaps surprising in the light of the aforementioned criterion of 'general

acceptability' and the apparent widespread dissatisfaction with the present tax treatment of spouses. The concession in question was introduced in the 1969/70 tax year as some recognition of the extra domestic expense which is or may be incurred when a wife goes out to work. It is also associated with the reduction of disincentives to women in the labour market, etc. The amounts allowed as a deduction were further boosted in 1982 and 1983 with the introduction of the final deduction system. In our view the scope and scale that the concessions in respect of (some of) the income of married women have reached to date, do not as yet represent a basic shift in the community's thinking on the proper and fair taxation of husband and wife. Of course, in an evolutionary situation a particular concession of this nature may in time become more closely identified with the essential structure of the tax.

Tax reliefs arising from international double taxation agreements are also considered to be part of the normal structure of the income tax for the purposes of this study. Some ad hoc concessions granted to foreigners in respect of income earned in South Africa do, however, result in tax expenditures, especially in view of the fact that the granting of such concessions often means that the fiscus of foreign countries gain at the expense of the Exchequer.

The treatment of capital gains in the South African context deserves some mention. In some countries, e.g., the US, capital gains are taxed as income, albeit at a lower rate. In such cases the differential rates applicable to different forms of income depending on whether it accrues in the form of capital gains or not are likely to give rise to tax expenditure. In other countries, e.g., the

UK, there is an entirely separate capital gains tax, so that the differential rate applicable to the latter does not give rise to tax expenditure unless some capital gains are taxed at a lower rate than others. By contrast, there is no separate capital gains tax in South Africa. Moreover, it is a fundamental of the income tax in South Africa that capital receipts (other than specific inclusions listed in the Act), are not included in the definition of taxable income. The question arises whether this does not result in a tax expenditure on the grounds that it represents a legislated exemption to the general provision that all income be taxed.

To decide whether capital gains are income or not in an economic sense would involve some complicated theoretical arguments about the meaning of income and its proper definition. In the light of our objectives it is best to avoid this controversy but instead to have regard to the generality of the particular provisions. That is to say, for the purposes of the study, the non-taxing as income of capital receipts (other than the specific inclusions) is considered to be a traditional or generally accepted feature of the income tax system. In other words, the tax status of capital gains in South Africa is viewed as a reflection of a general provision regarding the definition of income, which excludes capital receipts from income, rather than as a deviation from a general rule that all income be taxed. In this view the treatment of capital receipts or gains as income would be regarded as contrary to usual concepts of income in South Africa; consequently, the exclusion of capital is not used in the computation of tax expenditures for South Africa. On the other hand, the expensing of capital expenditures would, of course, give rise to tax expenditures.

The foregoing implies that whenever capital receipts are taxable by way of 'special inclusions' listed in the Act, it will give rise to so-called negative tax expenditures, unless the 'special inclusions' are 'corrected' by 'special deductions'. As already mentioned, negative tax expenditures are not considered in this study.

The hitherto separate and 'unequal' taxing of Black persons, possibly involving aspects of both tax expenditures and tax penalties (negative tax expenditures), depending on whether broad groups of Blacks paid less or more tax than Whites earning the same average income, is not considered. The separate taxation of Black persons was abolished from 1 March 1984 anyway, so will only be of historical interest.

Departmental practices have not been explored for the purpose of identifying tax expenditure arising from them, mainly because of a lack of information. Examples of special provisions in this latter category are fringe benefits derived by the private sector, e.g., those relating to housing which are untaxed or partly taxed in accordance with departmental practice. The whole question of the taxing of fringe benefits has in recent years been the subject of intense investigation and public debate. In his 1984 budget speech the Minister of Finance announced that fringe benefits will become taxable as from September 1984. The expected revenue for the current financial year amounts to R50 million.⁽¹⁰⁷⁾ At current tax rates the gain to the revenue for a full year would thus be approximately R100 million. There has now been a further postponement of the introduction of the tax until the 1985/86 tax year.

Allocation to Functions

The UK Treasury has defined tax expenditure budgeting as follows: "Tax expenditure budgeting involves a systematic identification of tax reliefs and allowances with related items of public expenditure".⁽¹⁰⁸⁾ In terms of this view, the functional classification of tax expenditure items is an essential part of the tax expenditure budget.

A number of advantages of a functional classification of tax expenditure have been mentioned.⁽¹⁰⁹⁾ Firstly, it would enable more accurate measurement of government activities in particular policy areas. Secondly, it would facilitate policy evaluation and budgetary control. Thirdly, it would promote greater understanding and be a stimulus for scrutiny. The identification of specific tax expenditures with related public expenditure programs would also facilitate comparisons and trade-offs between direct and indirect expenditure programs.

The functional grouping of tax expenditures is not without its problems. Whilst it is desirable that tax expenditures be classified according to the functional categories used for the budget outlays, tax expenditures do not always easily fit into the existing categories. In these cases, special functional categories have to be created. However, if the categories are too broad they become meaningless. In other cases individual tax expenditures can serve more than one objective. For example, relief for Post Office savings could be regarded as encouragement of thrift in support of social welfare policies, or as aid to the postal services, or even as support for macro-economic demand management. Arbitrary grouping is therefore often unavoidable: "Many (tax reliefs

and allowances) cannot easily be attached to particular programmes, although some have more relevance to one programme than another. Categorising them by programme would often be arbitrary and subjective".⁽¹¹⁰⁾

Despite these problems, there is fairly general support for the idea of classifying tax expenditures by objectives. In the US the listings produced by the Administration and the Congressional Budget Office are both grouped into functional categories.⁽¹¹¹⁾ Where possible, particular expenditures are grouped in accordance with the grouping used for budget outlays. Estimates are shown separately for individuals and corporations.

Canada's first Tax Expenditure Account grouped tax expenditure items into the functional categories that are used in the budgetary (public) accounts.⁽¹¹²⁾ The 1980 update of the Account contained twelve broad functional categories.⁽¹¹³⁾

There is at present no functional allocation of tax expenditure in the Australian budgetary papers. An appendix on 'Taxation Expenditures' merely groups indirect government assistance into (a) Assistance to Individuals, and (b) Industry Assistance.⁽¹¹⁴⁾ However, the Treasury's submission on tax expenditures to the House of Representatives Standing Committee on Expenditure listed 113 items by functional category.⁽¹¹⁵⁾

The Australian House of Representatives Standing Committee on Expenditure recorded fairly widespread support for a functional classification of tax expenditures and accordingly recommended that: "Individual taxation expenditure items be classified in functional groupings

similar to the classification of direct outlays". (116)
The Committee also recommended that: "The functional classification of taxation expenditures be cross-classified according to the departments responsible for the direct spending equivalents". (117)

In the UK, however, the current listing of Direct Tax Allowances and Reliefs in the Government's Expenditure Plans is merely classified by source, with no reference to the objectives pursued by the government.

As far as the present study is concerned, it has not been possible within the time available, to group the tax expenditure items listed below in accordance with budget outlay categories. However, some 21 broad functional categories and sub-categories are identified to illustrate the wide range of objectives pursued by the South African government through the normal income tax system. In those cases where particular items could not be allocated to particular objectives, they are grouped under: Other Income Tax Reliefs and Concessions.

The Time Focus of Estimates

To be most useful, a tax expenditure budget should provide tax costing of all items for the forecast year. Current year estimates would also be required for purposes of comparison. In practice, this ideal will be tempered by operational costing problems, forecasting difficulties, resource constraints, etc. This section briefly reviews the time focus of our own listing against the international background. The related problems of the costing of individual items is examined in the next section.

In the US the Administration's tax expenditure estimates show the loss of budget receipts resulting from each provision. The figures relate to the forecast year. For purposes of comparison, figures for the most recently completed fiscal years are also provided. For example, the budget of the US government for fiscal year 1985 provides estimates for the forecast year, the as yet uncompleted current year and the most recently completed year. It also includes estimates of tax expenditures calculated according to the 'outlay equivalent' concept covering the same period. (118)

As already mentioned, the Congressional Budget Office is required by the Congressional Budget Act of 1974 to publish a report every year that projects tax expenditures for each of the next five fiscal years. The Congressional Budget Office report dated October 1983, (119) comprised data for fiscal years 1983-1988, i.e., the current year plus the next five fiscal years. The estimating assumptions are similar to those adopted by the Administration.

In Canada the two Tax Expenditure Accounts published so far have not provided figures for the forecast budget year. The 1979 version of the Account, which was released in December of that year to coincide with the late 1979 Federal budget, provided estimates of tax expenditures for 1976 and the as yet uncompleted current year (1979). The 1980 Account (released in December 1980) provided estimates for the uncompleted current year (1980) as well as revised and updated figures for the four most recently completed years (1976-1979) for purposes of comparison. All the estimates were in terms of tax foregone.

In the UK, the list of Direct Tax Allowances and Reliefs

currently published in the Government's Expenditure Plans show the estimated cost of each tax provision for only one year, i.e., the as yet uncompleted current tax year. Estimates do not therefore relate to the forecast year. All estimates are in terms of tax foregone.

Thus far, discussion of tax expenditures in the Australian budget papers has revolved around estimates of revenue foregone in the current financial year, or earlier years in some cases. Figures relating to the forecast year are not yet provided. The House of Representatives Standing Committee on Expenditure recommended that: "In addition to the listing of all taxation expenditures and their objectives, the information in the Budget Papers contain the estimated cost to revenue of the major taxation expenditures for the budget year that is current and the two preceding years". (120)

No particular tax year or calendar year has been chosen for the purpose of costing the income tax expenditure items listed below, although this would have been desirable for purposes of comparison between particular items or with other global budgetary estimates. Partly, this is because one of the objectives of the costing provided here is merely to bring together in one place all available recent data relating to the revenue foregone by the government as a result of the existence of special tax provisions contained in the normal income tax. The costings are therefore for different years, and go as far back as 1978/79. Wherever possible we have supplemented published and unpublished costings with our own estimates, but these again do not necessarily refer to the most recent years as a result of a dearth of up-to-date information.

