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Articles

The Report of the Franzen Commission and the Rhodesian Budget

Mr. Schattil is a former Commissioner of Taxes in Rhodesia.

THE REPORT OF THE FRANZEN COMMISSION AND THE RHODESIAN BUDGET[1]

ALEC SCHATTIL

I want to discuss how the recommendations contained in the Report of the Franzen Commission have been applied in the latest Rhodesian Budget. So much has already been said and written about the Budget that it is surprising that I have any comments to make at all. Numerous articles have appeared in the local Press and the financial papers in South Africa that I find it exceedingly difficult to come up with any original ideas of my own!

I am honoured to address you, the members of the Rhodesian Economic Society, but I can lay no claim to being an economist myself. I hold no qualifications for such a claim, I can only describe myself as a practical man and it is in this spirit that I have framed this paper.

First of all, what is the Franzen Commission and why should its recommendations be of such interest to Rhodesians at this stage? The Franzen Commission was set up by the Government of the Republic of South Africa and its purpose can best be described by setting out its terms of reference:

1. to inquire into—
   (a) the present system of taxation;
   (b) the existing financial structure in South Africa; and
   (c) the fiscal and monetary policies of the South African authorities;
2. submit recommendations regarding modifications in the above connection which will tend to promote economic growth as well as financial stability in the Republic.

The Commission was appointed in November, 1967, and submitted its first report a year later. This report deals solely with proposed reforms to the tax structure of the Republic and a further report is promised which will deal with fiscal and monetary policy.

This Report is a ve·y lengthy document covering in all 127 pages, and I do not think that you expect me to analyse it in very great detail.

The Commission considered the present system of taxation in South Africa and its impact on the economy of the country. It found that too much reliance was placed on raising revenue by direct taxation and that the proportion of revenue raised by direct taxation in comparison with that raised by indirect taxation was far too high. It found that for the years 1963-1965, the share of direct taxation in the total tax revenue of the Republic amounted to 58% compared with 30-50% in the case of highly developed countries.

It also found that individuals made far too great a contribution to the revenue of the State. In South Africa only a very small number of individuals pay income tax (8% of the total population) as against 30-40% in most of the highly developed countries. Of the 8% who do pay direct taxation, a very large proportion is subject to tax at a very low rate of tax. It is surprising to note that of the relatively small number of taxpayers in South Africa, 94% contri-

1. Paper read to the Society in August, 1969.

buted only one third of the total tax revenue and the remaining 6% were responsible for two thirds. The Commission found that this imbalance was due to the particularly sharp increase in the marginal rates of income tax over R5,000 (£2,500). At an income of R15,000 (£7,500) South Africa has one of the highest average tax rates in the world, whereas, for incomes under R5,000, it is amongst those countries which have the lowest tax rates.

To correct this state of affairs, the Commission made recommendations which would shift the emphasis on raising revenue from direct to indirect taxation and for the burden of taxation to be removed to a great extent as feasible from the shoulders of a relatively small number of taxpayers who at present contribute the lion's share of revenue from direct taxation.

Before I go on to set out the Commission's Report in some detail, I would like to give you a few details of the state of affairs in Rhodesia. According to the Financial Statements, 1969, issued immediately after the latest Budget, the average annual revenue from direct taxation (including Personal Tax) for the financial years 1965-1969 was £30,450,000 out of an average of total revenue from all sources of £79,700,000 or approximately 40% of total revenue. This compares rather favourably with the 58% reflected in South Africa, but it must not be overlooked that Rhodesia began a shift from direct to indirect taxation with the imposition of a sales tax some years ago.

The latest annual Report of the Commissioner of Taxes also gives some enlightening information. The Report is for the assessment year ended 31st March, 1966, which was the year before the introduction of P.A.Y.E. This Report shows that 63,238 individuals were liable to income tax and that their contributions in taxation totalled some £11 million. If the population of Rhodesia was taken as 4 million at 31st March, 1966, this means that some £11 million in taxation was paid by 1.6% of the population. Further, of the total of £11 million, the major portion was contributed by 23,000 taxpayers with incomes over £2,000 per annum. In fact, 22,890 taxpayers contributed some £9 million in direct taxation which alone should explain why Rhodesians are (or were) so interested to find out how the Report of the Franzen Commission would be applied in Rhodesia!

