A CRITICAL ANALYSIS OF THE TAX IMPLICATIONS FOR SMALL AND MICRO BUSINESSES

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Summary

The South African economy has seen an increase in small businesses since 1994. This increase has been caused by an increase in unemployment rate and government interventions to promote small businesses. The government has through the National Treasury introduced various tax legislations to simplify and facilitate the tax processes that small businesses have to comply with. The discussion contained in this treatise seeks to critically analyse the tax implications for small and micro businesses.

One of the small business tax legislations, Small Business Corporations, is discussed in chapter 2. The Small Business Corporation legislation provides for two key concessions to qualifying small businesses. The first concession is the progressive tax rates that are lower than normal tax rates at taxable income level below R300 000. The second concession is the special capital allowances that the qualifying small business is entitled to.

The tax amnesty for small businesses was introduced in July 2006 to provide an opportunity to small businesses which were not up to date with their tax affairs, to regularise their tax affairs. Small businesses had to meet certain requirements and pay an amnesty levy ranging from 2 to 5 percent of their taxable income. The tax amnesty on small businesses was not as effective as intended, however a slight increase in the South African taxpayer base was achieved. The voluntary disclosure programme has recently been introduced in November 2010, to provide an opportunity for all businesses to voluntarily disclose their previous defaults without being subjected to criminal prosecution and penalties.
The government further attempted to simplify the tax compliance process by introducing turnover tax legislation. The turnover tax provides for a single tax system that does away with the need to account for normal tax, capital gains tax, secondary tax on companies and value added tax. The turnover tax system is optional to qualifying small businesses. The turnover tax is calculated by simply applying a tax rate to taxable turnover. Small businesses need carefully consider whether turnover tax will be beneficial to them. It is not advisable for small businesses that are making losses to adopt turnover tax.

Another small business tax legislation that promises to be effective is the venture capital incentive. This legislation provides for deduction of expenditure actually incurred in the acquisition of shares by qualifying businesses.

It appears that, given the challenges that small businesses still face, the government still has a lot more to do to simplify the tax process for small businesses.
Key words

1. Small business
2. Turnover tax
3. Tax amnesty
4. Investment income
5. Personal services
6. Informal business
7. National budget
8. Value added tax
9. Taxable income
10. Venture capital incentive
Chapter 1

1.1 Introduction

It is submitted that the end of the apartheid era and the beginning of the post 1994 period has seen an influx of micro and small businesses. The increase in the unemployment rate has also contributed to the increase in the number of small businesses. This has been compounded by the government’s initiatives to encourage the participation of the small and micro business in the main stream economy. The government’s initiatives include, amongst others, the broad based economic empowerment and the awarding of tenders to previously disadvantaged groups.

The South African Revenue Services (SARS) and the National Treasury identified a gap in the revenue collection from small businesses. Many small businesses operate informally and remain outside of the tax system and therefore do not contribute to the fiscus\(^1\). The National Treasury and the SARS introduced the small business tax amnesty in 2006\(^2\). The main objectives of the small business tax amnesty were firstly to increase the taxpayer base for SARS and secondly to offer and opportunity for long time defaulters to declare their income without facing penalties and additional taxes\(^3\). (Refer to Chapter 3 for a detailed discussion of small business tax amnesty)

\(^1\) Paragraph 1, page 2 of Explanatory memorandum on the small business tax amnesty and amendment of taxation laws bill, 2006
\(^2\) Paragraph 3, (supra)
\(^3\) Paragraph 4, (supra)
Following the small business tax amnesty, the National Treasury and SARS introduced the turnover tax for small businesses in 2009. The objective of the turnover tax is to simplify the tax compliance process for small businesses\(^4\).

### 1.2 Research objectives

The main objective of this study is to critically analyse the tax implications for small businesses in South Africa. The study will analyse the key legislative provisions for small and micro businesses i.e the small business corporation tax, the small business tax amnesty and the turnover Tax. Finally the study aims to analyse the impact of small business tax legislation on both the small business taxpayer and South African Revenue Services.