Measurement

The costing of tax expenditures is a world-wide problem. Of the four countries surveyed, the US has been the most successful to date as far as the costing of tax expenditures is concerned. As already noted, several different listings are currently published in the US by the different agencies, and a considerable amount of resources is evidently devoted to both the identification and measurement of tax expenditures. For example, the US budget for fiscal year 1985 listed and costed approximately 110 individual tax expenditure items on both the 'tax loss' and 'outlay equivalent' bases, separately for individuals and corporations, and for three consecutive fiscal years, i.e., 1983, 1984 and 1985.⁽¹²¹⁾ The performance of other US agencies is no less impressive in this regard if it is borne in mind that the Congressional Budget Office, for example, publishes five-year projections on a regular basis.

By contrast, costing attempts in the other three countries have been relatively modest so far. In the UK the first list of Direct Tax Allowances and Reliefs was divided into two parts. The first part separated out those items for which figures of cost were available. The second part listed items "where information as to cost cannot be obtained, is not available at present, or is less than £1 million".⁽¹²²⁾ This latter part contained over eighty individual items. The corresponding tax expenditure listing contained in the Government's Expenditure Plans 1982-83 to 1984-85 gave figures "for those tax reliefs and allowances for which costs can be given".⁽¹²³⁾ However, there was no further discussion of the reliefs for which costs could not be given, and no indication of how many items there were and what the amounts might have been.

To complete the Government of Canada Tax Expenditure Account (1980), approximately 1 745 individual cost estimates (349 individual items covering the five years from 1976 to 1980), were required. Out of this total number approximately 420 costings or 24 per cent of the total were not available. The Account noted that: "Some of the items which have not been quantified are significant in value".⁽¹²⁴⁾

The position in Australia was even less satisfactory in 1982. To complete the tax expenditure listing of the House of Representatives Standing Committee on Expenditure, a total of 357 individual cost estimates (119 items for 3 years), were required. However, only 85 cost estimates, or 24 per cent of the total, were available.⁽¹²⁵⁾ The Standing Committee noted several reasons for this paucity of information. These include delays in the supply of statistics by data collecting departments, shortcomings of the tax forms in use and computer and manpower constraints.⁽¹²⁶⁾

In South Africa the statistics are likewise far from complete and the authorities' own data collecting procedures are still in its infancy. For the purpose of the present listing, indirect methods of estimation were often used, and the reader is therefore warned that especially in these cases the available figures are subject to wide margins of error.

The listing provides cost estimates where possible, but all in all, it has been possible to quantify only a small proportion of the total number of items. Indeed, estimates of the tax foregone by the government are supplied

in only 64 cases or 40 per cent of the total number of items, mainly as a result of insufficient information. Note, however, that items are listed irrespective of whether they are quantitatively significant or not, and many items are likely to cost the Exchequer less than, say, R1 million. On the other hand, some of the items not costed are likely to be quantitatively significant.

Information has been drawn from a wide range of statistical sources. Some data were also supplied by the Department of Inland Revenue. The following are some general comments on the figures supplied by the Department, as detailed in Appendix II.

The Department has since 1975 employed certain statistical collection procedures in order to capture historical data, based on assessments issued, on a limited number of special income tax provisions. The latter relate to (a) the personal income tax rebates; (b) personal income deductions; and (c) some of the so-called incentive allowances to business enterprises (companies and individuals). According to the Department, additional information can, at this stage, only be obtained from sample surveys of assessments, which is a costly business. For some of the deductions under (b) above, the statistics are incomplete because only so-called salary cases are included, so that deductions claimed by farmers and other non-salary income earners are omitted.

The reliability of the information collected by the Department thus far depends, in the first place, on how meticulous, and with what degree of accuracy, the tax assessors all over the country complete the prescribed statistical returns. Although the situation will no doubt

improve over time as the assessors gain more experience, it is not possible at this stage to be 100 per cent certain of the reliability of the historical data accumulated so far, especially for the earlier years. Another factor influencing the accuracy of the Department's data is that assessments are often revised after they have been issued for the first time; however, the relevant statistical returns are not adjusted accordingly. Obviously, the reliability of the information for a particular year will also depend on whether the returns of the major corporate recipients of, say, the incentive allowances, have already been assessed for that year or not.

Another problem with the Inland Revenue figures is that in practice there is a considerable time lag before the data becomes complete enough to use. The reason for this is that the costing is based on actual assessments issued, so that reliable data in respect of a particular year will only become available after a considerable lapse of time, when all or most of the tax returns for that year have been received and processed. For example, at the beginning of tax year 1985, i.e., on 31 March 1984, the percentage of taxpayers assessed in respect of the previous four tax years would be approximately as follows (according to the Department of Inland Revenue):

Table 3 Taxpayers Assessed on 31 March 1984

Tax year	%
1980/81	97
1981/82	92
1982/83	78
1983/84	0

Table 3 shows that reasonably reliable data for a particular year, based on actual assessments issued in respect of that year, will not be at hand until about three years after the end of the relevant year.

All these factors are no doubt uppermost in the minds of the Authorities. The difficulties outlined above probably explain why the latter have not, until this year, ventured to publish some of the results of their research in this field, and why the published data are considerably out of date. Indeed, the relevant table in the Statistical/Economic Review, Budget 1984/85 (hereafter referred to as the 1984 Finance Department Presentation), which is based on the data compiled by the Department of Inland Revenue, relate to assessments issued up to 31 December 1983 in respect of the tax year 1980/81. That is, in relation to the 1984/85 budget estimates, four years out of date.

The unpublished data supplied by the Department of Inland Revenue for this study can be grouped into two broad categories. These will be discussed in turn.

Category 1 : Rebates

In the case of special provisions in the form of the granting of rebates, the tax foregone equals the rebates actually claimed by taxpayers. In order to produce estimates for 1984/85, the Inland Revenue figures are based on current, i.e., 1984/85 tax rates (rebates). However, the latter were applied to statistics obtained from 1981/82 income tax assessments. This means that it was assumed that the number of children, dependants, elderly persons, etc., have not changed between 1981/82 and 1984/85. Note also

that, as mentioned before, these numbers would have been derived from approximately 92 per cent of the total number of assessments for the tax year 1981/82. To take account of this latter shortcoming, the estimates received from Inland Revenue have been adjusted as follows:

Inland Revenue Estimates . x = total tax foregone in
1984/85 (x=100/92)

It should also be noted that the Department's estimates might overstate the tax cost of the rebates, to the extent that the rebates claimed by taxpayers exceed their schedule tax (liability for tax before deduction of rebates).

Category 2: Various Personal Deductions:

This category refers to deductions in respect of a wife's earnings, current and arrear contributions towards a pension or retirement annuity fund, deductions for disabilities, medical expenses, etc. As already mentioned, for some items the data would be incomplete in that they cover only the so-called salary cases and therefore excludes farmers and other individuals working for a commission, etc.; however, no adjustment has been made to correct this specific shortcoming. As before, the calculations are based on 1984/85 tax rates applied to statistics obtained from assessments issued to date (14 April 1984) in respect of the 1981/82 tax year. The tax loss would equal the deduction claimed, multiplied by the taxpayer's marginal tax rate.

Approximately two million taxpayers are involved. For each taxpayer the following calculation was made in respect of each item listed:

$$m-n = k$$

where

m=tax calculated on the assumption that the special provision did not exist, i.e., the 1984/85 tax rates were applied to the taxpayer's 1981/82 assessed income without the special exemption or deduction;

n=tax calculated on the assumption that the special provision is still in place, i.e., the 1984/85 tax rates were applied to the taxpayer's 1981/82 assessed income with the particular special provision; and

k=tax foregone in 1984/85 before adjustment for increases in nominal income between 1981/82 and 1984/85

The following further adjustment was made to take account of (1) increases in nominal income between 1981/82 and 1984/85, and (2) the consequential movement of taxpayers into higher tax brackets:

$$k.b=f$$

where

b=the ratio of the published estimated personal income tax yield for 1984/85 to the total tax payable by all individuals on their 1981/82 assessed income at 1984/85 tax rates
= R7 696 millions⁽¹²⁷⁾ / R2 753 millions⁽¹²⁸⁾
= 2,8

f=estimated tax foregone by the government in 1984/85 (after adjustment for increases in nominal income)

Next follow some general comments on the methodology and reliability of the estimates of tax losses arising from a number of incentive allowances, as published in the 1984 Finance Department Presentation. As mentioned earlier, these estimates are also based on the statistics compiled by the Department

of Inland Revenue, and are therefore also subject to the general limitations outlined above.

Tax expenditures in the category of incentive allowances are calculated by applying an appropriate tax rate to the various deductions claimed by companies and individuals. The estimates in the 1984 Finance Department Presentation are based on assessments issued to companies and individuals by 31 March 1983, in respect of the 1980/81 tax year. A tax rate of 42 per cent was applied in respect of allowances claimed by companies and a marginal rate of 40 per cent in the case of individuals (it is assumed that non-corporate taxpayers claiming the allowances in question are in the higher income tax brackets).

A number of qualifications need to be noted. Firstly, since the basic data refer to incentive allowances claimed by taxpayers in the respective years, there is no way of telling from the information available to what extent the granting of the allowances in question merely resulted in the creation, or further accumulation of assessed losses. To the extent that the granting of an allowance merely produces an assessed loss in the books of a business enterprise, the Exchequer will forego revenue in later years but not in the year in which the allowance has actually been granted.

