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<td>ANC</td>
<td>African National Congress</td>
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<td>APDP</td>
<td>Automotive Production Development Programme</td>
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<td>CBU</td>
<td>Completely Built Unit</td>
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<td>CGT</td>
<td>Capital Gains Tax</td>
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<td>Domestic Resource Mobilisation</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>Global Competitive Index</td>
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<td>IRCC</td>
<td>Import Rebate Credit Certificate</td>
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<td>ITD</td>
<td>International Tax Dialogue</td>
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<td>MDG</td>
<td>Millennium Development Goal</td>
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<td>METR</td>
<td>Marginal Effective Tax Rate</td>
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<td>MIDP</td>
<td>Motor Industry Development Programme</td>
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<td>MNC</td>
<td>Multinational Companies</td>
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<td>NGO</td>
<td>Non-Governmental Organisation</td>
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<td>OI</td>
<td>Oxfam International</td>
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<td>PAA</td>
<td>Productive Asset Allowance</td>
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<td>PIT</td>
<td>Personal Income Tax</td>
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<td>SACU</td>
<td>Southern African Customs Union</td>
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<td>SARS</td>
<td>South African Revenue Service</td>
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<td>SAVCA</td>
<td>South African Venture Capital Association</td>
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<td>SBC</td>
<td>Small Business Corporation</td>
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<td>STC</td>
<td>Secondary Tax on Companies</td>
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EXECUTIVE SUMMARY

Developing countries face challenges including widespread poverty, ever increasing unemployment and widening inequalities. South Africa’s experience of these challenges has given rise in the post-Apartheid era to an examination of the nature and dynamism of income distribution and the factors that drive it; the role of fiscal policy as a redistributive tool and the progressivity of tax and transfer policies have come into sharp focus.

The failure by any state to tax adequately is not only an indicator of, but also forms the basis for, underdevelopment. Therefore difficulties in collecting taxes are generally a reflection of a weak economy and an ineffective government. Most importantly, if governments do not have adequate tax revenues they are then forced to rely on external sources of support to provide public services.

There has been some consensus among policy makers and scholars that the major contribution of tax policy as a redistributive tool should be to raise the revenues that are essential to correcting horizontal inequities.

Taxes fund public infrastructure and facilitate social progress as well as economic development. Government activities reliant on tax revenues include the funding of essential public services such as the police services, defence force, justice system, health services, welfare, social services, and education and training.

In South Africa, taxes are administered by the South African Revenue Service (SARS) and include Personal Income Tax (PIT) charged at 40% for the top tax bracket, Corporate Income Tax (CIT) at 28%, Withholding Tax on Dividends at 15% and Value Added Tax (VAT) at 14%. The 2010/11 tax revenue contributions show that PIT contributed 34%, VAT 27.2% and CIT 20% to the national revenue – thus the PIT shouldered a larger share of the total tax burden compared to VAT and CIT.

Regarding the tax burden, the analysis shows that the highest taxable income group has the least number of taxpayers but they bring in a substantial amount of taxable income compared with the other groups. This may be because their tax rate is higher than the other income groups and therefore they bear a larger share of the total tax burden in comparative terms. However, an alternative explanation is that this group has substantially higher per-capita incomes.

The financial sector, consisting of insurance, real estate and business services, is contributing more to the CIT and is therefore bearing more tax burden compared to the other sectors.

High Net Worth Individuals (HNWIs), individuals who are either earning more than R7 million per annum or have assets of more than R75 million, are not properly captured by SARS and therefore not properly taxed. An investigation by SARS has identified approximately 9 300 such individuals in South Africa who are not compliant tax payers, and a collaboration between banks and SARS revealed that there may actually be as many as 20 000. Worth noting is the fact that while 2 300 of the 9 300 identified by SARS are on their register they are not tax compliant. The remaining balance of 7 000 are not even registered with SARS. Only a very small fraction of HNWIs in South Africa, about 360 individuals, are registered with SARS and tax compliant. The loss to the fiscus due to the failure to tax HNWIs is estimated at R48 billion in potential tax revenue. This is a substantial amount of money that could be channelled to the development of the country.

A sectoral analysis reveals that mining companies pay the normal 28% Corporate Income Tax. However, mining, including gold and uranium companies are treated differently. The Marginal Effective Tax Rate (METR) on capital for the mining sector is very low because capital expenditures related to mining are exempted from tax. There is currently no unambiguous empirical evidence to support the notion that these capital equipment tax
incentives are benefiting the mining sector in South Africa. The recommendation therefore, in this regard, is to gradually remove these capital equipment tax incentives in order free domestic resources for developmental initiatives.

The financial sector is largely exempted from VAT and is only subject to standard tax treatment with no particular sector specific incentives. With an overall weighted average METR on capital of just under 30%, the financial sector bears one of the highest marginal tax burdens on capital. This sector also has many sophisticated instruments. The proper taxing of these instruments is a challenge to SARS because the revenue service is presently lagging behind in terms of properly understanding the instruments’ structuring and functioning. The recommendation is that SARS should embark on an educational endeavour that will enable them to properly understand these instruments in order to appropriately tax this sector and mobilise more domestic resources for development.

The automotive industry receives significant government support through a set of incentives known as the Motor Industry Development Programme (MIDP). Although the South African government has been reducing its support in subsequent revisions of the MIDP, the incentives still remain substantial. This sector is exceptionally successful because it is dependent on the generous incentive scheme provided by government. It basically relies heavily on both imported capital and imported inputs. However, it is important to note that the effectiveness of the tax incentives fades in time, reaffirming the theoretically founded hypothesis that tax incentives may affect some business decisions particularly in the short run, but they are not a primary consideration for investors in the long run. It is therefore recommended that the current set of tax incentives for this sector be gradually eliminated in order to free resources for other developmental needs.
DOMESTIC RESOURCE MOBILISATION: AN OVERVIEW

1.0 INTRODUCTION

The post-apartheid era in South Africa has seen the country battling with the triple developmental challenges of widespread poverty, increasing unemployment and widening inequalities. These challenges have given rise to interest in the examination of the nature and dynamism of income distribution and the factors underlying it. More importantly though these challenges have brought into sharp focus the role of fiscal policy as a redistributive tool and the progressivity of tax and transfer policies.

This focus on the interaction between the progressivity of tax, transfer policies and income distribution has been necessitated by developmental issues in South Africa – encompassing tax incidence, governance, tax administration, tax evasion, the predominance of indirect tax, and capital and wealth tax.

There has been some consensus among South African policy makers and scholars that the major contribution of tax policy as a redistributive tool should be to raise the revenues essential for correcting horizontal inequalities. Therefore, tax systems should be characterised by broad bases, limited exemptions and low rates.

1.1 The objectives of the study

The main objective of the study is to evaluate the taxation and expenditure regimes in South Africa, and to inform the design of domestic resource mobilisation in government programming in the future. The study aims to contribute to a model of taxation that strengthens the state’s capacity to finance the provision of essential services.