I have now reached the stage where I can set out the recommendations of the Commission in some detail.

A. Taxation of Income of Individuals

1. The maximum rate of tax should be 60%. This rate should be reached at the following points:

Single persons	R24,000
Married persons	R28,000

2. New comprehensive graduated scales of taxation should be introduced combining initial abatements as under:

Single persons	R 500
Married persons	R1,000

3. The existing system of rebates be replaced by one of abatements. The abatements would be phased out on incomes in excess of R6,000.

4. There was no need for primary abatements as these were incorporated in the tax rates.

5. The abatement for children should be R500 per child regardless of number.

6. The abatement for dependants should be the same both for married and single taxpayers as under—

completely dependent ..	R200
not completely dependent	R80

7. The abatement for insurance premiums should be the amount of premiums paid with a maximum of R400.

8. An abatement for medical expenses should be granted to all taxpayers regardless of actual expenditure as follows:

Single taxpayers ..	R 75
Married taxpayers ..	R150

Where the single person is the sole support of a dependant, the abatement should be R150 and an additional abatement of R100 should be allowed for the year in which a child is born.

9. For married persons, the statutory exemption limit should be R750, for married persons above the age of 60 the limit should be raised to R1,200. For unmarried persons, the statutory exemption limit should be R500 rising to R750 for those above 60 years of age.

10. (a) The system of aggregation of joint incomes of husband and wife should be retained.
    (b) The fact that where both husband and wife are working, involves the family in additional financial burdens, should be recognised. This should be done by a reduction in their liability by exempting the first R500 of the earnings of a working wife.
    (c) This exemption to apply to income from employment only.
    (d) The exemption should apply to married couples with a joint taxable income of not more than R8,000. Thereafter the exemption should be phased out.

B. Indirect Taxation

The introduction of a selective sales tax based on private domestic consumption with the exclusion of food, clothing, cost of housing, certain health expenditure and certain exciseable goods.

C. Taxation of Capital Gains

It was recommended that a tax on capital gains should be introduced. Under such a tax the existing legal position regarding normal taxation on capital gains should be maintained but the tax would be levied on capital gains not liable to normal taxation.

D. Taxation of Intercompany Dividends

It was recommended that in the case of public companies undistributed profits tax should be levied on certain dividend income and branch profits fiom abroad.

I propose this evening to limit my comments chiefly to the income tax recommendations made by the Commission. A Sales Tax is already in existence in Rhodesia and the rate has just been increased from 8d. to 1/- in the £ in conformity with the recommendation that more revenue should be raised by indirect taxation. As you may be aware, the government of the Republic rejected the proposal that a tax on capital gains should be introduced. Rhodesia has not yet instituted any legislation which seeks to tax this type of profit. However, in view of the existing uncertainty under our tax system whether a profit is of an income or capital nature, the introduction of a tax on capital gains can be justified in certain circumstances.

Now let us consider the recommendations of the Commission under the heading of the taxation of the incomes of individuals and see how these recommendations have been followed in Rhodesia.

1. Our maximum rate of tax has now been fixed at 8/- in £, that is at a rate of 40%. This is considerably below the South African maximum of 60% but we reach the top rate when taxable income exceeds abatements by £3,000 in the case of both single and married persons, whereas in South Africa, the top rate is not reached until taxable income exceeds abatements as under—

Single persons	R24,000 (£12,000)
Married persons	R28,000 (£14,000)

2. In Rhodesia a new system of tax rates has been introduced with effect from the 1970 tax year. These new rates tend to reduce the burden of tax borne by taxpayers in the income brackets in excess of £2,000. However, the relief granted is not as great as that in South Africa and Rhodesians still pay more tax than their counterparts in South Africa. A few examples will illustrate this statement.