Secondly, some tax concessions, e.g., the machinery initial allowances, allow for an acceleration of depreciation, and therefore has the effect of a tax deferral. That is to say, for a particular asset the special provision defers tax liability rather than eliminate it. Whilst a taxpayer may experience a tax saving (the government a tax loss) in the first years of the life of an asset, an equal off-setting increase in tax liability (a tax gain to the government) will occur over the rest of the life of the asset. As regards a particular asset

the loss to the Revenue will be zero over the life of the asset (unless the tax rates change in the mean time). The foregoing implies that the net revenue cost to the government of the particular concession in a particular year cannot be adequately measured by the so-called 'first year' costs to the Revenue, because 'first year' tax losses will be off-set in part by revenue gains carried forward from previous years if the specific provision has been in operation for a number of years. Since the Finance Department's Presentation's version of the cost of the machinery initial allowance is based on 'first year' allowances claimed by investors, it fails to take into account such off-sets arising in the particular year from an acceleration of depreciation on assets before tax year 1980/81. As a measure of the cost to the Revenue of the machinery initial allowance, as opposed to a situation where the latter never existed, the published figure would be an overstatement. On the other hand, it needs to be emphasised that the foregoing does not imply that the net tax cost in every year would be zero in cases of tax deferral. Indeed, it has been shown that in a stable or growing economy in which new investments are undertaken each year, the net cost to the Revenue resulting from a tax deferral scheme will initially be positive but variable, and that this tax loss will not necessarily be recovered in later years. In a growing economy it might even continue to be positive indefinitely.⁽¹²⁹⁾ It needs also to be noted that the so-called 'first year' tax costs are indeed the only element of the net cost which is 'missing' from the budgetary estimates of revenue, since the gain to the Revenue arising from the acceleration of depreciation in earlier years is already implicitly incorporated in the usual estimates of revenue.

The tax costing of accelerated depreciation and tax deferrals in general is therefore a complicated concept. Elements of several tax expenditure items listed below, such as mining capital

expenditure allowances, the farming allowances for 'developments and improvements', and even the deductibility of contributions to a pension fund fall into this category. Where costing of such items is at all possible, the 'first year' tax costs are given below, mainly because the data required to make more accurate calculations are not at hand.

Lastly, the simultaneous withdrawal of all the tax incentives listed in the 1984 Finance Department Presentation would probably change taxpayers' behaviour significantly, and result in severe deflationary effects on the economy with a fall in tax revenue as a result. Consequently, the net income tax gain to the Revenue is likely to be substantially less than the aggregate amount shown (£977 million in tax year 1980/81). For this reason, and because of the interdependence of some income tax concessions, tax expenditure costings are not usually aggregated as is done in the aforementioned Presentation.

This present introductory section on costing may be concluded with a number of general comments. Firstly, both the published and unpublished tax expenditure figures supplied by the Department of Inland Revenue are not directly comparable with ordinary budgetary estimates of revenues. The reason is that different accounting bases are used for the two sets of figures; whilst the budgetary figures are estimated on a cash collections basis, the Department's estimates of tax expenditures are based on assessments issued and are therefore on an accrual basis.

Secondly, the recipients of tax-exempted war pensions, disability pensions, unemployment insurance benefits and other similar social welfare payments, are likely to be mostly in relatively low income categories. In such cases we have applied the relatively low marginal tax rate of 10 per cent to the payments but even this rate may be too high in many individual

cases, especially if the recipients of the concessions are in income classes falling below the threshold levels. Further qualifications and assumptions of this nature are incorporated in Appendix II.

Finally, the tax costings provided below are subject to the usual assumptions which should be borne in mind. They are that: (1) Each item is costed separately on the assumption that all other provisions of the tax law remain in place; (2) Taxpayers' behaviour would be unaffected by the withdrawal of particular concessions; (3) There is no effect on the overall level of economic activity as a result of the withdrawal of a given concession. In practice, these assumptions are unlikely to be realistic, especially if a number of major concessions are to be withdrawn simultaneously. Aggregation would thus not give an accurate indication of the total revenue gains to be obtained from the simultaneous withdrawal of all concessions.

A Listing of Normal Income Tax Expenditures by
Functional Classification

This section contains a provisional listing of tax expenditures embodied in the normal income tax at the time of writing. (130)

The tentative nature of the listing should be underlined. A careful scrutiny of our income tax laws has revealed that the tax expenditure system is a vast one, and although we have endeavoured to be as complete and accurate as possible, there are some areas which require a great deal more research and study than what we have been able to devote to the topic.

All statistical sources are detailed in Appendix II. As already mentioned the individual items are grouped into broad functional categories, but these are not in accordance with

budget outlay categories.

HEALTH, WELFARE AND SOCIAL SECURITY

1. Child rebates

- * Rebate for children (under 18)
- * Rebate for child (18-21 years, and 21-26 years who is a full time student). See also Education and Training, Item 52.
- * Favourable calculation of child's rebate in the event of the birth or death of child during the year of assessment.
- * Child's rebate claimable in certain circumstances by both parents when they are divorced or separated
- * Rebate for child of any age, married or unmarried, who is unable to maintain himself because of mental or physical illness.

Cost: R250 million for 1984/85

2. Special rebates for persons over 60 and 70.

Cost, R54 million for 1984/85

3. Rebate for dependants

- * Rebate for child dependant
- * Rebate for elderly, ill or infirm dependant
- * Rebate for aged parents or other couples

Cost, R5 million for 1984/85

4. Insurance and funds rebate (subject to a maximum)

- * Rebate for premiums on policies against death, accident or illness
- * Rebate for fees, subscriptions or contributions to provident or benefit funds
- * Rebate for contributions to UIF
- * minimum insurance and funds rebate for widows/widowers and other single people who are treated as married persons for tax purposes (There has been a minimum insurance and funds rebate from tax year 1982).

Cost: R93 million for 1984/85

5. Deduction for medical expenses

- * Deductibility of medical and dental expenses (including contributions to any registered medical scheme)

- * Preferential maximum deduction for medical and dental expenses for widows/widowers
- * Preferential maximum deduction for medical and dental expenses for an unmarried person with a child.
- * Preferential maximum deduction for medical and dental expenses for persons over 60

Cost: R303 million for 1984/85

6. Deductibility of expenditure as a result of physical disability.

Cost: R4 million for 1984/85

7. Standard deduction

- * Standard allowance in lieu of medical and dental expenses (see Item 5); donations to educational institutions (see Item 51); expenditure as a result of physical disability (see Item 6); and the tool allowance (not classified as a tax expenditure)
- * Preferential standard deduction for widows/widowers and other single people who are treated as married for tax purposes.

8. Preferential tax rates for unmarried persons who wholly or mainly maintain a child.

9. Preferential primary rebate for widows/widowers.

10. Preferential tax rates for widows/widowers.

11. Preferential primary rebate for unmarried persons who wholly or mainly maintain a child qualifying for a child's rebate.

12. Exemption of disability pensions paid under the Social Pensions Act, 1973.

Cost: R9 million for 1980/81.

13. Exemption of compensation for mining diseases.

14. Exemption of disability pensions paid under the Workmen's Compensation Act, 1941.

Cost of Items 13 and 14: R2 million for 1980

15. Exemption of war pensions

Cost: R5 million for 1980/81.

16. Exemption of unemployment insurance benefits
Cost: R8 million for 1980.
17. Exemption of employer's share of medical aid contributions.
Cost: R84 million for 1983.
18. Exemption of employer's share of UIF contributions.
Cost: R3 million for 1980.
19. Exemption of lump-sum benefits from benefit funds
20. Exemption of retirement gratuities (other than leave gratuities) in the public service.
21. Exemption of income of benefit funds.
22. Deductibility of current contributions to a pension fund (subject to certain limits).
23. Deductibility (in full) of current contributions to a pension fund established by law or for the benefit of employees of local authorities and control boards.
Cost of Items 22 & 23: R579 million for 1984/85.
24. Deductibility of arrear contributions to a pension fund.
Cost: R10 million for 1984/85.
25. Deductibility of retirement annuity fund contributions, subject to certain limits.
Cost: R161 million for 1984/85.
26. Deductibility of arrear contributions to retirement annuity funds.
Cost: R1 million for 1984/85.
27. Taxing on a favourable basis of lump-sum benefits from approved pension and provident funds on resignation, retirement from fund and death of member.
Cost: R66 million for 1979.

28. Exemption of lump-sum benefits from any pension or provident fund established by law or for the benefit of employees of any local authority or control board.

Cost: R38 million for 1979/80.

29. Exemption of employer's share of pensions and provident fund contributions.

Cost: R579 million for 1984/85.

30. Exemption of pensions and annuities awarded (except by the government) where less than two years' service in the ten years preceding the date from which the pension first became due were rendered in South Africa.

31. Exemption of income of pension funds, provident funds, retirement annuity funds.

32. Special preferential basis of taxing insurance companies.

Cost: R38 million for 1982/83.

33. The taxing of resignation and retirement benefits on a favourable basis.

34. Exemption of income of non-profit bodies providing medical, dental, blood transfusion, hospital or nursing services.

35. Exemption of income of charitable institutions.

HOUSING AND HOME OWNERSHIP

36. Building allowances on "residential Units" as part of a "housing project".

- * 10 per cent initial allowances
- * per cent annual allowances.

Cost: R1 million for 1982/83.

37. Deductibility of scrapping allowance on "residential units" (see Item 36).

38. Allowance for expenditure on housing for employees.

Cost: R10 million for 1980/81.

39. Exemption of housing benefits in the public service and other public bodies.

Cost: R50 million for 1984/85.

40. Treatment of Building Society dividends on ordinary indefinite and fixed-period "shares" as genuine dividends and not as interest in the hands of investors.