Specifically, the study aims:

i. To determine the importance and the role of taxes in the South African economy
ii. To analyse the tax instruments or tax sources in South Africa
iii. To assess the effective tax burden in South Africa
iv. To perform an analysis of High Net Worth Individuals’ tax practices
v. To analyse the tax regime in three different sectors

1.2 The Value-add of Domestic Resource Mobilisation in South Africa

In South Africa, the value-add of domestic resource mobilisation is realised in the financing of government projects to cover basic essential public services such as poverty alleviation, the reduction in the rate of unemployment, improvement in the education and health systems, rural development, infrastructure development, and combating crime.

There are four main sources of government revenue in South Africa: taxes, service charges, grants and loans. In the 2009/10 fiscal year, taxes accounted for 81.5% of total government revenue (Durham & Verwey, 2012). In real terms, South African tax revenue has surged by approximately 70% over the period spanning 2000/01–2010/11. This means that in absolute terms, the South African budget has significantly more resources available for allocation than a decade ago. Given that the rate of resource growth has surpassed the population growth rate, the budget has more revenue available per capita, than it did ten years ago (Durham & Verwey, 2012).

South Africa continues to address the legacy of apartheid which presented developmental challenges such as inadequate infrastructure, widespread poverty and inequality, structural unemployment and a slow pace of transformation. In line with this objective, the 2012 National Budget proposals focus on developing infrastructure, supporting job creation and improving local government services. Education, healthcare and social protection continue to account for the largest share of government resources, with spending on these functional areas growing in average real terms by 1%, 1.5% and 3% respectively.
For South Africa to sustainably increase its spending on education, healthcare and social protection over the decades to come, domestic resource mobilisation will be crucial. Mobilising domestic resources will ensure counter cyclicality, debt sustainability and intergenerational equity.

2.0 THE IMPORTANCE AND ROLE OF TAXES IN THE SOUTH AFRICAN ECONOMY

2.1 Introduction

Taxes fund public infrastructure which is crucial in the delivery of public services. They also facilitate social progress and economic development. Through tax exemption some industries may be able to invest more and therefore accelerate their own growth and ultimately national growth. Taxes may also be used to discourage use of certain products by imposing heavier charges, such as sin taxes which are imposed on tobacco products. Local industries may be protected through taxation by imposing high customs duties on foreign goods. Moreover, taxation can be used to reduce inequalities in wealth and income by imposing progressively higher taxes on higher income groups as in the case of estate and income tax.

2.2 The role of tax in alleviating poverty and inequalities

The role of tax in the alleviation of poverty and inequalities is closely linked to the concept of social security. Social security refers to the action programs of the government intended to promote the welfare of the population through assistance measures guaranteeing access to sufficient resources for food and shelter. These measures, such as the provision of social grants, aim to promote health and wellbeing for the population at large and in particular for potentially vulnerable segments such as children, the elderly, the sick and the unemployed.

3.0 ANALYSIS OF THE TAX INSTRUMENTS/SOURCES IN SOUTH AFRICA

3.1 Introduction

As defined earlier in the study, taxes are essential for the financing of government activities, but at the same time, they should be set and administered to be as growth enabling as possible. The revenue raising authorities in South Africa are the National Treasury responsible for setting the tax policy and SARS which administers the tax policy.

In providing the revenue to fund all government initiatives, SARS plays a vital enabling role for government service delivery that enhances economic growth and social development, while supporting government’s integration into the global economy. It is therefore necessary to ensure good governance throughout the agency and observe the principles of relevant good practice within the parameters of public sector legislation. Generally, administrative reforms through modernisation programmes have contributed more to the spread of the tax burden, and have improved the ability of the revenue service to detect and deter non-compliance, thereby promoting fiscal rewards and improving accuracy of processing and service to taxpayers (Ramalho, 2007).

The basic goal of any tax system includes raising revenue, equity and freedom from economic burden. The South African income tax system is a combination of a progressive and proportional rate. In an increasingly global economy, it is also important that a tax system be competitive, but without contributing to unfavourable tax consequences by, for instance, discouraging tax compliance. Tax administration in South Africa functions in a complex and fast changing environment. A new range of factors, arising from the local, regional and international contexts, create an impact on the capacity of government to collect taxes and develop its economy. Similarly, globalisation, trade liberalisation, the establishment of regional economic and political blocks, the rapid movement of capital across national boundaries, innovations in telecommunications and technology in general all impact on government’s ability to generate revenue (Gelb et al., 2007). However, at the same time, there is a greater need to raise revenue for public spending – not only to cushion the financial difficulties experienced by the public, but also to sustain economic growth.

A commitment to a sound income tax system contributes toward well informed policy formulation and effective fiscal and economic policy decisions and also facilitates a more effective response to changing economic conditions, thereby helping to reduce the incidence and severity of economic and financial crises (National Treasury, 2009).

### 3.2 Tax Revenue Collection in South Africa

Taxes are the most important source of government revenue. The three main sources of national tax revenue are Personal Income Tax (PIT), Company Income Tax (CIT), and Value Added Tax (VAT). Robust economic growth during the mid-2000s and improved tax compliance and administration have resulted in an upward trend in tax revenue over the last ten years. However, the 2007/08 global financial crisis negatively affected tax revenues. The projections by the National Treasury reflect a recovery of tax revenues in the medium term, from 24.7% to 25.5% of GDP in 2011/12 to 2013/14 respectively (National Treasury, 2012).

SARS was responsible for the collection of 98% of the total budget revenue of government or 88.9% of the consolidated revenue of government (which includes non-tax revenue, revenue from provinces, social security and selected public entities as well as the Southern African Customs Union (SACU) payments) in 2010/11 (National Treasury, 2011).

South Africa has had the benefit of a revenue and customs administration with an exceptional record of growing revenue yield during periods of either economic growth or contraction.

The tax system in South Africa is residence-based. This implies that residents are, subject to certain exclusions, taxed on their worldwide income irrespective of where their income was earned. Non-residents are, however, taxed on their income from a South African source. Foreign taxes are credited against South African tax payable on foreign income and may be subject to any provisions in tax treaties that South Africa has in place with other countries (National Treasury, 2011).

PIT, CIT and VAT contribute approximately 80% of total tax revenue, while the fuel levy, excise and customs duties account for around 12% and other taxes are responsible for the balance. The main drivers of the upward movement in nominal tax revenue include among other things inflation, high commodity prices, high wage settlements, increases in the value of imports, private consumption in the economy as well as improvements in tax administration and tax compliance (National Treasury, 2011).
Figure 1 below shows that PIT contributed 28% to total tax revenue in 2006/07, VAT 27% and CIT 24%. This means that in 2006/07 PIT payers shouldered a larger share of the total tax burden compared to VAT and CIT (National Treasury, 2011).