### 1.3 Research Methods

The research methods that have been followed are a combination of both qualitative and quantitative. The qualitative methodology will however be the most dominant. The quantitative methodology has been applied to analyse the impact of small business tax amnesty on both the small business taxpayer and the South African Revenue Services. Statistics were collected from the National Treasury. These statistics have be analysed and interpreted.

The qualitative methodology has been applied on the critical analysis of various tax legislation affecting the micro and small businesses. Data has been collected from reading books, journals, tax articles and tax legislation.

\(^4\) Chapter 24.1 of Notes on South Africa Income Tax, Page 670
This data has then been analysed and a contribution to the subject has been made.

1.4 Outline of the treatise

The study analysis the key legislative provisions for small and micro businesses i.e. the small business corporations (Chapter 2), the small business tax amnesty (Chapter 3) and the turnover tax (Chapter 4). The analysis of small business legislative provisions includes the impact on both the small business taxpayer and SARS. The effectiveness of the small business tax legislation is considered in the relevant chapters. A brief overview of how the venture capital incentive impacts on small businesses is considered in Chapter 5.
Chapter 2

Small Business Corporations

2.1 Introduction

One of the special dispensations introduced by the government to date for small businesses is the Small Business Corporation (SBC) legislation. The SBC legislation was introduced with effect from years of assessment commencing on or after 1 April 2000\(^5\).

2.2 Definition of SBC

SBC is defined as any close corporation, co-operative or any private company whose entire shareholders are natural persons, and its gross income does not exceed R14 000 000\(^6\). One question that can be raised on the definition of SBC is whether a company whose shares are held by a trust qualifies as an SBC. It is submitted, in an article by Duncan McAllister, that a company whose shares are held in trust will qualify as an SBC provided the trustees and beneficiaries holding a vested interest in those shares are all natural persons\(^7\). At the introduction of the SBC legislation, the gross income of the SBC was capped at R1 000 000 for the years of assessment commencing on or after 1 April 2000. The limitation of R1 000 000 was increased to R3 000 000 in respect of years of assessment ending on or after 1 April 2002. The Minister of Finance increased the limit to R5 000 000 in the 2003 budget.

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\(^5\) Paragraph 1 of Income Tax Interpretation Note 9, dated 13 December 2002
\(^7\) Shareholder of small business corporations, Duncan McAllister, Senior Specialist SARS legal and policy.
speech.\(^8\) In the 2005 and 2006 budget speeches the limit was increased to R6 000 000\(^9\) and R14 000 000\(^{10}\) respectively.

The definition of gross income in section 1 of the Income Tax Act (‘ITA’), includes all income received or accrued but excludes receipts of a capital nature. Taxable capital gains are included in taxable income in terms of the provisions of section 26A of the ITA. In determining whether a taxpayer qualifies for the SBC legislation, the taxpayer should therefore include trading income, interest and dividends.

The R14 000 000 limitation on the gross income refers to the gross income received or accrued for a full period of 12 months, i.e. a full year of assessment. Where a taxpayer started trading during the year of assessment, the R14 000 000 cap must be reduced proportionately in order to determine whether the gross income received or accrued for the relevant period in question would have exceed the limit of R14 000 000, had the taxpayer been trading for the full year of assessment\(^{11}\).

The R14 000 000 turnover limit has not been adjusted for inflation since 2007. It is submitted that the SBC is disadvantaged by this because any inflationary growth in turnover level beyond R14 000 000 will exclude the SBC from the SBC legislation.

The SBC legislation offers a bigger gross income limit compared to turnover tax legislation. Turnover tax offers a turnover limit of R1 000 000 (Refer to

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\(^{8}\) Page 18 of the 2003 Budget Speech.  
\(^{9}\) Page 28 of the 2005 Budget Speech.  
\(^{10}\) Page 17 of the 2006 Budget Speech.  
\(^{11}\) Section 12E(4)(a)(i) of the Income Tax Act No. 58 of 1962
Chapter 3). It is however submitted that the SBC legislation is limited in scope because the definition of SBC does not cover natural persons, sole proprietorships and partnership operating as small businesses.