Cost: R35 million in 1982/83

41. The right of building societies to offer, within certain limits laid down by the Treasury, tax-free indefinite period and subscription shares.

Cost: R43 million in 1982/83.

42. Deductibility of dividends paid to investors in the determination of the taxable income of building societies.

43. Exemption of income of Housing Associations.

44. Exemption of income of terminating building societies.

45. Exemption of income of non-profit housing bodies.

EDUCATION AND TRAINING

46. Special additional deduction for the training of employees in terms of a registered training centre or scheme.^a Special incentive allowance in respect of training expenses in EDA (see Item 85).

Cost of Items 46 and 85: R32 million for 1981/82.

47. Exemption of amounts received from an industrial training fund.

48. Deductibility of expenditure on post-graduate study courses.^b

49. Exemption of gratuities awarded for obtaining degree or diploma or passing some examination.

50. Exemption of bursaries and study grants.

51. Deductibility of donations to educational institutions.

Cost: R0,45 million for 1984/85.

52. Rebate for child (18-21 years and 21-26 years who is full-time student). See also Health, Welfare and Social Security, Item 1.

Cost: See Item 1.

53. Exemption of income of educational institutions of a public character.

SCIENTIFIC RESEARCH

54. Deductibility of capital expenditure on scientific research.

55. The non-applicability of the general recoupment provision to current and capital expenditure on scientific research.

56. Exemption of income of non-profit bodies conducting or promoting scientific, technical or industrial research.

57. Exemption of income of the Council for Scientific and Industrial Research.

58. Exemption of income of the SA Inventions Development Corporation.

59. Exemption of income of non-profit bodies established by law to conduct scientific, technical or industrial research.

INVESTMENT IN GOVERNMENT SECURITIES

60. Exemption of interest on treasury bonds.

Cost: R14 million for 1982/83.

61. Exemption of interest on defence bonus bonds.

62. Exemption of interest on certain post office investments.

Cost: R27 million for 1982/83.

63. Exemption of interest on income tax loan levies.

Cost: R16 million for 1982/83.

64. Exemption of interest received by non-residents on public stocks of the Republic.

Cost: Nil in 1982/83.

REGIONAL GOVERNMENT

65. Exemption of income of provincial administrations.
66. Exemption of income of the administration of South West Africa.
67. Exemption of income of local authorities (including the local authorities of foreign states).

NATIONAL DEFENCE AND SECURITY

68. Concessional taxing of gratuities payable to members of citizen force or commandos.
69. Exemption of remuneration, allowances, bonuses or benefits received by members of the citizen force of the commandos.
70. Exemption of allowance for any uniform, ration or lodging received by members of the defence force.

Cost of Items 69 and 70: R31 million for 1984/85.

71. Deductibility of security expenditure at "key points".
72. The non-applicability of the general recoupment provision to security expenditure at "key points" (see Item 71).
73. Exemption of income of the Armaments Development and Production Corporation (and certain wholly-owned subsidiaries).

ECONOMIC SERVICES

Manufacturing

74. Deductibility of machinery investment allowance.^c
- Cost: R435 million for 1983/84.
75. Non-applicability of the general recoupment provision to the machinery investment allowance (see Item 74).

76. Deductibility of machinery initial allowance.
Cost: R365 million for 1983/84.
77. Deductibility of industrial building investment allowance.
Cost: R100 million in 1983/84.
78. The non-applicability of the general recoupment provision to the building investment allowance (see Item 77).
79. Deductibility of 2 per cent industrial building annual allowance.
Cost: R10 million in 1983/84.
80. Deductibility of industrial building scrapping allowance.
81. Allowing recoupments on the sale of an industrial building (factory) to be off-set against the cost of a new factory purchased to replace the first one, without the recoupments being subject to tax.
82. Allowance recoupments on the disposal of machinery or plant damaged or destroyed to be set off against the cost of replacements without the recoupments being subject to tax.
- Industrialisation in Economic Development Areas
83. Deductibility of special incentive allowances.
- * Power, water, transport
 - * Housing
 - * Development allowances^d
 - * Supplementary allowance^c
- Cost: R9 million for 1980/81.
84. Deductibility of cost (non-otherwise deductible) of detailed submissions to Director-General: Industries, Commerce and Tourism.
85. Deductibility of special incentive training allowance.
Cost: See Item 46.

86. Deductibility of capital allowances.
- * Machinery initial allowances.
 - * Machinery investment allowances
- Cost: See Items 74 and 76.
87. Deductibility of capital allowances:
- * 2 per cent building initial allowance
 - * building investment allowance
- Cost: See Items 77 and 79.
88. Exemption of state subsidies for wages and the training of workers.
- Cost: R13 million for 1985/85.
89. Exemption of state subsidies for relocation expenditure.
- Cost: R5 million for 1984/85.
90. Exemption of state cash grants in lieu of the development allowance.
- Cost: R5 million for 1984/85.
91. Exemption of interest on investments with the Corporation for Economic Development.
- Cost: Negligible for 1984/85.
- Farming
92. Deductibility of expenditure on "developments and improvements".
- Cost: R117 million for 1983/84.
93. Non-applicability of general recoupment provision to expenditure or allowances on "developments and improvements" in the case of non-movable assets.
94. Exemption of interest subsidies from state.
- Cost: R6 million for 1983/84.
95. Deductibility by lessor of cost of soil erosion works on land let for farming purposes.

- 96. Income tax averaging for farmers.
- 97. Income tax averaging of plantation income.
- 98. Concession in respect of sugar cane fields damaged by fire.
- 99. Allowing farmers to adopt artificially low values for livestock (including breeding stock).

Cost: R4 million for 1981/82.

- 100. Taxation of farming income on a special basis when farming land is acquired by certain public bodies.
- 101. Exemption of income earned by children of taxpayer from reasonable quantities of livestock donated by the latter.
- 102. Allowing farmers the option to deduct the cost of livestock purchased to replace livestock sold on account of drought, stock disease, damage to grazing by fire or plague, or participation in a government livestock-reduction scheme during the year of purchase or during the year in which the livestock was sold.
- 103. Optional deferment of assessment on proceeds of livestock disposed of on account of drought on or after 1 March 1982.
- 104. Deductibility of rates and taxes and bond interest on farm dwellings occupied by farmers.

Agricultural Co-operative Societies

- 105. Deductibility of machinery allowance.
 - * Machinery initial allowance
 - * Machinery investment allowance
- Cost: See Items 74 and 76.
- 106. Deductibility of storage building allowances:
 - * 2 per cent annual allowance on storage buildings
 - * Storage building investment allowance.
- Cost: See Items 77 and 79.
- 107. Deductibility of some bonuses distributed to members.

108. Deductibility of amounts transferred by the KWV to a price stabilisation fund.

109. Deductibility of the cost of repaying certain loans obtained by a co-operative.

Mining

110. Deductibility of capital expenditure on a special basis.

Cost: R838 million for 1983/84.

111. Exemption of amounts accruing to assisted gold mines.

112. Exemption of mining profits made under lease granted under Act No. 35 of 1908, of the Transvaal.

113. Tax concessions to so-called assisted gold mines.

114. Application of a special rating formula to "special remuneration" of mining employees who are members of a proto-team.

Exports

115. Deductibility of Exporters' Marketing Allowance.

Cost: R74 million for 1980/81.

116. Deductibility of beneficiation allowances on plant and machinery and buildings.

117. The non-applicability of the general recoupment provision to the beneficiation allowance (see Item 116).

118. Exemption of state assistance for finance or promotion of exports.

Cost: R33 million for 1984/85.

119. Deductibility of exporters' compensation credit.

120. Deductibility of exporters' compensation allowance.

121. Exemption of income of SAFTO.

Tourist Industry

122. Deductibility of capital allowances on hotel equipment.

- * Investment allowance
- * Initial allowance

123. Deductibility of capital allowances on hotel buildings and improvements.

- * Investment allowance
- * Annual allowance

Cost: See Items 74 and 76.

124. Deductibility of annual grading allowance on hotel buildings and improvements.

Cost: R5 million for 1980/81.

125. Exemption of income of local publicity associations.

Commerce

126. Favourable basis of valuation of trading stock (LIFO)^e

Cost: R50 million for 1983/84.

127. Special deduction allowed to "closed" co-operative trading societies for bonuses distributed to members.

Transport

128. Exemption of income of South African Transport Services.

129. Deductibility of special capital allowances on the cost of qualifying ships.

130. Deductibility of special capital allowances on the cost of qualifying aircraft.

Small Businesses

131. Exemption of subsidies or assistance payable by the state to the Small Businesses Development Corporation.

Cost: R4 million for 1984/85.

Other Economic Services

132. Exemption of income of non-profit bodies promoting commerce, industry or agriculture.

133. Exemption of income of non-profit bodies established by law to provide necessary or useful commodities, amenities or services to the state (including the South African Transport Services and Provincial Administration) or members of the public.

134. Exemption of income of the following:

- * SA Gas Distribution Corporation
- * Rand Water Board
- * South Atlantic Cable Company
- * SWA Water & Electricity Corporation
- * SA Special Risks Insurance Association
- * Mutual Savings Banks
- * Mutual Loan Associations
- * Fidelity and Indemnity Funds
- * Trade Unions
- * Chambers of Commerce and Industry
- * Non-proprietary Stock Exchanges
- * Certain companies that realise gold bullion or shares

RECREATION AND CULTURE

135. Exemption of income of amateur sporting associations.
136. Exemption of income of non-profit social or recreational bodies.
137. Exemption of income of non-profit cultural bodies.
138. Exemptions of income of ecclesiastical institutions.