Figure 1: Tax revenue source 2006/07

Source: National Treasury, 2011 Statistics

Figure 2: Tax revenue source 2010/11

The situation was relatively the same for the 2010/11 period as shown in Figure 2 above – the noticeable difference being that PIT contributed even more to total tax revenue at 34% compared with 28% in 2006/07. There was a marginal increase in the contribution of VAT to total tax revenue from 27.1% in 2006/07 to 27.2% in 2010/11. The contribution of CIT to total tax revenue experienced a decline over the same period under review from 24% to 20% (National Treasury, 2011). This means that PIT has continued to bear a larger share of the total tax burden compared to VAT and CIT between 2006/07 and 2010/11.
3.3 The analysis of the tax instrument trends in South Africa.

This study will focus mainly on analysing trends in the following tax instruments:

- Personal Income Tax (PIT)
- Company Income Tax (CIT)
- Value Added Tax (VAT)

3.3.1 Personal Income Tax (PIT)

Personal Income Tax is a tax levied on the taxable income, i.e. gross income less exemptions and allowable deductions, of a person for a specific year of assessment. Taxable capital gains also form part of taxable income. Individuals generally receive most of their income as salary or wages, pension or retirement payments, and investment income (interest and dividends). Some individuals, such as sole proprietors and partners, may also have business income which is taxable as personal income.

The number of individuals in South Africa registered for income tax has grown from over 4.7 million in 2007 to over 5.9 million in 2010. Subsequent to growing at a rate of 9.3% in 2008, the annual growth rate in registered individuals slowed to 6.9% in 2010 (National Treasury, 2011).

However, the number of employed people captured by Statistics South Africa between 2008 and 2011 is higher than the number of individuals captured in the SARS register. The percentage difference between the Statistics South Africa register and SARS register on the number of people employed is 54.9% for 2010, 57.3% for 2009, and 62.4% for 2008 (Statistics SA, 2008, 2009, 2010). The discrepancy in these figures highlights the possibility of a high number of people outside the tax net and therefore the need for SARS to bring these individuals into the tax net and widen South Africa’s narrow tax base.

The distribution of taxpayers, taxable income and tax paid – assessed through a major taxable income group analysis – reveals that between 2007 and 2010 the majority of the assessed individual taxpayers, that is to say 47.9% in 2010, fell within the R120 001–R400 000 income group. In 2010, 5.7% of assessed individual taxpayers fell within the R0 income bracket, and 8.8% fell in the R400 001–R500 001+ bracket as shown in Figure 3 below.

**Figure 3: Distribution of taxpayers, (individuals’ percentage) 2007–2010**

Source: National Treasury, 2011 Statistics
However, 52.6% of the tax collected in 2010 was contributed by 47.9% of the people assessed by SARS who fall in the R120,001–R400,000 bracket, and 36% of collected tax in 2010 was obtained from individuals falling in the R400,001–R500,000+ bracket and together these two groups make up 8.8% of overall taxable individuals. Figure 4 below show the tax collected in percentages for the years 2007 to 2010.

Figure 4: Distribution of taxpayers over selected taxable income 2007–2010

Source: National Treasury, 2011 Statistics

The above analysis show that there are generally few individual taxpayers within the highest taxable income group (R400,001–R500,001) but they bring in a substantial amount of taxable income compared with the other groups. This implies that their tax rate is higher than that of the other groups and therefore they bear a larger share of the total tax burden compared to the other income groups. The alternative thesis would be that this group has a substantially higher income per capita.

3.3.2 Company Income Tax (CIT)

According to the international Corporate Tax Rates for South Africa from 2008 to 2012, the CIT was reduced from 29% in 2008 to 28% in 2009, and has been maintained at that level up to now. However, certain sectors of the economy have different effective tax rates due to specific tax dispensations and deductions. Examples are the gold mining formula, farming deductions and valuation, and accelerated depreciation of capital for qualifying sectors. Small business corporations with a turnover of not more than R14 million can apply for a special tax dispensation in the form of a graduated income tax rate table as opposed to having a fixed rate. Micro businesses with an annual turnover of less than R1 million may also elect to only pay turnover tax. As part of CIT, companies may also have to pay Capital Gains Tax (CGT) on disposal of assets. Secondary tax on companies (STC) has been payable at a rate of 15% on dividends when declared, though STC has been replaced by a dividends withholding tax as of 1 April 2012.
However, there was a change in provisional tax patterns after the introduction of the 80% rule in January 2009 through Revenue Laws Second Amendment Act, 2008. This rule, which was implemented for companies with year-ends after 1 March 2009, requires taxpayers with taxable income in excess of R1 million to settle at least 80% of their tax liability by the time they make their second provisional payment or incur significant penalties. As a result, the 2009/10 fiscal year saw a significant decline in third payments (from R27.3 billion in 2008/09 to R9.5 billion in 2010/11) while first and second provisional payments increased relative to the total provisional tax for each year (National Treasury, 2011).

According to the South African Revenue Services register, over 2 million companies have been registered with SARS between the 2007 and 2010 tax years, and of these companies over 1.6 million are active and pay their taxes. Tax base broadening through education, outreach and enforcement initiatives have resulted in a 10.6% increase in the number of companies registered since 2009.

3.3.3 Company Income Tax by Sector

In 2007, the financing, insurance, real estate and business services sector was the largest sector, with a 28% share of the tax assessed. It was followed by mining and quarrying (10%), transport, storage and communication (8%), long-term insurance (7%), retail trade (8%), coal and petroleum products (5%), metal (including metal products) (5%), wholesale trade (4%), vehicles, parts and accessories (4%) and food, drink and tobacco (3%) as shown in Figure 5 below (National Treasury, 2011).

Figure 5: Tax assessed by sector (all companies), 2007

Source: National Treasury, 2011 Statistics
The picture changed slightly in 2010; the financing, insurance, real estate and business services sector maintained its dominance as the largest sector, with a 27% share of tax assessed. It was followed by transport, storage and communication (12%), retail trade (9%), coal and petroleum products (5%), wholesale trade (5%), food, drink and tobacco (4%), mining and quarrying (4%), metal (including metal products) (3%) and vehicles, parts and accessories (2%), long-term insurance (1%), as shown in Figure 6 below (National Treasury, 2011).

**Figure 6: Tax assessed by sector (all companies), 2010**

Source: National Treasury, 2011 Statistics

The analysis shows that the financial sector, consisting of insurance, real estate and business services, is contributing more to the CIT and is therefore bearing a greater tax burden than the other sectors.

### 3.3.4 Value Added Tax (VAT)

In September 1991, South Africa replaced its General Sales Tax (GST) with a consumption-type Value Added Tax (VAT). The original statutory rate was 10%, which was subsequently raised to 14% in 1993. The South Africa VAT is levied on the domestic supply and imports of goods and services, while exported goods (such as gold) and services are zero-rated. With a rebate for intermediates and investment purchases, the VAT is generally seen as a consumption tax as the consumer pays it at the final stage of production. The advantage of a VAT is that, unlike other indirect taxes, it eliminates the cascading effects of taxes on intermediate inputs and, as such, it removes distortions affecting input choices in production (Kearney et al., 2005).