Taxable Income	1970 *Tax*	
Single Person	*South Africa*	*Rhodesia*
£	£	£
2,000	213	237
4,000	659	895
8,000	2,098	2,495
10,000	3,063	3,295
15,000	6,043	7,295
Married Person		
2,000	150	133
4,000	461	691
8,000	1,571	2,291
10,000	2,372	3,091
15,000	5,084	5,091

I have taken the primary abatement only into account in my calculations. The South African tax rates are for the province of the Transvaal and have been taken from tax tables published by Dr. A. S. Silke.

3. Rhodesia adopted the system of abatements many years ago and in this respect we are ahead of South Africa.

Whilst on this point, I wonder why the Minister of Finance has not taken the opportunity, now that our currency is to be decimalised, to round off the abatements. It seems rather odd that we should have abatements expressed in such amounts of £960 for married persons and £450 for single persons, £144 for children, dependants and insurance. I would suggest abatements as follows:

Single person	£500
Married person	£1,000
Child	£200
Dependant (maximum) ..	£200
Insurance (maximum) ..	£200

Incidentally, the abatements when income tax was first levied in 1918 was £500 for a single person and £1,000 for a married person. Surely there is a case for upgrading these abatements after a lapse of some 50 years.

4. I think there is a case for increasing the abatement for children from the present amount of £144 for each child. The same applies for the abatements granted for dependants and insurance. The amount for insurance has been pegged at £144 for many years and an increase beyond this figure would be an added incentive for Rhodesians to provide for their old age.

5. Rhodesia already has an abatement for medical expenses but any claim must be supported by accounts and receipts. This system entails the expenditure of much time and effort by the taxpayer and the staff of the Income Tax Department who are obliged to check each claim in detail. The granting of a fixed medical expenses abatement has much merit.

6. No relief is granted in Rhodesia in respect of the earnings of a working wife. This has been a bone of contention with Women's Organisations over many years. The time is now opportune for our tax system to take note of the fact that a family in which the wife works is obliged to incur additional expense on this account. No doubt the Minister wishes to encourage married women to go out and work otherwise there could be a breakdown in certain essential services where married women play a prominent part. I mention the nursing service and teaching profession in this connection. It would be a comparatively simple exercise for the Commissioner of Taxes to work out a method whereby a measure of tax relief could be given to families where both spouses work. I would suggest that the systems in force in South Africa and Zambia be examined for a lead in this matter.

This brief resume covers the main recommendations made by the Franzen Commission in connection with the taxation of the incomes of individuals. I do not propose to say much about the Sales Tax as we already have such a tax in Rhodesia. As regards the proposed Capital Gains Tax which has not been accepted by the Government of the Republic, I can see no reason for the introduction of such a tax in Rhodesia at the present time.

As far as the Budget itself is concerned, it is obvious that the Minister proposes to reduce reliance upon direct taxation as the source of the major portion of revenue. We can expect an increase in indirect taxation from now on with a possible introduction of a value added tax at some time in the future. Besides bringing in a scale of graduated tax rates which definitely does materially reduce the burden of tax on incomes above £2,000, the Minister has also abolished the Personal Tax, Supertax and the Undistributed Profits Tax.

The abolition of Personal Tax was long overdue, and it does compensate the lower income groups for the imposition of a higher sales tax and increased excise and customs duty. However, I doubt whether the reduction of £2 per annum in direct taxation for a large segment of our population is going to fully compensate them for the increased indirect taxes they will now bear.

I welcome the abolition of supertax and undistributed profits tax as this will undoubtedly simplify our tax structure and further ease the burden of taxation. Unfortunately, the new tax measures tend to favour the affluent section of our community, and I do not think enough attention has been paid to those members who will now have to bear a large share of taxation without any material increase in their wage packets. The abolition of supertax and the complete exemption of Rhodesian dividends from taxation are, on the surface, admirable measures, but there are two points I would like to make on this subject.