GENERAL PUBLIC AFFAIRS

139. Exemption of income of foreign states.
140. Exemption from income tax of salaries and emoluments of officers of foreign governments (and their servants).
141. Exemption from income tax of salaries, emoluments and pensions payable to State President, Vice-State President and widows of former State President and Vice-State President.
142. Exemption of income of reserve banks of foreign states.
143. Exemption of income from public service rendered outside South Africa in certain circumstances.
144. Exemption of salaries and emoluments paid by the SA government (including the Railway Administration) for any period of service in SWA (Namibia).
145. Exemption of income of any subject of a foreign state who is temporarily employed in South Africa if the

exemption of his salary and emoluments is authorised by an agreement entered into by his government and the South African government.

- 146. Exemption of income of registered political parties.
- 147. Exemption of non-pensionable allowances of judges.

OTHER INCOME TAX RELIEFS AND CONCESSIONS

- 148. The basic interest exemption (natural persons only).

Cost: R13 million for 1982/83.

- 149. The basic dividend deduction (related to Item 148).

- 150. Allowing persons (other than companies) a percentage of their dividend income as a deduction. Building society dividends that are not tax-free qualify for the percentage dividend deduction (see Item 41).

- 151. Deductibility of wife's earnings allowance.

Cost: R434 million for 1984/85.

- 152. Optional deferment of tax liability in the event of the exchange of fixed property and shares until the assets in question have been disposed of.

- 153. Debtor's allowance for instalment sales.

- 154. Deductibility of foreign exchange losses and forward-exchange contract premiums irrespective of the capital or revenue nature of the related expenditure.

Cost: R1 million for 1978/79.

- 155. Optional spreading of retrospective increases of salary or pension over a period.

- 156. Exemption of allowances for uniforms.

- 157. Exemption of "restraint" payments.

- 158. Optional deferment of assessment on gain from right to acquire shares until any period during which it is prohibited to sell the shares in question has elapsed.

- 159. Exemption of amounts derived by an author in consideration for the assignment of, or the grant of, an interest in the copyright in a work if the

amounts are chargeable with income tax in a foreign country.

160. Deductibility by lessee of cost of leasehold property improvements in terms of lease.

Cost: R100 million for 1983/84.

161. Lessor's special allowance when the free use of leasehold improvements will not be enjoyed until the end of the lease.

9. BUDGETARY PRESENTATION

An issue which has not yet been raised specifically in the study is the various ways in which data on tax expenditures may be incorporated in the budget document, although various aspects of the subject have come to the fore in earlier sections. It would be useful to have some international background on this subject, so this penultimate section of the study briefly focuses on the presentational aspects of tax expenditure budgeting in the US, the UK, Australia and Canada. Since the manner of presenting tax expenditures is to some extent related to the manner in which the control of tax expenditures is integrated into the actual budgetary process, the two issues are dealt with together.

Canada

At this stage, most countries that publish tax expenditure budgets do so for informational purposes alone. Of the four countries listed above, only Canada has thus far integrated the consideration of tax expenditures into their formal expenditure budgeting process.

As already noted, the Canadian Department of Finance has thus far published three major studies of tax expenditures as separate budgetary documents, with adequate coverage of conceptual aspects. Integration of tax expenditures into the budget process is achieved as follows.

In 1979, the Federal government introduced a new policy and management system which is usually referred to as the 'envelope system'. In terms of the system all the

government's spending programs are assigned to one of ten policy areas or 'envelopes'. The spending programs include tax expenditures enacted or proposed after 1979, and the combined total of direct expenditures and tax expenditures in each policy area is required to stay within a spending limit set for each fiscal year. In a recent personal communication from the Canadian Department of Finance, the latter noted that "while tax expenditure accounts are not a regular feature of budget presentations, I should point out that new tax expenditures or modifications to existing items are taken into account under the expenditure management system. In these cases, the revenue foregone due to the new measures are quantified and reduce the funding available to the particular spending envelope. For example, the cost of a measure increasing the tax deduction for medical expenses would reduce the funds available to the Social and Native Affairs spending envelope. In this fashion, new tax expenditures are treated in the same manner as direct expenditure programs".

An important advantage of the 'envelope system' is therefore that tax expenditures can no longer be used as an indirect method of increasing the funds made available to particular policy areas, because: "Under the new system, the revenue cost of any changes in tax expenditures proposed by program ministers will reduce the envelope allocation for that particular policy area. The fiscal discipline implied by the initial envelope allocations can no longer be avoided through the use of tax incentives". (131)

The United States

The integration of the consideration of tax expenditures into the budgetary process is not nearly as thorough in

the United States as in Canada. As already mentioned, the Congressional Budget Act of 1974 requires the federal administration to publish an annual listing of tax expenditures in the budget. However, this listing is presented as one of a number of so-called Special Analyses, and it is published for informational purposes alone. It, therefore, plays no formal part in the budgetary process despite elaborate attempts to classify tax expenditures according to budget outlay categories. Thus, after noting that tax expenditures are broken down into budget functional and sub-functional categories by the Administration, and are even allocated according to spending committees (by the CBO), a recent Congressional Budget Office Report commented as follows: "All this has been done solely for informational purposes, however; no actual legislative decisions are made on the basis of these breakdowns and allocations".⁽¹³²⁾

Tax expenditures in the US are consequently controlled in only a limited and indirect way through the setting of overall revenue targets. That is, increases or decreases of tax expenditures are only one of a number of ways in which congressional budget resolutions setting revenue targets can be implemented. However, the present system of setting a floor on federal revenues compels the policy-makers to scrutinise the tax expenditure option closely because of competing claims: "Given a revenue floor, increases in tax expenditures crowd out opportunities for rate reductions or other forms of general across-the-board tax reductions, while reductions in tax expenditures make revenues available for more general kinds of tax cuts. The explicit competition between these two different approaches to tax reduction that is forced by a floor on revenue puts an extra burden of proof on the use of tax

expenditures". (133)

Two further aspects of tax expenditure budgeting in the US are worth mentioning. The first is that the listings are accompanied by detailed but useful analyses of conceptual aspects relating to identification and measurement. The second is the practice followed by the Congressional Budget Office of publishing a list of expiry dates of some of the major tax expenditures.⁽¹³⁴⁾ According to the aforementioned CBO report, it has become common to enact expiry dates for new tax expenditures. The rationale usually advanced for the latter is: "that the scheduled expiration date will provide an opportunity to review the provision carefully to determine whether it should be enacted".⁽¹³⁵⁾

Australia

Australia has likewise not integrated the consideration of tax expenditures into their formal budgetary process. As noted previously, a review of indirect assistance programs undertaken through the tax system is incorporated in the summary budget document as an Appendix to a Statement entitled: "Estimates of Receipts".⁽¹³⁶⁾ Australian taxation expenditures are therefore considered under the revenue heading rather than the expenditure heading. Once again, however, this is for informational purposes alone, and any control over tax expenditures that does exist is therefore exercised indirectly.

The 1982 report on tax expenditures by the House of Representative Standing Committee on Expenditure stressed the importance of annual reviews of tax expenditures. Thus it recommended that full exposure be given in the budget papers to the scope, cost and objectives of tax expenditures,

and that when a bill relates to tax expenditures: "...the Government incorporates an explanation as to why the taxation system is preferred to direct outlays for giving assistance". (137)

Finally, the budget document makes no mention of the conceptual problems related to the identification and measurement of tax expenditures.

The United Kingdom

In the UK the planning of public expenditure is to a large extent divorced from the determination of tax and fiscal policy, in that public sector spending plans are debated in Parliament some time before the Chancellor of the Exchequer is in possession of the information on which he usually bases his annual tax proposals.⁽¹³⁸⁾ Indeed, the Chancellor of the Exchequer's annual (sometimes more often) budget speech is the cornerstone of the revenue side of the budget, although both the outlays and revenues of the public sector (and the central government) are brought together in the annual Financial Statements and Budget Report which accompanies the budget speech.

Against this background it is interesting to note that the UK government's annual listing of Indirect Tax Allowances and Reliefs is published as part of its expenditure plans rather than with the revenue estimates at budget time. However, there is no attempt to classify the special allowances and reliefs according to budget outlay categories, or to distinguish structural from non-structural reliefs. Apart from a brief outline of basic estimating assumption, there is no text.⁽¹³⁹⁾ According to a recent Congressional Budget Office report: "The problems

of definition and measurement in estimating tax expenditures have discouraged British tax officials from more extensive work in this area. Any new procedure to integrate tax expenditures into the budget process is therefore highly unlikely".⁽¹⁴⁰⁾ Of the four countries surveyed, the UK seems least enthusiastic about the concept of tax expenditure budgeting.

10. CONCLUSIONS

The purpose of this final section is to summarise and draw together all the major conclusions that emerge from the study, and to consider its implications for tax expenditure budgeting in South Africa.

The Scope of Tax Expenditures in South Africa

The first and perhaps most significant conclusion concerns the scope of tax expenditures in South Africa. It has emerged that the income tax system of South Africa embraces an extensive range of special provisions favouring particular classes of taxpayers or kinds of activity. As elsewhere, these provisions have been grafted on to the essential structure of the tax over a period of many years. But they have no basic relation to that structure, and consequently represent a system of government subsidies and incentives that merely uses the mechanism of the income tax as the means to both apportion and disburse government assistance.