A supplier of zero-rated supplies is not required to charge output tax on these supplies but is nevertheless entitled to a deduction of input tax paid on goods or services acquired for the purpose of making them. There is a wide range of basic food items as well as petrol, diesel and illuminating paraffin that are zero-rated. Exports are also zero-rated. Exempt
supplies are excluded from VAT – an example of supplies that are exempt from VAT is rental of residential property. Unlike either standard-rated or zero-rated supplies, exempt supplies are not taxable activities, so a supplier of exempt goods or services is not allowed to claim input VAT in relation to the input side of those supplies (National Treasury, 2011).

The largest number of VAT vendors for 2010/11 were in the financing, insurance, real estate and business services sector (33.8%) followed by the agriculture, forestry and fishing (13.3%) and retail trade (9.8%) sectors. Companies in the financing, insurance, real estate and business services sector made the largest proportion of gross domestic VAT payments totalling R66 billion (32.1%) in 2010/11. The companies in the mining and quarrying sector at 0.5% and 3.2% of the total gross VAT payments for 2010/11 were negative contributors to net VAT.

The number of vendors registered for VAT purposes has been declining since 2007/08. This has been due to the additional registration and legislative requirements as well as a clean-up of the VAT register. A vendor is regarded as active if a payment was received or a refund was made to the vendor during the fiscal year.

4.0 HIGH NET WORTH INDIVIDUALS (HNWIs)

SARS defines HNWIs as those individuals earning more than R7 million per annum, or alternatively those who have assets of more than R75 million. A collaborative investigation between banks and SARS has revealed that there is a significant number of HNWIs who are under-declaring their income, resulting in significant revenue losses. According to this analysis there are between 10 000 and 20 000 individuals in the country that meet the high net worth threshold. Only between 2 000 and 3 000 of these individuals have declared this income to SARS (SARS, 2012a).

SARS’s own investigation has identified approximately 9 300 individuals who meet the criteria set of High Net Worth Individuals but are not registered and compliant as HNWIs. About 2 300 of these individuals are on SARS’s register but are not tax compliant while 7 000 are unregistered (Vanek, 2012). Only 360 HNWIs are registered with SARS and are compliant. This is costing the fiscus an estimated R48 billion in potential revenue. SARS has documented some glaring anomalies in the financial affairs of non-compliant HNWIs – such as 50 individuals who own luxury private planes that are valued at over R20 million, but who have declared gross income of less than R1 million in their tax returns. Over 1 100 individuals have been identified who own property in excess of R30 million in value, the majority of whom appear to earn very modest incomes that are not reconcilable with assets registered in their names. Some individuals identified own luxury cars including Lamborghini and Ferraris even though they claim to have gross income of less than R350 000.

The main tax instrument that applies to HNWIs is the Capital Gains Tax (CGT), which has increased to R9.061 billion in 2010/11 from R3.661 billion in 2007/08 of total CGT raised. However, CGT paid by individuals went up to R2.012 billion from R 1.167 billion over the same period. This raises the top effective Capital Gains Tax rate by 32% (from 10% to 13.2%) of any capital gain for HNWIs.

There is a great need for SARS to properly capture these individuals in order to adequately tax them and raise more funds for developmental initiatives and provision of essential services.
SECTOR ANALYSIS

1.0 MINING SECTOR

1.1 Overview and importance of the sector in the economy

South Africa is a country with substantial mineral resources. It is the world’s largest producer of platinum group metals, chrome ore, manganese and vanadium and a major supplier of gold, iron ore, nickel and uranium. Most of the world’s largest mining companies are either South African or have their origins in South Africa. They include among others: DeBeers, Anglo American, Anglo Platinum and Anglo Gold Ashanti.

According to the 2011 Chamber of Mines annual report, the mining sector in the country contributes 19% to GDP (and 8.6% directly), directly employs 500 000 people, and its mineral resources valued at US$2.5 trillion make it the world largest mining industry. Approximately 60% of the country’s export revenue is attributable to mining, mineral production and secondary beneficiated products (National Planning Commission, 2011). South Africa’s mining industry in 2008 ranked fifth in the world in terms of the contribution of mining to GDP (Baxter, 2011).

The mining sector is also linked to other sectors in the economy through externalities to a cluster of industries that either supply it or use mining outputs. This cluster of industries includes: energy, financial services, water services, engineering services, specialist seismic, geological and metallurgical services, power generation, the chemicals sector, the steel manufacturing sector and the construction sector.

The Chamber estimates that another R200 billion in sales value and 150 000 jobs are from the downstream beneficiation sectors in South Africa. All of the country’s gold and Platinum Group Metals are refined locally and more than 50% of the diamonds by value are sold locally into the downstream diamond cutting and polishing industry.

While mining remains crucial to the South African economy, the pace of mineral exploitation has fallen over the years and the mineral base has depleted. The value added to GDP by the mining sector remained flat despite the historic commodities boom experienced between 2001 and 2008 (National Treasury, 2011b). Mine production fell by 12.7% year on year in October 2011 (Statistics South Africa, 2011b).

According to Canada’s Fraser Institute, South Africa is on a downward spiral on the policy potential index. Using the ranking of attractiveness of mining destinations to investors as a yardstick, South Africa was ranked 28 out of 47 jurisdictions in 2002/03 but fell to position 67 out of 79 jurisdictions in 2010/11 (McMahon & Cervantes, 2011). It is a fall that represents a steep decline in the country’s standing as an investment destination. According to Ernst & Young, there has similarly been a marked decline in the number of South African mining and metals transactions over the last decade, with deal values falling from US$13 billion in 2001 to US$2.9 billion in 2010 (Ernst & Young, 2011).

1.2 Sector specific tax regime issues

Mining companies pay the normal 28% Corporate Income Tax. However, as explained below, gold and uranium companies are treated differently. Capital expenditures related to mining are exempted from tax in the year in which they occurred. As a result of ring fencing in the mining sector, only the income from the mine at which the applicable capital expenditures were incurred, is tax exempt. In addition to normal tax, companies are also
liable for Withholding Tax on Dividends (WTD) to a maximum of 15% on net dividends distributed as of 1 April 2012. The effective tax rate for companies is therefore a combination of normal tax and WTD and is variable depending on the amount of the dividend declared. Capital Gains Tax is also applicable at an effective rate of 14% (FIAS, 2006). The new dividend withholding tax also qualifies for treaty relief.

**Gold Industry Taxation**

The gold mining formula applies a high marginal tax rate to the taxable income of mines, though the capital exemption can keep taxable income low. For a company electing the STC exemption, the marginal tax rate is 45% on every rand of profit in excess of the 5% tunnel protection.