2.3 Requirements for qualifications as SBC

In addition to the above definition of SBC, a company, close corporation or co-operative has to meet certain requirements before qualifying as SBC. Those requirements are as following:

i. ‘None of the shareholders or members of the company, close corporation or co-operative are permitted to hold shares in another company other than in

(a) a listed company;
(b) collective investment scheme;
(c) body corporate or share block company;
(d) less than 5% interest in a social or consumer co-operative or a co-operative burial society, friendly society;
(e) less than 5% interest in a primary savings co-operative bank or a primary savings and loans co-operative bank;
(f) a venture capital company’\(^\text{12}\).

It is submitted that holding of a share in the above entities is permitted as it is unlikely to be done for the purpose of splitting businesses into different companies to keep the turnover per company below R1 000 000.

Ownership of shares or interest in any company, close corporation or co-operative that has not carried on any trade during any year of assessment, and has not owned assets in excess of R5 000 in market value does not prohibit a person from becoming an SBC\textsuperscript{13}. This provision allows for a shareholder of SBC who has interest in other shelf companies, to qualify for SBC benefits\textsuperscript{14}. If a shareholder owns multiple trading companies, these companies may not access SBC relief. The purpose of this prohibition is to prevent shareholders from dividing a single large business into multiple small businesses so as to artificially obtain undue tax benefits for each of these divided parts (Refer to 4.2 below). Ownership of shares in a company that is in the process of liquidation, winding up or deregistration does not prohibit a person from holding shares in SBC\textsuperscript{15}.

\begin{itemize}
  \item[ii.] ‘Not more than 20 per cent of the total of all receipts, accruals and all capital gains of the company consists collectively of investment income and income from rendering personal services’\textsuperscript{16}.
\end{itemize}

Investment income includes interest, dividends, royalties, rental income in respect of immovable property, annuities, or any other income subject to the same treatment as income from money invested. Investment income includes any proceeds derived from investment or trading in financial instruments, marketable securities or immovable property in the definition of investment income\textsuperscript{17}.

\begin{footnotes}
\item[14] Explanatory memorandum on the Taxation Laws amendment bill, 2009
\item[15] Section 12E(4)(a)(ii) of the Taxation Laws amendment bill, 2009
\item[17] Section 12E(4)(c) supra
\end{footnotes}
Personal services means any service in the field of accounting, actuarial science, architecture, auctioneering, auditing, broadcasting, broking, commercial arts, consulting, draftsman-ship, education, engineering, financial services, health, information technology, journalism, law, management, real estates broking, research, sport, surveying, translation, valuation or veterinary science\(^{18}\). There are two conditions for the above services to qualify as personal services for the purposes of SBC. Firstly the service must be performed by any person who holds an interest in the SBC. Secondly the SBC must not employ three or more full time employees other than any employee who is a shareholder of the SBC\(^{19}\). Refer to chapter 4.3 (3) for a discussion on the interaction of SBC and turnover tax regarding the above.

Where the small business, for example, has no investment income, the income from rendering personal services may not exceed 20% of the total of all receipts and accruals (other than those of a capital nature) and all the capital gains of the company, and vice versa.

The SBC legislation was introduced for the purpose of encouraging new start up businesses and the creation of employment. The SBC legislation was therefore not designed to benefit any professional persons, hence the limitation of personal service income and investment income to 20% of the gross income of the taxpayer.

It is submitted that the taxpayer has a duty to keep accurate records in order to prove that the portion of the SBC’s gross income attributable to


\(^{19}\) Section 12E(4)(d)(ii) supra
investment income and personal services rendered, does not exceed the 20% limitation. This is necessary as Commissioner of SARS has the power to request this information\(^\text{20}\) and because of the burden of proof requirement placed on the taxpayer in terms of section 82 of the ITA.

iii. ‘The company, close corporative or co-operative must not be a personal service provider as defined in the Fourth Schedule to the Income Tax Act\(^\text{21}\).