The number of identifiable tax expenditure items is quite substantial. It is possible, on the basis of a definition of the essential structure of the income tax that gives maximum recognition to the community's own perception of the tax, to identify no less than 161 individual instances where the actual tax rules depart from what may be regarded as the generally accepted view of the essential structure of the normal income tax. It is true that the inclusion of some of the items listed, such as the child rebate and perhaps some of the other personal rebates and business reliefs as well, might be regarded as controversial, mainly because they could also

be interpreted as attempts either to adjust a person's tax liability in accordance with his ability to pay, or to take account of special circumstances regarding the production of income that prevail in particular productive sectors. After all, the concepts of income and ability to pay underlie much of the rationale for, and structure of, an income tax. However, the inclusion of these items in the listing represents an endeavour to minimise the usual danger inherent in any tax expenditure listing, namely, that items omitted because they are borderline may be lost sight of or be regarded as unimportant when tax expenditures are concerned. At this stage of the development of the concept of tax expenditure budgeting in South Africa, it is especially important that items located right on the frontier between the structural and non-structural should be included in any listing that will serve as a basis for further refinements.

Tax expenditures in South Africa penetrate deeply into and influence almost every sphere of our social and economic life. About 20 broad functional categories have been identified, ranging from culture and sport to regional government and national defence. The young, the elderly, the ill, the disabled and handicapped, the retired, the widowed, the unemployed, the war veterans, and even just plainly the poor in some cases, all are the direct or indirect beneficiaries of government subsidisation programs operated through the normal income tax system. In economic life, saving, investing, manufacturing, farming, mining, exporting, tourism, small businesses, housing, and education and training, etc., receive indirect governmental assistance and encouragement through the apparatus of the normal income tax.

The amounts of tax monies involved are equally impressive, especially if viewed against the background of the government's overall finances. Despite the very fragmentary and incomplete information available, Section 8 has demonstrated that the numerous concessions built into our income tax system can only be maintained at a substantial cost to the Exchequer. Of the 161 items listed, 64 items or 40 per cent of the total number have been costed for one recent year. However, although the costed items cover different years going as far back as 1978/79, these items account for a total tax loss of approximately R5 178 million. Moreover, some, if not many, of the remaining 97 items are likely to be quantitatively quite significant too, so if all the items could be costed the overall tally would probably be far in excess of the amounts recorded here. Unfortunately, it is quite impossible, given the present state of our knowledge, to give even a very rough estimate of the combined tax losses resulting from all the concessions embodied in our income tax law (refer also to Section 6 on measurement and the dangers of aggregation). The present study does not therefore attempt the impossible.

It should nonetheless be useful to place the quantifiable tax expenditures into some perspective. Whilst direct comparisons of the latter with the budgetary estimates for a particular year could be misleading, given the sketchy nature of our information, some very interesting and valuable insights can nevertheless be obtained from comparisons with the 1984 budget, provided the qualifications noted above are kept in mind. Since tax expenditures represent the interface of government expenditures and taxes, both sides of the budget should be considered.

If viewed from the perspective of total government

spending, the costed tax expenditures are equal to approximately 21 per cent of the published estimate of direct government expenditures for the 1984/85 financial year. This means that a substantial proportion, which is probably in excess of 20 per cent, of the aggregate of government spending is currently undertaken through the normal income tax system. This part of total spending therefore escapes regular Parliamentary scrutiny and is furthermore not subject to the usual controls by the Treasury and Cabinet.

If, on the other hand, tax expenditures are related to the government's revenues, it can be shown that the aforementioned tax losses equal approximately one quarter of the published estimate of government revenues from all sources, and no less than 40 per cent of the estimated revenue from the normal income tax (on individuals and companies) alone for budget year 1984/85.

These proportions are particularly striking if viewed against the background of (a) the fact that the study was confined to the normal income tax, and (b) the aforementioned incompleteness of the available information. They represent a picture of huge but largely unspecified amounts of tax revenue being effectively disbursed by the revenue authorities before they reach the Exchequer.

International Perspectives

The study also examined the international background. This has shown that despite the existence of operational problems a notable number of countries have already introduced formal tax expenditure budgets, or have experimented with listings. The US started with tax

expenditure budgeting in 1969, and Canada introduced their new expenditure management system in 1979. The UK has since 1979 published a list of Direct Tax allowances and reliefs without, however, attempting to distinguish structural from non-structural reliefs. In Australia the regular review of some major tax incentives has been a feature of the federal budget for some years. In addition, a recent report by the Australian House of Representatives Standing Committee on Expenditure (August 1982) in favour of a more formal and comprehensive listing of tax expenditures, is presently under consideration by the government. Finally, a report of a New Zealand Task Force on Tax Reform (April 1982) in favour of "more explicit accounting" of tax expenditures, is also currently under review by the government of that country.

Final Conclusions

The extra-budgetary disbursement of revenues by the government on the scale suggested above, under conditions of inadequate knowledge of, and control over, the exact amounts, and without the tax losses being subjected to close and regular scrutiny in the light of the nation's changing expenditure priorities, is much too important to be ignored or treated lightly by Parliament. The point at issue is not whether or not all the existing tax aids would survive the full glare of publicity in their present form. Perhaps most would. Rather, the contention is that all tax expenditures should be scrutinised as meticulously and regularly as direct expenditure. Their costs should therefore be known for purposes of fiscal planning and public scrutiny. To argue that information about costs is not available or that costing is not worthwhile because of problems of identification and measurement, implies

that the government does not know how much it is spending and that Parliament has lost control over how the nation's taxes are applied for the good of the nation as a whole.

If tax expenditures in South Africa are compared with developments abroad, we seem also to be lagging behind comparable countries as far as the budgetary exposure of this dimension of the budget is concerned.

That is, in comparison with other countries, the budgetary exposure of tax expenditures in South Africa seems rudimentary. Although the 1984 budget has taken the innovative step of quantifying the amount of tax revenues foregone by the Treasury (in 1980/81) as a result of a select number of tax incentives in the income tax, the very brief section dealing with the matter in the Statistical/Economic Review, Budget 1984/85 does not go nearly far enough. The 'listing' obviously lacks comprehensiveness, there is little text, and, because of its out of date time focus, is not comparable with budget forecasts. Moreover, the 1984 budget speech even failed to make mention of the important new development, despite the fact that the subject of tax expenditures was broached in the speech on more than one occasion.

The foregoing represent a strong case for the drawing up and publication of a tax expenditure budget for South Africa. This will have several major advantages. Firstly, the exercise of subjecting the South African tax laws to close scrutiny in order to identify, describe and cost all the tax concessions and incentives, would serve to sharpen the Treasury's awareness of the extent to which extraneous, non-structural provisions affecting both the level and built-in flexibility of tax revenues have, in

fact, intruded into the tax system over the years. Secondly, the acceptance of a policy of regular internal review and public exposure of tax expenditures should make a major contribution towards the achievement of the government's declared objective of exercising more effective control over its spending and borrowing requirement. Lastly, the publication of a tax expenditure budget will bring South Africa in line with developments abroad as far as this important aspect of budgetary policy and presentation is concerned.

As far as the question of the measurement of tax expenditures is concerned, this whole subject is much too extensive to cover in detail here. Suffice to say that if a tax expenditure budget is adopted, perhaps initially only for the income tax, the development by the Treasury of appropriate estimation skills should receive the highest priority. The publication in the budget of estimates of tax losses for the as yet uncompleted current budget year should be regarded as a minimum, but the present data collection procedures are wholly inadequate for that purpose.

Finally, the importance of especially income tax expenditures warrants a separate budget document for the listing. The latter should also be treated on a par with the corresponding estimates of revenues and direct expenditures in any budget summary that might be published in future.

APPENDIX I

The following is a complete list of tax expenditure changes and costings supplied in the last five budget speeches.

The 1980 Budget Speech

1. Increased deduction for medical expenses.
No tax cost estimate supplied.
2. Reduced maximum for tax-free building society subscription shares.
No estimate of revenue gain supplied.
3. Increased maximum for tax-free lump-sum benefits paid out of a pension, provident or retirement annuity fund.
Tax cost: R2 million in 1980/81 and R4 million for a full year.
4. Increased deduction from married women's earnings.
Tax cost: R28 million in 1980/81 and R31 million for a full year.
5. Increased maximum deduction for the disabled.
Tax cost: R0,2 million in 1980/81 and R0,4 million for a full year.
6. Increased deduction of business expenditure on housing for employees.
Tax cost: R2 million in 1980/81 and R4 million for a full year.

The 1981 Budget Speech

1. Additional primary rebate to persons over 70.
Tax cost: Negligible in 1981/82 but R4,6 million for a full year.
2. Retirement benefits:
 - (a) A bigger exemption for lump sum awards received on retirement;
 - (b) A favourable basis for the taxation of non-exempt amounts received on retirement (a new concession).Tax cost: R0,10 million in 1981/82 but R2, million for a full year.
3. Raising of interest rate on tax-free shares offered

by building societies and the raising of the limit on tax-free indefinite period shares offered by building societies.

No tax cost estimate supplied.

4. Increased deduction from married women's earnings.
Tax Cost: R2,4 million in 1980/81 and R18,9 million for a full year.
5. Deduction for disabled children (a new concession).
No tax cost estimate supplied.
6. Announcement of extension of tax concession in regard to donations to universities and colleges, to certain other educational institutions (proposals to be circulated).
7. The write-down of purchased breeding stock to standard values (new concession).
Tax cost: Nil in 1981/82 and R3,8 million for a full year.

The 1982 Budget Speech

1. Introduction of an exemption for the first R100 of interest (new concession).
Tax cost: R13 million in 1982/83.
2. Increased deduction from the earnings of a married woman.
Tax cost: R19 million in 1982/83.
3. Housing: residential units initial and annual allowance (new concession).
Tax cost: R1 in 1982/83 thereafter R0,50 million for each R10 million invested in such projects in a full year.
4. Raising of tax rates applicable to long-term insurers.
Tax gain to the revenue: R38 million in 1982/83.