The tax on gold mining is highly progressive because relatively unprofitable mines pay a low average tax rate while more profitable mines pay a much higher average tax rate. The capital expenditure exemption further exacerbates this because mines in early stages of development normally face higher capital expenditures and therefore have less taxable income while mature mines normally face low capital expenditures and thus have higher taxable income.

The gold formula was initially intended to tackle this effect. Generous capital exemptions and a steeply progressive burden were aimed at encouraging gold mines nearing the end of their life cycle to undertake new investments in deeper shafts. While the costs of production for these investments are very high, the gold formula was aimed at reducing the tax burden for such expansions. The jury is still out on whether the formula has succeeded in this endeavour. However, worth noting is that gold production has declined and the gold industry’s principal inputs have increased faster than basic inflation. The overall gold production cost structure, excluding capital expenditure, has dramatically increased compared to the prices. Thus profitability has suffered (FIAS, 2006).

**VAT**

Exports are zero rated. The mining industry therefore does not pay any VAT and mining companies are also entitled to claim a refund for all their input taxes because most mineral production is exported.

1.3 Analysis of the tax regime

**Effective Tax Rate**

According to the 2006 Sector Study of the Effective Tax Burden of South Africa by the Foreign Investment Advisory Service (FIAS), the Marginal Effective Tax Rate (METR) on capital for the mining sector is 0.4% (FIAS 2006). The study states that the lower METR is a result of generous tax treatment for the mining sector. For instance, the gold formula lowers the overall CIT rate. The lower METR was also as a result of mining companies being able to write off all machinery and equipment as well as mine development expenditures. The METR on equipment for the mining sector is negative 32% because of this immediate write-off provision. This suggests that there is a substantial subsidy to investment in equipment in the mining sector.

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(2) Gold mining Tax = 45 – 225/x on all mining income, and 37% on non-mining income, where x is the ratio of operating profit to total revenue, which implies a marginal tax rate of 45% for companies electing the STC exemption. For companies not electing the STC exemption, the formula was: Tax = 35 – 175/x on all mining income, and 29% on non-mining income, which implies a marginal tax rate of 35%.
Resources Rent Tax

In 2011 the National Working Committee of the African National Congress (ANC), the governing political party in South Africa, appointed a research team to investigate and report back on the feasibility of mine nationalisation in South Africa. The three-person research team has conducted a detailed inquiry, involving extensive case studies of Botswana, Brazil, Chile, China, Finland, Malaysia, Nigeria, Norway, Sweden, Venezuela, Zambia and Zimbabwe.

The report has recommended that some form of windfall profits tax be introduced, modelled on Australia’s resources rent tax for the mining industry; and that restrictions be placed on the export of unprocessed minerals (which will be subject to export duties) to encourage domestic beneficiation and a substantially increased role for the state mining company, possibly modelled on Codelco, the Chilean state-owned copper producer.

There is some scope for mobilising more domestic resources in this sector through an upward revision of the tax rate and gradual removal of tax incentives.

2.0 FINANCIAL SECTOR

2.1 Overview and importance of the sector in the economy

The financial sector certainly plays a critical role in the realisation of the developmental aspirations of any country, including South Africa. The sector acts as a catalyst for economic growth and employment creation, and ensures sustainable economic development for the country and its people. It provides a platform for ordinary citizens to transact and exchange payments for goods and services. Through its important intermediary role, the financial services sector touches the lives of ordinary people around the globe.

The South African financial sector comprises over R6 trillion in assets, contributing 10.5% of the Gross Domestic Product of the economy annually. It employs above a quarter of a million people, translating to about 4% of total formal employment and contributing at least 15% of Corporate Income Tax. Since 2000, the sector has grown at an annual rate of 9.1%, compared to broader economic growth rate of 3.6%. Growth in employment has also been very strong: over the same period, the number of people employed in the sub-sector increased by 24.5% and the financial sector has become one of the fastest-growing employers in South Africa. The total assets of the sector have also grown significantly, registering nominal compound average growth of 12.3% between 2000 and 2010. Financial sector assets now stand at 252% of GDP (National Treasury, 2011a).

South Africa’s financial sector is backed by a sound regulatory and legal framework, and includes dozens of domestic and foreign institutions providing a full range of services from commercial, retail and merchant banking, mortgage lending, insurance and investment services.

Financial services are exempted from VAT. The sector is subjected to standard tax treatment with no particular sector-specific incentives. Instead, extremely complex, innovative and evolving products and services characterise the financial sector.
Interest income earned by financial institutions is VAT-exempt. Since interest constitutes a high portion of income, especially for commercial and retail banks, only a small portion of the VAT paid by banks is recoverable. SARS applies a VAT recovery formula to most financial institutions, based on fee income divided by total income. For most banks, this works out to about 10% of total VAT paid as recoverable. This creates an incentive to convert as much of their income as possible from exempt forms (mainly net interest margin and trading profits) into fees, to increase their VAT recovery percentage, which in turn may partly explain the high commercial bank charges in South Africa (National Treasury, 2011a).

With some exceptions, most of the activities of banking institutions, an important part of the financial sector, are exempt from VAT. This means that banks do not charge VAT nor are they able to claim input credits for the VAT paid on much of their inputs. Thus, like non-registered Small Business Corporations (SBCs), banks can bear a heavy effective ‘sales tax’ type burden on their inputs.

With an overall weighted average METR on capital of just under 30%, the financial sector bears one of the highest marginal tax burdens on capital of any of the sectors studied. This is because the sector is not the beneficiary of any special incentives in terms of the statutory CIT rate or allowances for its capital expenditures, and because of the exemption from VAT. Information from SARS suggests that about 25% of the turnover of all financial institutions is tax exempt. The resulting indirect tax on bank inputs is what generates the high METR on capital equipment in the financial sector (National Treasury, 2011a).

One should note, however, that while the METR calculations suggest a high capital tax burden on the financial sector, there are many subtleties of the tax system as it relates to this sector that cannot be captured by the METR methodology. In particular, structured financing and the ability of financial institutions to easily move money, and book loans, between jurisdictions is a well known problem in this sector.

The Financial Transaction Tax (FTT)

This is an envisaged tax to be levied on people or businesses that buy or sell a share of stock, a bond, a futures contract, an options contract, or any of the commonly traded financial instruments.

The potential revenues from this tax are huge; recent reports suggest a broad-based, low-rate FTT (0.01%–0.05%) could generate revenues of nearly €200 billion annually in the EU and €480 billion globally for immediate economic needs and further ease the effects of government budget cuts. FTTs would also make speculative trading and speculative arbitrage less attractive by increasing trading costs. FTTs could raise even more revenue if combined with complementary taxes such as the International Monetary Fund’s (IMF) proposed Financial Activities Tax (FAT), which would compensate for the VAT exemptions that benefit financial services.

Even though South Africa was reported to be in support of this tax, there has been no official statement from either the National Treasury or the Presidency on functionality and implementation details (Hazelhurst, 2011)3.