The abolition of supertax must have been accompanied by a great sigh of relief by many taxpayers and their advisers who have practised tax avoidance on a grand scale up to the introduction of the tax avoidance provisions in the Income Tax Act on 1st April, 1966. Until that date it was an easy matter to avoid supertax by the formation of a series of companies to hold a taxpayer's investments. These companies held up the flow of dividends to the promoter and so supertax was avoided. Vast sums in untaxed profits must have been locked up in the coffers of these companies and ever since 1st April, 1966, their shareholders have been scratching their heads wondering how they could get out these profits without paying tax. Well they can now cease this unprofitable pastime and sleep peacefully in their beds from now on. The Minister of Finance has made a present to them of the undoubtedly vast amount of unpaid supertax which was due on these accumulated profits. These profits can now be paid out without a penny of tax having to be paid. The Minister will indeed go down in history, in their minds, as a public benefactor.

The other point I wish to make concerns the taxation of Rhodesian dividends. Their complete exemption from tax should encourage investment in Rhodesian equities, although I have not noticed any rush to buy Rhodesian shares on the local Stock Exchange. Is it equitable, however, that a person with an income of say £50,000 per annum from Rhodesian dividends should not pay one penny in direct taxation? This will be the position from the 1st April, 1969, for residents who are fortunate enough to have their income in the form of Rhodesian dividends. I think dividends should be taxed and it is not beyond the capabilities of our able Commissioner and his staff to devise a fair and reasonable method. This can be done without restoring supertax and without causing undue hardship.

Another criticism I offer on the Budget proposals is that we are called upon to pay increased indirect taxes now, but except for the abolition of personal tax, most of us will not receive any noticeable benefits until we are called upon to pay our income tax next year.

Finally, I think the Minister has not given sufficient encouragement to a major industry in his Budget proposals.

If there is one industry which should be encouraged in Rhodesia at the present time, it is the mining industry. The production of minerals will earn our country an ever-increasing amount in foreign exchange and the opening up of new mines will lead to a large influx of immigrants, the establishment of new industries and the revival of our economy. It will also, in my opinion, be a major means of breaking down the infamous sanctions which have been imposed upon our country.

What incentives could be granted to the mining industry? I would suggest the following:

1. The complete exemption of gold mining profits from taxation. This would cost the Exchequer a mere £170,000 per annum according to the latest report of the Commissioner of Taxes. I am sure such a step would lead to an intensification in the search for new gold mines.

2. I would introduce a new formula for calculating the tax payable by other mines in order to encourage the opening up of mines which can only operate on a small profit margin. The maximum rate of tax should be 40% as at present, but this rate should be scaled down for mines whose profit ratio (profits to outputs) does not exceed a certain percentage. Such a formula would entail that high-grade mines would pay 8/- in the £ on their profits, but mines with a lower grade would pay correspondingly less.

3. Finally, I would introduce measures which would encourage the sale or transfer of mines to persons (companies) who have the capital and expertise to bring them into production. Rhodesia needs big mines which will come into operation at the earliest possible date. There must be claims which have the potential of becoming company propositions but their owners are reluctant to sell because of the heavy taxation which may be involved. Under our tax law it is not easy to decide whether a profit on sale of claims is a capital or revenue profit, and this uncertainty is also a drawback.
   If the Minister would exempt such profits from tax for a period of say five years (compare his munificence in the case of dividends) or introduce any of the following suggestions:

   (i) permit the spread of profits on mining claims over a period of years;
   (ii) tax such profits at a special rate of tax as in the case of foreign dividends.

   I am sure he would encourage the opening up of new mines.

There is one other matter I would like to mention whilst on the subject of taxation. Parliament in its wisdom has introduced measure which are meant to encourage industry, but taxpayers find that the Department of Taxes is prone to try and cut down these incentives to a minimum. I would appeal to the Commissioner of Taxes to ensure that these incentives are not whittled away by too much application of his pruning shears, and that he adopts a liberal approach in matters of this nature.