The 1983 Budget Speech

1. Initial and investment allowances on industrial plant, machinery and buildings.
The phasing out of investment allowances in 1985.
Raising of machinery and plant initial allowances from 1985.
Introduction of a building initial allowance from 1986.

2. The proposed future phasing out of tax concessions to building societies.
Tax cost: Not applicable in 1983/84.
3. Change in the method of providing relief for farmers who are forced to dispose of their livestock.
Tax cost: Minimal in 1983/84.
4. More favourable basis of taxing retirement benefits (including a new concession in regard to the deductibility of contributions to a retirement annuity fund from income not derived from a trade).
Tax cost: R7 million in 1983/84 and R15 million for a full year.
5. Additional rebate for persons over 70.
Tax cost: R3 million for 1983/84 and R4,5 million for a full year.
6. An increase in the maximum tax-free interest on Post Office Savings Bank Certificates.
Tax cost: R0,9 million in 1983/84 and R3 million for a full year.

The 1984 Budget Speech

1. Spreading of the initial and investment allowance on industrial machinery or plant over two years.
Gain in revenue in 1984/85 financial year: R285 million.
2. Withdrawal of the Last In First Out (LIFO) concession introduced in the Income Tax Act in 1976.
Tax saving resulting from the withdrawal of this concession (and two other items): R30 million in 1984/85.
3.
 - (a) Raising of limit on the deduction for physical disablement;
 - (b) Raising of maximum deduction for medical expenses in the case of persons over 60, and the abolition of the ceiling in the case of persons over 70;
 - (c) Raising of ceiling on pension fund contributions in respect of backdated pensionable service;
 - (d) Raising of ceiling on contributions to a retirement annuity fund in respect of reinstatement of membership where the member had previously discontinued his contributions.
Tax cost: (a) to (d): R4 million in 1984/85.
4. The curtailment of training allowances from 1 September 1984.
Tax saving: R6 million for 1984/85.

APPENDIX II : STATISTICAL SOURCES AND NOTES

The item numbers below refer to the corresponding numbers used in the listing contained in Section 8.

1. Department of Inland Revenue.
2. Department of Inland Revenue.
3. Department of Inland Revenue.
4. Department of Inland Revenue.
5. Department of Inland Revenue.
6. Department of Inland Revenue. Includes only so-called salary cases, i.e., excludes farmers and unincorporated businesses
12. South African Statistics 1982, Chapter 6. Inclusive of pensions to the blind (R2 262 000) and disability pensions (R88 424 000). Assumed average tax rate of 10 per cent.
- 13-14 South African Statistics 1982, Chapter 6. Pensions and one-sum benefits (R21 317 000). Assumed average tax rate of 10 per cent.
15. South African Statistics 1982, Chapter 6. War Veterans' pensions (R25 868 000) and Military pensions (R20 306 000). Assumed average tax rate of 10 per cent.
16. South African Statistics 1982, Chapter 6. Total benefits payable R82 758 048 in 1980, inclusive of all races. Assumed average tax rate of 10 per cent.
17. Report by the Registrar of Medical Schemes for the year ended 31 December 1983. Total membership fees in 1983 are R837 million. It is assumed that employers and employees contribute on a 50/50 basis. Assumed an average tax rate of 20 per cent.
18. South African statistics 1982, Chapter 6. Total contributions by employers and employees in 1980 are R78.533 902. It is assumed that employers/employees contribute on a 62,5/37,5 basis. Assumed average tax rate of 10 per cent.
- 22-23 Department of Inland Revenue.

- 24 Department of Inland Revenue.
- 25 Department of Inland Revenue.
- 26 Department of Inland Revenue.
27. South African Statistics 1982, Chapter 6. Lump-sum benefits totalled R329 million in 1979. Assumed average tax rate of 20 per cent.
28. South African statistics 1982, Chapter 6. Lump-sum benefits totalled R188 274 000. Assumed average tax rate of 20 per cent.
29. If it is assumed that employers and employees contribute on a 50/50 basis, the tax cost of item 29 would be roughly the same as the cost of Items 22-23.
32. Republic of South Africa, Budget Speeches, 1982-83, p.19. This is a minimum and is based on the gain to the revenue of the raising of the measure for the determination of taxable income from life insurance from 30 per cent to 40 per cent of gross income derived from investments.
- According to The Income Tax Reporter (15 May 1982): "it is patently clear that the industry, like several other industries, enjoys favoured tax treatment..." (p.87).
36. Republic of South Africa, House of Assembly Debates (Hansard), No. 8, 22-25 March 1982, column 3671.
38. Based on information supplied in the 1980 budget speech. See Republic of South Africa, House of Assembly Debates (Hansard), No. 8, 24-28 March 1980, Col. 3487.
39. Estimated interest subsidy to government officials on mortgage loans total R102 million for 1984/85. See Republic of South Africa, Estimate of the Expenditure to be defrayed from State Revenue Account during the Financial Year ending 31 March 1985, First Print (RP2-1984), p.21-15. Since the quoted figure includes only the government's own officials, and therefore excludes amounts payable to all other recipients of similar subsidies in government or semi-government service, the overall amount is estimated at R250 million for 1984/85. An average tax rate of 20 per cent is assumed.

40. The Building Societies, The Financial Markets and Monetary Policy. Second Interim Report of the Commission of Inquiry into the Monetary System and Monetary Policy in South Africa, RP 93/1982, p.4.
41. Ibid., p.4.
- 40-41 In the 1983 budget speech the Minister of Finance estimated the cost to the Exchequer of the concessions to building societies as "perhaps R100 million per year". See Republic of South Africa, House of Assembly Debates, No.9, 28-31 March 1983, column 4299.
- 46/85 Statistical/Economic Review, Budget 1984/85, p.30. Inclusive of training allowances claimed by both companies and individuals.
51. Department of Inland Revenue. Inclusive of so-called "salary cases" only - therefore excludes farmers and unincorporated businesses.
60. Information supplied by the Department of Finance. Tax-free interest on Treasury Bonds in 1982/83 amounted to R46,2 million. Assumed a marginal tax rate of 30 per cent.
62. Interest amounting to R135 million was paid to investors in 1982/83. See Annual Report of the Postmaster General of the Republic of South Africa, 1982/83, p.21. An average tax rate of 20 per cent is assumed.
63. Information supplied by the Department of Finance. Tax-free interest on loan levies amounted to R80,56 million in 1982/83. Assumed a marginal tax rate of 20 per cent.
64. According to the Department of Finance these stocks were issued at a premium but were discontinued in 1979.
- 69-70 Based on information supplied by the Department of Defence. Assumed a tax rate of 10 per cent.
- 74/76 According to the 1984 budget speech the postponement of one-third of the total of the initial and investment allowances for 1984/85 would produce additional revenue of R285 million. This implies that the total tax loss for 1984/85 would have been

R855 million if there was no postponement. The corresponding tax loss for the 1983/84 tax year is therefore estimated at R800 million, allocated as follows:

	R(m)
Initial allowance	365
Investment allowance	435
Total	<u>800</u>

Other recent estimates are shown below for purposes of comparison.

(a) Estimate from the Report by the Standing Commission of Enquiry with regard to Taxation Policy of the Republic on the System of Initial and Investment Allowances (W.P.H -'83), pp.5-6:

	R(m)
Investment allowance	549
Initial allowance (see p.47)	389
Total	<u>938</u>

(b) Estimate from the Sunday Times, 19 September 1983 (Barry Sargaent). According to Sargaent the tax foregone in respect of the machinery initial and investment allowances equalled R1500 million in 1982.

(c) According to the Statistical/Economic Review, Budget 1984/85, p.30 the tax foregone in 1980/81 was made up as follows:

	R(m)
Initial allowance	380
Investment allowance	444
Total	<u>824</u>

The following calculations from basic data (for 1983/84) are also shown for purposes of comparison with the estimate accepted for this study:

Expenditure on plant and machinery in the manufacturing sector in 1983:

	R(m)
Private business enterprises	2460*
Taxpaying public corporations	139*(†)
Total	<u>2599</u>

Allowances:

Initial allowance (25%)	650
Investment allowance (30%)	780

Tax loss in 1983/84 (46% of allowances):

Initial allowance	299
Investment allowance	359
Total	<u>658</u>

* Figures supplied by the South African Reserve Bank.

@ Assumed to be one-half of the combined capital expenditure by all public corporations.

77/79 The tax losses in respect of items 77 and 79 are calculated as follows:

Expenditure on buildings and construction in the manufacturing sector in 1985:

	R(m)
Private business enterprises	864*
Taxpaying public corporations	227*@
Total	<u>1091</u>

Allowances:

2 % annual building allowance	22
20% building investment allowance	218
Total	<u>240</u>

Tax loss in 1983/84 (46% of allowances):

	R(m)
2% annual building allowance (item 77)	10
20% bldg. invest. allowance (item 79)	100

* Figures supplied by the South African Reserve Bank.

@ Assumed to be one-half of expenditure on buildings by all public corporations.

83. Statistical/Economic Review, Budget 1984/85, p.30.

88. Estimated cash grants total R26 million for 1984/85. See Republic of South Africa, Estimate of the Expenditure to be defrayed from State Revenue Account during the Financial Year ending 31 March 1985, First

Print (RP.2-1984), pp.18-10. Assumed a tax rate of 50 per cent.