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Financial transactions inflows

Capital inflows are crucial to the South African economy because they contribute to the financing of the current account deficit. However, they can trigger abrupt currency volatility that may cause lasting damage to the economy. There is therefore a need to slow down the capital inflow into the economy, particularly that of ‘hot money’ as this has the potential to bring about financial instability.

There is an opportunity for SARS to better understand the sector in order to tax it properly and raise funds for developmental purposes.

3.0 AUTOMOBILE SECTOR

3.1 Overview and importance of the sector in the economy

The automotive industry is the leading manufacturing sector in the South African economy. It is the third largest contributor to national GDP after the mining and financial sectors. According to the Automotive Export Manual for 2011, the industry contributed 6.17% to 2010 GDP; and on average from the year 2000, the industry contribution to the country’s GDP has been 6.9%. The total employment in the sector was estimated at 130 000 people in the manufacturing of accessories, components and vehicles, translating to about 5.9% of total manufacturing employment whilst the retail segment employs about 200 000 people (Werbeloff, 2011). Most of the major global vehicle brand manufacturers are represented in South Africa. These include Toyota, BMW, Volkswagen, Mercedes-Benz, Nissan, General Motors and Ford. Many of the models produced are for both the domestic and export markets.

The South Africa automobile industry accounted for 0.61% of total production of vehicle manufacturing worldwide in 2010 and was ranked 24th for vehicle production in terms of global market share. Its main export destinations increased from 62 in 1995 to 131 in 2010. It has also fostered trade and business partnerships with the essential trading blocs, such as the EU, NAFTA and Mercosur. South Africa’s main automotive trading partners, in terms of added exports and imports, are advanced economies. In 2010, South Africa’s automobile trade with Germany stood at 43% of total trade, Japan 19%, and the USA 18% (Alfaro et al, 2012).

The South African automotive supply chain encompasses manufacturing, distribution, and maintenance and servicing. Domestic and international firms supply inputs for the manufacturing process. The value chain begins by utilizing basic materials produced through industries such as mining and livestock. These initial suppliers then provide inputs to other layers of suppliers, who in turn provide the necessary manufactured inputs for final vehicle assembly. The subsequent stages of retail and distribution are supported by dealerships, marketing, financial services, vehicle maintenance, transportation and logistics providers.

The auto assemblers are at the centre of the industry and rely heavily on the support from suppliers, manufacturers, and aftermarket industries. In addition, the cluster is supported by Government agencies, research and development centres, and a wide range of Institutions for Collaboration (IFC) (Alfaro et al, 2012).
3.2 Sector specific tax regime issues

The industry is subjected to the standard Corporate Income Tax. Vehicles manufactured are also liable for Carbon Dioxide emission taxes as a government effort to reduce the emission of greenhouse gases, of which carbon dioxide is the major contributor to global warming. The carbon dioxide tax emission on passenger vehicles is R75 per gram CO₂ emission in excess of 120g/km and on double cabs is R100 per gram in excess of 175g/km.

The automobile industry receives significant government support through a set of incentives known as the Motor Industry Development Programme (MIDP). The MIDP came into effect in 1995 to assist an industry that was self-sufficient as a result of extremely high import duties and local content requirements.

The original goal of the MIDP program was to help the automotive industry in South Africa adjust to trade liberalisation and become internationally competitive. The program was confined to export facilitation, which entailed a reduction of tariffs, a removal of local content requirements, duty-free imports of components up to a percentage of the wholesale value of the vehicle, and duty rebate credits earned on exports. In simple terms, the local value-added of components or built-up vehicles exported earns credits that can be used to offset import duties on components and vehicles. These duty credits are tradable and can either be used to import or sold to provide a separate source of revenue for the exporter.

The program was initially scheduled to run for five years, but it has been extended three times, and is slated to end in 2020. The latest revision has resulted in a new program called the Automotive Production and Development Programme (APDP). It will set import tariffs at 25% for built up vehicles and 20% for components from 2013. The local assembly allowance will enable vehicle manufacturers producing more than 50 000 vehicles a year to import 20% of their components duty free, and will reduce tariffs to 18% (Werbeloff, 2011).

Although the South African government has been reducing its support in the subsequent revisions of the MIDP, the incentives still remain very significant (Black & Mitchell, 2002). Import duties on vehicles have fallen from 65% in 1995 to 40% in 2002 and 30% in 2007. Import duties on components have fallen from 49% to 30% and then 25% in the same years. In order to offset the reduction in the value of incentives a new feature, the Productive Asset Allowance (PAA), was introduced, which in effect subsidises investments in new facilities for export production rather than directly supporting export production.

The motor industry is exceptionally successful because it is dependent on the generous incentive scheme from the government. It basically relies heavily on both imported capital and imported inputs. Both of these attract nominal tariff rates ranging from 5%–15%. The manufacturing sector faces an overall weighted average METR on capital of 21%. Manufacturing firms are able to write off equipment over four years, at 40:20:20:20, rather than five years at 20% per annum. It is not very likely that this accelerated depreciation schedule drives any investment decision, or drives the 5% per annum depreciation allowance for industrial buildings.

This sector is heavily subsidised. The gradual removal of subsidies will provide government with additional resources to fund other developmental challenges.
CASE STUDY – VOLKSWAGEN SOUTH AFRICA

Volkswagen Group background

The Volkswagen Group is one of the world’s leading automobile manufacturers and the largest carmaker in Europe. In 2011, the Group increased the number of vehicles delivered to customers to 8.265 million, reflecting a 12.3% share of the world passenger car market. In Western Europe, over 23% of new vehicles come from the Volkswagen Group (Volkswagen Aktiengesellschaft, 2012b). The company recorded impressive group sales revenue of €159 billion in 2011, with a profit of €15.8 billion after tax (Volkswagen Aktiengesellschaft, 2012b).

The Group is made up of ten brands from seven European countries: Volkswagen, Audi, SEAT, ŠKODA, Bentley, Bugatti, Lamborghini, Volkswagen Commercial Vehicles, Scania and MAN. Each brand has its own character and operates as an independent entity on the market. The product spectrum extends from low-consumption small cars to luxury class vehicles. In the commercial vehicle sector, the product offering ranges from pick-ups to buses and heavy trucks (Volkswagen Aktiengesellschaft, 2012b).

The Group operates 94 production plants in 18 European countries and a further eight countries in the Americas, Asia and Africa. It sells its vehicles in 153 countries (Volkswagen Aktiengesellschaft, 2012b).

Regional comparative analysis

The Group has taken the global automobile industry by storm. It has recorded an impressive growth in all regions. Figure 7 below shows a comparison of world car market and Volkswagen Group growth in deliveries to customers from January 2011 to June 2012. The comparison reveals that Volkswagen’s performance over this period was stronger than the rest of the car market in all the regions covered. In Central and Eastern Europe the discrepancy was more pronounced with Volkswagen recording a growth of 27.3% while the rest of the car market managed only 10.8%. In North America, Volkswagen also recorded an impressive 22.1% growth compared to 13.8% growth in the rest of the car market. The picture is relatively the same for the other regions. The overall growth for the Group is 8.9% while for the rest of the car industry it is 8.5% (Volkswagen Aktiengesellschaft, 2012a).