Personal service provider is defined as a company or trust where the services are rendered personally by any person who is a connected person to such company or trust and

(a) such person would be regarded as an employee of such client if such service was rendered by such person directly to such client, other than on behalf of such company or trust; or

(b) where those duties must be performed mainly at the premises of the client, such person or such company or trust is subject to the control or supervision of such client as to the manner in which the duties are performed or are to be performed in rendering such service; or

(c) where more than 80 per cent of the income of such company or trust during the year of assessment, from services rendered, consists of or is likely to consist of amounts received directly or indirectly from any one client of such company or trust, or any associated institution as defined in the Seventh Schedule to this Act, in relation to such client,

\(^{20}\) Section 74A supra

\(^{21}\) Section 12E(4)(a)(iv) supra
except where such company or trust throughout the year of assessment employs three or more full-time employees who are on a full-time basis engaged in the business of such company or trust of rendering any such service, other than any employee who is a shareholder or member of the company or trust or is a connected person in relation to such person\textsuperscript{22}.

2.4 Concessions for SBC

The SBC, having qualified with the above requirements, is entitled to the following concessions:

i. ‘In the financial years ending on any date between 1 April 2010 and 31 March 2011, the SBC is to be taxed on the basis of a progressive tax rate as follows\textsuperscript{24}:

- 0% on the first R57 000 of the taxable income
- 10% on taxable income in excess of R57 000 but not exceeding R300 000
- R24 300 plus a rate of 28% on taxable income in excess of R300 000’

It will be noted from this concession that although the taxpayer may comply with all requirements of the SBC, it will lose the benefits of this concession on taxable income in excess of R300 000. The first R300 000 taxable income is taxed at 8,1% (i.e. R24 300/R300 000) and any excess is taxed at a normal tax rate of 28%.

\textsuperscript{22} Paragraph 1 of Fourth Schedule to the Income Tax Act.

\textsuperscript{24} Appendix 1 of Taxation Laws Amendment Act 7 of 2010, Government Gazette No 33726, 2 November 2010.
The R300 000 taxable income level at which the 28% tax rate comes in to effect has not be adjusted for inflation since 2007. It is submitted that the SBC whose taxable income has increased beyond R300 000 due to inflation will be unnecessarily disadvantaged in respect of taxable income in excess of R300 000.

It is submitted that the low tax rates have a negative impact on the revenue collection for the National Treasury.

ii. The SBC is entitled to special capital allowances under section 12E. These capital allowances can be split into three types, namely, manufacturing assets, non-manufacturing assets and moving expenses.

(a) Manufacturing Assets

‘Plant and machinery owned by a taxpayer that qualifies as SBC or acquired by such a taxpayer under an instalment credit agreement as defined in paragraph (a) of the definition of instalment agreement in section 1 of the Value Added Tax Act, used in a process of manufacture for the first time after 1 April 2001 by the SBC for the purpose of trade, qualify for the immediate 100% write off in the year it is brought into use\(^{25}\). This allowance is not apportioned for a portion of a year of assessment. The asset brought in to use by the taxpayer does not necessary have to be a new asset. An asset that has qualified for an allowance in terms of section 12E of the Act, (other than assets acquired after 1 April 2005) will not qualify for any other allowance available in terms of the Act because the full

\(^{25}\) Section 12E(1) of the Income Tax Act No. 58 of 1962
cost of the asset is deducted when the asset is brought in to use for the first time.

Refer to point (b) below regarding assets acquired after 1 April 2005 where the taxpayer has an option of electing section 11(e) provisions or section 12E of the ITA.

(b) Non Manufacturing Assets

In respect of non-manufacturing assets, the SBC can elect to either claim the wear and tear allowance under section 11(e) of the ITA or an accelerated write off allowance as follows:

- 50% of the cost of the asset in the year of assessment during which it was first brought into use,
- 30% in the second year of assessment, and
- 20% in the third year of assessment.

No apportionment of the above allowances is required where the SBC started trading during the year.

The SBC would elect section 11(e) if it provides a more favourable allowance. This is the case in respect of an asset cost less than R10 000 that qualify for immediate 100% write off of cost on acquisition, or where the write-off period is less than three years.

(c) Moving expenses

‘Any expenses incurred by the SBC in moving the asset from one location to another, which is not deductible under section 11(a) will be allowed in

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26 Section 12E(1A) supra
28 Section 11(e) supra
equal instalments over the remaining years of capital deduction (in terms of s12E(1) or 12E(1A)). Only moving expenses relating to assets that qualify for capital allowance in terms of section 12E (1) and section 12E (1A) of the ITA\textsuperscript{29} qualify for this moving expenses allowance.