89. Estimated compensation for removal of factories and key personnel total R9,5 million for 1984/85. See Republic of South Africa, Estimate of the Expenditure to be defrayed from the State Revenue Account during the Financial Year ending 31 March 1985, First Print (RP2-1984), pp.18-9.
90. Estimated subsidy in lieu of income tax concession total R10 million for 1984/85. See Republic of South Africa, Estimate of the Expenditure to be defrayed from State Revenue Account during the Financial Year ending 31 March 1985, First Print (RP2-1984), p.18-9.
91. The Corporation for Economic Development ceased to exist on 31 March 1984. Its savings facilities were taken over by the Development Bank for Southern Africa. According to figures supplied by the Bank the tax-free interest on outstanding balances amount to approximately R1,78 million per annum. The amount on interest foregone by the Exchequer would be small.
92. Tax losses are calculated as follows:

Expenditure on capital expenditure (1983):

		R(m)
Non-residential buildings		96*
Construction works		100*
Transport equipment	125*	
less wear & tear (20%)	25	100
Other equipment	363*	
less wear & tear (20%)	73	290
Total		586

Allowances:

100% of expenditure on 'developments and improvements'	586
Tax loss in 1983/84 (20% tax rate)	117

* Figures supplied by the South African Reserve Bank.

94. Based on information supplied by the Department of Agriculture. Assumed a tax rate of 20 per cent.

99. For the concession in respect of breeding stock alone.
See 1981 Budget Speech.

100. The tax losses are calculated as follows:

Capital expenditure in mining and quarrying (1983):

Plant and machinery:

	R(m)
Private business enterprises	852*
Taxpaying public corporations	21* [@]
	<u>873</u>
less wear & tear (33%)	288
Total	<u>585</u>

Building and construction:

Private business enterprises	1124*
Taxpaying public corporations	23* [@]
	<u>1147</u>
less wear & tear (5%)	57
Total	<u>1090</u>

Allowances:

Plant and machinery	585
Building and construction	1090

Tax loss in 1983/84 (50% of allowances):

Plant and machinery	293
Building and construction	545
Total	<u>838</u>

* Figures supplied by the South African Reserve Bank

@ Assumed to be one-half of expenditure by all public corporations.

115. Statistical/Economic Review, Budget 1984/85, p.30.

118. Aid to exporters in respect of beneficiation of base minerals amounted to R65 million in 1984/85. See Republic of South Africa, Estimate of the Expenditure to be defrayed from State Revenue Account during the Financial Year ending 31 March 1985, First Print (R.P.2-1984), pp.18-18. Assumed a tax rate of 50 per cent.

124. Statistical/Economic Review, Budget 1984/85, p.30.

126. Rough estimate based on (a) information supplied in the 1984 budget speech, and (b) discussions with

officials of the Department of Inland Revenue.

131. Estimated interest subsidies, rent subsidies and other contributions to the SBDC total R8 million for 1984/85. See Republic of South Africa, Estimate of the Expenditure to be defrayed from State Revenue Account during the Financial Year ending 31 March 1985, First Print (RP2-1984), pp.18-25; and Republic of South Africa, House of Assembly Debates (Hansard), No. 9, 26-30 March 1984, columns 3901-3902. A company income tax rate of 50 per cent has been applied.
148. Republic of South Africa, House of Assembly Debates (Hansard), 22-25 March 1982, No. 8, column 3667.
151. Department of Inland Revenue.
154. Republic of South Africa, Budget Speeches, 1978-79, p.20.
160. According to the Sunday Times, 19 September 1983, the tax cost of this concession lay between R100 million and R500 million in 1982. We were unable to obtain confirmation of such estimates and have accordingly decided to accept the conservative figure of R100 million for 1983/84.

Notes

- a Reduced from 1 September 1984.
- b Not available for expenditures incurred on attendance at post-graduate courses that commence on or after 1 March 1984.
- c Expires on 30 June 1985.
- d Not available after 1 March 1984.
- e Concession withdrawn as from 1984/85 tax year.

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1. See J.R.M. Willis and P.J.W. Hardwick, Tax Expenditures in the United Kingdom, Heinemann Educational Books, London, 1978. p.1.
2. Ibid., p.1.
3. Parliament of the Commonwealth of Australia: Tax Expenditures, Report from the House of Representatives Standing Committee on Expenditure, August 1982, p.5.
4. Noted in Special Analysis F(Tax Expenditures), The Budget of the United States Government for Fiscal Year 1978, p.120.
5. Stanley S. Surrey: Pathways to Tax Reform, The Concept of Tax Expenditures, Harvard University Press, Cambridge, Massachusetts, 1973.
6. Cited in ibid, pp.3-4.
7. Cited in "The Interface of Public Expenditure and Taxation", Memorandum on the Control of Public Expenditure, Expenditure Committee, Minutes of Evidence, Session 1977-78, HMSO, London, February 1978, p.8.
8. See Annual Report of the Secretary of the Treasury on the State of the Finances, for the Fiscal Year ended June 30, 1968, pp.326-338.
9. Refer The 1969 Economic Report of the President, Hearings before the Joint Economic Committee, Part 1, 91st Congress, 1st Session (Washington, D.C.: Government Printing Office, 1969).
10. See, for example, Special Analysis G (Tax Expenditures), Budget of the United States Government for Fiscal Year 1984, pp. G1-48.
11. See, for example, Congress of the United States: Tax Expenditures: Current Issues and Five-year Budget Projections for Fiscal Years 1984-1988, Congressional Budget Office, October 1983.
12. Noted in ibid, p.xiii.
13. "Experience with Tax Expenditure Budgeting in other Countries", Tax Expenditures: Current Issues and Five-year Projections for Fiscal Years 1984-1988, Congressional Budget Office, October 1983, p.23.

14. See department of Finance, Canada: Government of Canada Tax Expenditure Account, December 1979.
15. See Department of Finance, Canada: Government of Canada Tax Expenditure Account, December 1980.
16. Department of Finance, Canada: Analysis of Federal Tax Expenditures for Individuals, November 1981.
17. Mentioned in "Experience with...", op cit., p.28.
18. See Budget Speech 1980-81 and Statements, 1980-81 Budget Paper No. 1, Australian Government Publishing Service, Canberra, 1980, pp.244-247.
19. Parliament of the Commonwealth of Australia: Taxation Expenditures, Report from the House of Representatives Standing Committee on Expenditures, August 1982, p.7.
20. Parliament of the Commonwealth of Australia, Budget Statements 1982-83, Parliamentary Paper No. 234/1982, pp.263-287. The 1983/84 budget paper analysed the tax concessions provided in respect of retirement and other employment termination benefits, see Budget Statements 1983-84, 1983-84, Budget Paper No. 1, Australian Government Publishing Service, Canberra, 1983, pp.293-298.
21. See, for example, The Government's Expenditure Plans 1982-83 to 1984-85, Vol. Two, Cmnd 8394-11, HMSO, London, March 1982, pp.98-99.
22. See The Government's Expenditure Plans 1979-80 to 1982-83, Cmnd 7439, HMSO, London, January 1979, pp.17-29.
23. "The Interface...", op cit., pp.5-6.
24. See ibid., pp.9-10.
25. Mentioned in "Experience with...", op cit., p.40.
26. See ibid., p.41.
27. Report of the Task Force on Tax Reform, April 1982, Chapter 4, p.62.
28. Ibid., p.65.
29. Cited in "The Interface...", op cit., p.8.

30. See Studies on International Fiscal Law, Volume LXIa, Kluwer, the Netherlands, 1976.
31. Willis and Hardwick, op cit.
32. Roger S. Smith: Tax Expenditure: An Examination of Tax Incentives and tax Preferences in the Canadian Federal Income Tax System, Canadian Tax Papers No. 61, Canadian Tax Foundation, 1979.
33. "The Interface...", op cit., p.5.
34. Willis and Hardwick, op cit., p.10.
35. See J. van Dyk: Die Identifikasie, Klassifikasie en Meting van Subsidies in Suid-Afrika, Unpublished M.Com. Dissertation, University of Pretoria, May 1979, pp.140-145. For a discussion of van Dyk's study, see Section 7 below.
36. S.S. Surrey and P.R. McDaniel: "The Tax Expenditure Concept: Current Developments and Emerging Issues", Boston College Law Review, Vol.XX, January 1979, No.2, p.242. Quoted in Taxation Expenditures, Report from the House of Representatives Standing Committee on Expenditure, Parliament of the Commonwealth of Australia, August 1982, p.17.
37. Surrey, op cit., p.7.
38. Department of Finance, Canada, Government of Canada Tax Expenditure Account, December 1979, p.4.
39. Special Analysis F(Tax Expenditures), The Budget of the United States Government for Fiscal Year 1978, p.120.
40. Stanley S. Surrey and Emil M. Sunley (Jr.): General Report, Studies on International Fiscal Law, 1976, p.17.
41. Ibid.
42. Willis and Hardwick, op cit., p.3.
43. Surrey, op cit., p.17.
44. Annual Report of the Secretary of the Treasury on the State of the Finances, for the Fiscal Year ended

June 30, 1968, p.327. The reader will no doubt recognise the similarity between this definition and the one adopted by the International Fiscal Association for their 1976 Congress (see p.23).

45. See ibid., p.329.
46. Ibid., p.330.
47. Cited in Special Analysis F (Tax Expenditures), The Budget of the United States Government for Fiscal Year 1978, p.119.
48. Ibid., pp.119-120.
49. Ibid., p.120.
50. Special Analysis G(Tax Expenditures), Budget of the United States Government for Fiscal Year 1985, p.G-1.
51. See ibid., p.G-5.
52. Congress of the United States: Tax Expenditures: Current Issues and Five-year Projections for Fiscal Years 1984-88, Congressional Budget Office, October 1983, p.xiii.
53. See ibid., p.4.
54. Congress of the United States: Tax Expenditures: Budget Control Options and Five-year Projections for Fiscal Years 1983-87, Congressional Budget Office, November 1982, p.21.
55. Ibid., p.21.
56. See Special Analysis G(Tax Expenditures), Budget of the United States Government for Fiscal Year 1985, p.G-5.
57. In the sense of being non-discriminatory rather being neutral in an economic sense.
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