This impressive performance by Volkswagen validated the notion that the company has been quickly becoming a leader in the automobile industry in recent years.

Figure 7: World car market vs Volkswagen Group deliveries to customers, January 2011–June 2012

Source: Volkswagen Group half yearly financial report 2012
Figure 8 below shows the growth in percentages of deliveries of passenger cars and light commercial vehicles to customers by region, between 2010 and 2011. Germany as a country has been included in the graph because it is a parent company. South Africa has been included because it is the country under review.

The analysis shows that the Volkswagen Group is experiencing a healthy growth of deliveries of passenger cars and light commercial vehicles to customers in all the regions and the countries covered with a worldwide growth of 14.3%. South Africa experienced the highest growth at 39.4%. In terms of the regions, North America experienced the highest growth at 21.4%, followed by Asia Pacific at 20%, Europe at 11.3% and South America at 5%. Germany alone recorded a growth comparable to Europe’s at 11.4% (Volkswagen Aktiengesellschaft, 2012b).

The growth in South Africa stands out and can be explained partly by the MIDP incentives. It is worth noting however that the Volkswagen Group performed well in other regions where the MIDP incentives do not exist. This may suggest that the Group would perform well in South Africa even without the MIDP incentives. However, it is equally important to note that investment environment settings in the other regions are heterogeneous compared to those in South Africa. It is therefore possible that the MIDP incentives act as a trade-off to other negative factors that are unique to South Africa.

**Figure 8: Growth in percentages and deliveries of passenger and light commercial vehicles to customers by region, 2010–2011**

Source: Volkswagen Group facts and figures navigator 2012

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**Does the Volkswagen Group benefit from investing in tax haven countries?**

Given that the Group reports its financials as a group and not aggregated according to its subsidiaries it is difficult to answer this question – a fundamental one for this study. The issue is further complicated by the definition of the concept of a tax haven. Various international institutions including the Tax Justice Network, the OECD and the IMF have attempted to define what a tax haven might be, without much success; as they realised that as soon as they defined a tax haven governments and businesses quickly changed their behaviour in an attempt to avoid the label.
Tax Research UK (the resource developed by tax expert Richard Murphy) has, however, come up with a very broad and comprehensive definition of a tax haven. It defines a tax haven as:

A location that promotes facilities providing tax haven characteristics such as:

• Secrecy whether it be with regard to banking information, tax data, financial information or ownership and management information and whether it be from public or official enquiry;
• Low taxes, often ring fenced (even if by subterfuge) from those charged to those resident in the jurisdiction;
• Ease of initial regulatory compliance (there being no location which does not have such regulation now);
• Limited or no regulatory filing required e.g. the absence of tax returns and other forms of data supply to any official body;
• The failure to enquire as to where an entity registered in the jurisdiction might be located if not considered resident within it;
• Rapid relocation of activities is allowed at the whim of the owner of the offshore structure e.g. by trust relocation or company redomiciliation;
• Flexible trust arrangements that do not meet the standards required by onshore jurisdictions and the Hague convention on trusts;
• Limited information exchange;
• The presence of major banking, accounting and legal entities disproportionate to any identifiable local need;

The definition further incorporates the commitment to innovate to ensure that these advantages are retained despite change in international regulation and attitudes; significant notional flows of funds through the location unjustified by any apparent economic activity undertaken there; and the registered ownership of assets in the location in excess of any obvious need inherent in the local economy.

The lack of disaggregated financial information for Volkswagen Group South Africa means that it is not possible to use this definition to properly ascertain whether or not the company benefits from investing in tax haven locations.

**Limitations of the analysis of the case study due to lack of financial data**

The reporting of all the Volkswagen Group’s financials, including profits and taxes, in a consolidated format without any disaggregation for any of its subsidiaries, is a major handicap to the analysis of this case study because it precludes a proper analysis of profits that accrue to Volkswagen Group South Africa and more importantly the taxes that the company pays to SARS. An accurate quantification of the MIDP incentives is virtually impossible in the absence of this vital financial information.

It is worth noting that the ability of states to mobilise revenue is seriously undermined by illicit capital flight. A report published by Forum Syd – a group of Swedish civil society organisations collaborating for human rights and global justice – entitled *Bringing the Billions Back* (2011) has found that on an annual basis huge unreported flows of money are leaving developing countries, ending up in rich countries or tax havens (Froberg & Waris, 2011).

The report further notes that if properly reported this illicit capital flight would generate at least US$160 billion per year in tax revenue which translates to more than one and a half times the total annual aid to the developing world. These are resources that could be crucial in the fight against poverty.
Perhaps more striking is that, according to the report, only a small share, 3% to 5%, of illicit capital flight stems from corruption. Yet almost two thirds originates from multinational companies evading tax. Moreover, as a percentage of GDP, capital flight from Africa is greater than from other parts of the world.

It must also be noted that this illicit capital flight is exacerbated by financial secrecy in tax havens and corporate secrecy that allows multinational companies to shift profits out of developing countries to tax havens.

**Volkswagen Group South Africa**

Volkswagen Group South Africa is a wholly owned subsidiary of Volkswagen Aktiengesellschaft (VWAG) in Germany. It is the largest German investment in South Africa. It is located in Uitenhage, an industrial town near Port Elizabeth in the Eastern Cape and employs 6 500 people (Volkswagen Aktiengesellschaft, 2012a).

Volkswagen Group South Africa has achieved great success with the introduction of the Citi Chicco in 1995. Apart from exporting built-up units to overseas markets, it also exports body and engine parts and catalytic converters to countries like Argentina, Spain, Belgium and Germany. Volkswagen Group South Africa manufactures Golf 4, Golf 5, Golf 1 and Polo models for local and export markets (Volkswagen Aktiengesellschaft, 2012a).

Given the lack of financial information on Volkswagen Group South Africa, the sales figures were analyzed and used as a proxy for the performance of the company as detailed below.

**Sales Performance**

Volkswagen Group South Africa recorded significant growth in its first quarter sales figures – from 17 007 in 2010 to 24 861 in 2011 – reflecting an increase of 46%.

The company continued to enjoy impressive sales as it recorded a 12.5% increase in the first quarter of 2012, delivering 27 958 vehicles compared with 24 861 vehicles in the first quarter of 2011. The positive start to 2012 gave the company a 17.8 % market share in the South African total car market. Polo Vivo was the top selling brand in the passenger car market with 8 461 units.

Volkswagen Group South Africa led in the passenger car market with total sales of 8 260 units and market share of 23.7 % in May 2012. A total of 34 820 new passenger cars were sold in South Africa, an increase of 18% when compared to sales in April 2012 and a growth of 20.8% against the same period (April–May) in 2011. From January to May 2012, the market improved by 11.3% against the same period in 2011.