The cost of the asset for the purposes of section 12E of the ITA is determined at the lower of cost to the taxpayer or the cost which would be incurred if asset is acquired under a cash transaction concluded at arm’s length\textsuperscript{30}. Any direct cost of installation or erection is to be included in the cost of the asset but interest and finance costs are excluded. Any amount recovered or recouped in respect of an asset which is disposed off will be subject to the recoupment provisions in terms of section 8(4)(a) of the ITA.

It is submitted that the intention of the section 12E concession is to promote capital investment by the small businesses. The small businesses will be encouraged, by the immediate write off of plant and machinery, to engage in more capital investment. The immediate write off of assets has an effect of reducing the taxable income and tax expense thereby improving the taxpayer’s cash flow position. The additional cash available to the SBC can be utilised for other investment projects. It is however submitted that this reduces the revenue collected by the National Treasury. Although the SBC legislation reduces revenue collected by the National Treasury, it improves the compliance culture of small businesses\textsuperscript{31}.

\textsuperscript{29} Section 12E(3) \textit{supra}

\textsuperscript{30} Section 12E(2) \textit{supra}

\textsuperscript{31} Page 2 of Investment Climate in Practice report by FIAS, February 2010.
2.5 Conclusion

The SBC legislation offers a higher turnover limit (R14 000 000) compared to turnover tax system (R1 000 000). The SBC legislation is however not available to natural persons and sole proprietorships (Refer to 2.2 above). The immediate write off of manufacturing assets reduces taxable income and lowers the tax charge. This has an impact of improving the cash flow position of the SBC (Refer 2.4 above).

The lack of adjustment of the turnover limit (Refer 2.2) for qualifying for SBC legislation and the R300 000 taxable income (Refer 2.4) level is a disadvantage for SBC’s.

It is submitted that overall, the SBC legislation is one of the most attractive concessions introduced given the low tax and high wear and tear rates applicable. The SBC also benefits SARS and National Treasury as it improves the compliance culture of small businesses.

A discussion of small business tax amnesty as an attempt to attract more small businesses into the SARS tax base follows in the next chapter.
Chapter 3

Small Business Tax Amnesty

3.1 Introduction

The President of the Republic of South Africa promulgated the tax amnesty for small business on 25 July 2006\(^{32}\). The tax amnesty for small business was contained in the Small Business Tax Amnesty and Amendment of Taxation Laws Act, 2006 (No 9 of 2006) which came into effect on 1 August 2006. The Second Small Business Tax Amnesty and Amendment of Taxation Laws Act, 2006 (No. 10 of 2006) was later promulgated to provide further clarity.\(^{33}\)

Many of the small businesses are informal. An example of this is a person operating a small shop in the corner of the street in the township. This person is not concerned about registering his business with the Companies and Intellectual Property Registration Office. Neither is he concerned with registering his business for tax purposes because it is burdensome and costly. Small businesses are also often unable to access finance from the major financial institutions. This is due to the stringent requirements and the security required for approval of finance. Small businesses are therefore often excluded from the main stream economy and in most cases, it is submitted, remain outside the tax system.

Some of the small businesses who are outside of the tax system are keen to regularise their tax affairs, but they face an obstacle in the form of their past

\(^{32}\) Government Gazette No 29068
\(^{33}\) Government Gazette No 29069
non-compliance and potential tax liabilities arising out of past non-compliance. The intention of the tax amnesty for small business was to provide an opportunity for small businesses which were not up to date with their tax affairs, to regularise their tax affairs. The small businesses who took advantage of the tax amnesty for small businesses were not subjected to penalties and interest\textsuperscript{34}.

3.2 The objectives of the tax amnesty for small businesses\textsuperscript{35}

1. ‘To broaden the tax base’.

Due to the general increase in government expenditure, the National Treasury is always looking for ways and means to increase the taxes collected. One of the tools for increasing taxes collected is to increase the tax base. This is a better option compared to increasing tax rates because it does not lead to an increased tax burden on existing taxpayers.

2. ‘To facilitate the normalisation of the tax affairs for small businesses’.

The exemption from interest and penalties to taxpayers applying for tax amnesty was intended to encourage small businesses outside the tax system to normalise their tax affairs. A small business person who had been outside of the tax system for a number of years would be discouraged to disclose his true financial affairs if he was to be faced with stiff penalties and interest due to non-compliance.

\textsuperscript{34} Paragraph 9(i) of the Small Business Tax Amnesty and Amendment of Taxation Laws Act No 9, 2006

\textsuperscript{35} Paragraph 1 of the Second Small Business Tax Amnesty and Amendment of Taxation Laws Act No 10, 2006
3. ‘To improve the tax compliance culture’.

Small businesses are generally not compliant due to the compliance requirements imposed on them compared to small revenues they generate.

4. ‘To facilitate participation in the taxi recapitalisation programme’.

The taxi industry is one of the many informal sectors which have not complied with tax regulations. This had been due to lack of internal and external regulations in the taxi industry. The introduction of the taxi recapitalisation programme has also seen various attempts to formalise the taxi industry. One of those attempts has been to register taxi operators with SARS. The small business amnesty was also targeted at taxi operators in this regard.

### 3.3 Taxpayers who qualified for tax amnesty

Natural persons, unlisted companies, close corporations, trusts and co-operatives were allowed to apply for tax amnesty for small businesses\(^{36}\). These taxpayers had to comply with the following requirements:

1. ‘The individual or entity must have carried on a business’\(^{37}\).

The small business tax amnesty was not available to entities that had been dormant. Taxpayers must have received trading income before they could qualify for tax amnesty. Shelf companies also did not qualify for the tax amnesty.

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\(^{36}\) Paragraph 2(a) of the Small Business Tax Amnesty and Amendment of Taxation Laws Act No 9, 2006

\(^{37}\) Paragraph 2(b) *supra*
2. ‘The turnover of the business must not have exceeded R10 000 000’\textsuperscript{38}. The National treasury had to differentiate between small and large businesses. One of the ways to do this is look at the level of turnover the business is generating. In 2006 when the small business tax amnesty was introduced, the turnover requirement for a SBC was R10 000 000 in terms of the ITA. Businesses generating a turnover exceeding R10 000 000 did not qualify for small business tax amnesty.

3. ‘In the case of a company or close corporation all the shares or members’ interest had to be held by natural persons throughout the 2006 year of assessment’\textsuperscript{39}.

The purpose of this condition was to prevent large businesses holding shares in small business obtaining tax amnesty via small businesses. (Also refer to paragraph 2.2 of Chapter 2)

4. ‘In the case of a trust, all beneficiaries of the trust had to be natural persons’\textsuperscript{40}.

This condition also prevented large business from benefiting from small business tax amnesty via trusts.

For the purposes of amnesty, the 2006 year of assessment was defined as the year of assessment which ended during the period of 12 months from 1 April 2005 to 31 March 2006\textsuperscript{41}.

\textsuperscript{38} Paragraph 2(b) of the Small Business Tax Amnesty and Amendment of Taxation Laws Act No 9, 2006

\textsuperscript{39} Paragraph 2(a)(ii) supra

\textsuperscript{40} Paragraph 2(ii) supra

\textsuperscript{41} Paragraph 1 supra
Small businesses which were unregistered for tax purposes at the end of the 2006 year of assessment and those which had undeclared income relating to period before 31 March 2006 benefited from the small business tax amnesty\textsuperscript{42}.

Applicants to tax amnesty for small business had to provide completed 2006 income tax returns and statement of asset and liabilities as at the end of 2006 year of assessment, together with their application forms. Application forms had to be submitted at any time during the period 1 August 2006 to 31 May 2007\textsuperscript{43}.

3.4 Amnesty Levy

The amnesty levy ranged from 2 to 5 percent of taxable income of the applicant for 2006 year of assessment\textsuperscript{44}. If the applicant had an assessed loss carried forward from 2005 year of assessment, the assessed loss was ignored for the purposes of calculating the 2006 taxable income\textsuperscript{45}. The amnesty levy was payable in lieu of normal tax in the 2006 year of assessment.