The Volkswagen Commercial Vehicles sector reported sales of 575 units of which 249 were Amarok Single and Double cabs in June 2012. Supply constraints in Argentina continue to impact on the delivery of the Amarok range into South Africa.

The company maintained its leadership position in the new passenger car market in June 2012 and reported total sales of 7 754 units and a market share of 21.6%.
During June 2012, an industry total of 35,918 new passenger cars were sold in South Africa, an increase of 3.2% when compared to the reported sales in May 2012 and a growth of 14% when compared to the same period in 2011. In the first half of 2012, new passenger car sales improved by 11.8% against the same period in 2011, whilst in the second quarter of 2012, sales went up by 15.5% compared to the second quarter of 2011 (Volkswagen Aktiengesellschaft, 2012a).

Volkswagen Group South Africa maintained its top position in the new passenger car market for 2012 with total sales of 8,689 units. During July 2012, 37,844 new passenger cars were sold in South Africa. The market increased by 5.4% when compared to June 2012, and grew by 18.2% when compared to July 2011, bringing the January to July 2012 market to a level 9.7% above the same period for 2011 (Volkswagen Aktiengesellschaft, 2012a).

Volkswagen Commercial Vehicles sold 720 units and 477 of these units were Amarok single and double cab models in July 2012 (Volkswagen Aktiengesellschaft, 2012a).

It is important to note that the Volkswagen Group reports all its financial including profits and taxes in a consolidated format without any disaggregation for any of its subsidiaries including Volkswagen Group South Africa.

Because of the Volkswagen Group’s practice of consolidated reporting, Volkswagen Group South Africa financials were not readily available to enable a proper analysis of financial performance and of the impact of the MIDP incentives on the finances of the company. However, the Volkswagen Group financials and the comparative regional analysis above show that the company is doing well both in Germany and in most of the regions in which it is operating. A high level conclusion can therefore be reached that Volkswagen Group South Africa can compete effectively in the world markets even without the incentives that it currently enjoys. This highlights the possibility of using domestic resources currently directed towards automobile sector incentives, for other developmental initiatives.
CONCLUSION AND RECOMMENDATIONS

Despite impressive developmental strides, inequality, unemployment and poverty remain high in South Africa. There is therefore a need to mobilise domestic resources that will enable the country to face these developmental challenges.

In South Africa just about 10% of the population, which translates to about 5.9 million people, pay taxes to support a total population of over 50 million people. The tax base is therefore very narrow. Statistics South Africa has recorded approximately double this current number of tax-payers as employed people in South Africa, highlighting that about half of the employed people are potentially outside the tax net.

It is recommended that SARS update its register to truly reflect the number of people employed and thus broaden the tax base to mobilise domestic resources for the developmental challenges facing the country.

There are over 2 million companies currently registered in the country but just over 1.6 million are active and pay their taxes. There is therefore a substantial number of companies that are dormant and do not pay taxes. It is recommended that SARS clean up its company register to accurately reflect the number of active companies who are paying tax in order to mobilise more resources for the development of the country. There is also too much dependency on the financial sector for revenue. It is therefore recommended that SARS allocate more resources to investigating why the other sectors are lagging behind in paying taxes in a bid to spread the tax net fairly across all sectors.

There are too many High Net Worth Individuals (HNWIs) who are outside the tax net in South Africa. It is recommended that SARS continue to track these individuals with the aim of having an accurate register and bringing all of them into the tax net to mobilise more domestic resources for socio-economic development.

It is also recommended that government take different steps aimed at encouraging voluntary disclosures from HNWIs – such as introducing amnesty laws to ease the punitive burden associated with disclosure of information and to encourage the repatriation of resources kept abroad, and speedily issuing tax rulings to help taxpayers know what tax burden they are subject to. Tax administrators should maintain a cooperative attitude in engaging with taxpayers, which would help to facilitate the negotiations on what tax burden HNWIs should bear.

SARS should, in partnership with the international community, institute initiatives that are aimed at tracking the patterns of spending for these individuals in addition to increasing international and cross-border cooperation geared towards ending secrecy in their financial transactions.

Regarding tax evasion and avoidance, it is recommended that three policies, Automatic Tax Information Exchange, Beneficial Ownership registries, and country-by-country reporting for multinational companies, be investigated and instituted by SARS as key measures to curtail these activities.

Automatic Tax Information Exchange would require SARS to collect from financial institutions data on income, gains, and property paid to non-resident individuals, corporations, and trusts. This data would be collected and automatically provided to the tax authorities where the non-resident person or entity is located. Reciprocally, the competent tax authorities of third states will automatically exchange information on the foreign income of residents of South Africa.
The intention is to create a global standard to greatly limit the ability of people and companies to avoid or evade taxes in their home country by hiding funds in another jurisdiction.

A Beneficial Ownership provision would have two prongs: action by SARS and action by the financial institutions in South Africa. It would require SARS to ensure that the beneficial ownership, control and accounts of companies, trusts and foundations be readily available on public record to facilitate effective due diligence. With respect to the financial institutions, this provision would explicitly require that they identify the ultimate beneficial owners or controllers of any company, trust or foundation seeking to open and operate an account.

Since tax avoidance is facilitated by tax haven structures created to shroud business activity in secrecy, country-by-country reporting would require that all multinational companies report sales, profits, and taxes paid in all jurisdictions in their audited annual reports and tax returns.

The overall Marginal Effective Tax Rate for the mining sector is currently very low. It is therefore recommended that the capital equipment tax incentives are gradually removed to free domestic resources for development purposes.

The financial sector bears the highest Marginal Effective Tax Rate on capital of all of the sectors studied. It is recommended, however, that SARS embark on an educational endeavour that will enable them to understand the financial instruments used in this sector in order to tax the sector properly and mobilise more domestic resources for development.

The automotive industry receives significant government support through a set of incentives known as the Motor Industry Development Programme (MIDP). Although the South African government has been reducing its support in the subsequent revisions of the MIDP, the incentives still remain substantial. It is therefore recommended that the tax incentives for this sector be gradually eliminated in order to free resources for other developmental needs.

The sales performance of Volkswagen Group South Africa in the case study conducted reveals that the company is doing well. Taking into consideration the Volkswagen Group financials and the comparative regional analysis, a high level conclusion can be reached that Volkswagen Group South Africa can compete effectively in the world markets even without the incentives that it currently enjoys. It is therefore recommended that the current tax incentives provided to the automobile industry in South Africa be investigated further to find out if incentives should not be gradually removed to generate more resources for social investments.

In sum, South Africa continues to face challenges of widespread inequalities, high unemployment and poverty. In order to tackle these challenges head on, substantial domestic resources must be mobilised. This analysis has shown that there is great potential to raise these resources through improved efficiencies in PIT and CIT for the mining, financial and automobile sectors.