If the applicant earned employment income, business income and investment income (not part of carrying business) only business income was taken into account in calculating the amnesty levy\textsuperscript{46}.

In the Estimate of National Revenue by the National Treasury dated 11 February 2009, it was reported that small business amnesty tax amounting to R12 828 000 was collected in the 2007/8 tax year. In the 2008/9 tax year,

\textsuperscript{42} Explanatory Memorandum on the Small Business Tax Amnesty and Amendment of Taxation Laws Bill, 2006
\textsuperscript{43} Paragraph 4 of the Small Business Tax Amnesty and Amendment of Taxation Laws Act No 9, 2006
\textsuperscript{44} Paragraph 6(3) supra
\textsuperscript{45} Paragraph 6(4) supra
\textsuperscript{46} Paragraph 6(2) supra
R51 627 000 was collected\textsuperscript{47} It is estimated that R100 000 000 would be collected in the 2009/10\textsuperscript{48}. In 2007, 353 388 applications were received by SARS. (Refer to paragraph 3.6 of this Chapter)

3.5 Additional conditions

In addition to requirements discussed under taxpayers who qualified for small business tax amnesty above, applicants had to comply with the following conditions before they could benefit:

1. ‘The applicant had to pay the full amount of the tax amnesty levy within 12 months from the date of approval or a longer period as the Commissioner may allow’\textsuperscript{49}. If the applicant was unable to pay the full amount of the tax amnesty levy within the stipulated 12 months, an arrangement for payment could be entered into with a SARS office.

2. ‘The applicant had to make full disclosure of any information or amounts required in the application, income tax return for 2006 year of assessment and in the statement of assets and liabilities as at the end of the 2006 year of assessment. If upon the processing the application form it transpired that the applicant did not make full disclosure, the application would be declined’.

3. ‘Any estimates made by the applicant should not have been materially incorrect\textsuperscript{50}. Some of the small businesses did not keep accurate records partly because they were informal and not registered for tax. These

\textsuperscript{47} Page 166 of 2010 Budget Review.
\textsuperscript{48} Page 167 \textit{supra}.
\textsuperscript{49} Paragraph 7 of the Small Business Tax Amnesty and Amendment of Taxation Laws Act No 9, 2006
\textsuperscript{50} Paragraph 4(3) \textit{supra}
taxpayers were allowed to include estimates in their applications. However these estimates should not have been materially different compared to the actual figures.

4. ‘A taxpayer who was subject to an ongoing audit, investigation or any other enforcement action could not qualify for tax amnesty’. It is submitted that the reason for this condition is that the small business amnesty was not intended to absolve taxpayers from pending audits or investigations but was intended for taxpayers who wanted to regularise their tax affairs. It is submitted that businesses not registered with SARS and subsequently not paying their taxes would qualify for small business tax amnesty while those with pending audits would not.

The Financial Intelligence Centre Act requires tax advisors acting as intermediaries between taxpayers and South African Revenue Services to report suspicious transactions arising from information disclosed to them by taxpayers\(^{51}\). As part of the tax amnesty for small business process, an exemption notice for tax advisors was gazetted on 13 October 2006 in a special Government gazette no. 29299. This exemption effectively removed the possibility of prosecution of tax advisors, accountants and practitioners advising taxpayers to apply for tax amnesty\(^{52}\).

\(^{51}\) Paragraph 27 of Financial Intelligence Centre Act No 38 of 2001
\(^{52}\) Government Gazette No. 29299, dated 13 October 2006
3.6 Voluntary Disclosure Programme

Subsequent to the small business tax amnesty, the government has introduced a Voluntary Disclosure Programme (VDP). The VDP came into effect on 2 November 2010\(^{53}\). The purpose of the VDP is to provide an opportunity to all taxpayers who have defaulted on their tax affairs in the past to voluntarily disclose their defaults without being subjected to criminal prosecution, penalties, additional tax and interest. In contrast to small business tax amnesty that was available to small business only, the VDP is available to all businesses.

The opportunity to voluntarily disclose defaults will be available for the period from 5 November 2010 to 31 October 2011\(^{54}\). The VDP will be available to taxpayers who are not aware of a pending audit or investigation into their tax affairs\(^{55}\). It is submitted that a taxpayer whose audit or investigation has commenced but not yet communicated to the taxpayer will be considered as not being aware of pending audit or investigation.

A full and complete voluntary disclosure of a default that has potential application of a penalty or additional tax is required for a voluntary disclosure to be valid\(^{56}\). On acceptance of a valid voluntary disclosure, the Commissioner will not pursue criminal prosecution and will grant 100% relief of additional tax.

\(^{53}\) Voluntary Disclosure Programme and taxation laws second amendment Act No 8 of 2010.

\(^{54}\) Government Notice 1026 in Government Gazette 33731 of 5 November 2010

\(^{55}\) Section 3 of Voluntary Disclosure Programme and taxation laws second amendment Act No 8 of 2010.

\(^{56}\) Section 4 \textit{supra}
and penalties. The Commissioner will also grant 100% or 50% relief in respect of interest payable. The 50% relief in respect of interest payable is applicable where the taxpayer has been directed by the Commissioner to disclose. Non disclosure of material facts may lead to the Commissioner withdrawing the relief granted and pursuit of criminal prosecution. It is submitted that the National Treasury expects to increase revenue collection while providing amnesty against prosecution, penalties and additional tax.

3.7 Conclusion

In 2007, the South African Revenue Services (SARS) received 353 388 small business tax amnesty applications. Twenty two percent of the 353 388 was from new taxpayers. Of the 353 388 applications, 298 814 were for amnesty and 54 574 were for the waiver of additional tax, penalties and interest. The taxi industry contributed 24 174 applications. In the 2008/9 tax year, R51 627 000 small business tax amnesty levies were collected.

The fact that only 22% of the applications for small business tax amnesty came from new taxpayers is an indication that the small business tax amnesty was not as effective as intended. However it is submitted that this was a positive exercise because there was a slight increase in the South African taxpayer base despite the continuing tax compliance burden which is discussed in detail in the following chapter.

57 Section 6 (a) and (b) of Voluntary disclosure programme and taxation laws second amendment Act of 2010
58 Section 6 (c) supra
59 Section 8 supra
60 2007 Medium term budget policy statement.
61 Page 166 of 2010 Budget Review.
Given the low response to small business tax amnesty, SARS subsequently engaged in a heightened targeted enforcement drive. This targeted drive resulted in the issue of more than 200 arrest warrants, nearly 1000 summonses and the collection of more than R70 000 000 through its collection efforts.\(^{62}\)

The VDP provides an opportunity to those taxpayers who did not utilise the small business tax amnesty to voluntarily disclose their defaults without criminal prosecution or additional taxes. It is still early to assess the effectiveness of the VDP however it is submitted that the response from taxpayers will be low, similar to small business amnesty.

Due to the relative failure of the small business tax amnesty amongst other factors, the government has attempted to introduce a simplified tax regime. The turnover tax regime aimed at reducing the tax compliance burden has been introduced. (Refer to the next chapter for a detailed discussion of the turnover tax)

\(^{62}\) The Business Day, 31 October 2007
Chapter 4

Turnover tax

4.1 Introduction

South Africa’s small businesses face an unnecessarily high tax burden when one considers the tax compliance costs\(^{63}\).

It is submitted in the Foreign Investment Advisory Service (FIAS) report that it costs the average small business R1 478 to register, which is one reason why about 60% of them decide to stay ‘informal’\(^{64}\).

The research contained in the FIAS report was performed at the request of the National Treasury and the South African Revenue Service (SARS). It measures the time and cost burdens for small businesses in SA in paying four main taxes (corporate tax, provisional tax, value-added tax and employees’ tax), including registration for taxes, tax return preparation and filing, queries and objections, inspections and audits\(^{65}\).

The FIAS defined small business as including small and medium enterprises with a turnover not exceeding R14 000 000 for the purposes of their study\(^{66}\). It must be noted that although R14 000 000 is the turnover threshold for SBC, the study was intended to cover all small businesses including natural persons.

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\(^{63}\) Foreign Investment Advisory Service 2007 Annual Report, Page 25, Business Taxation paragraph.

\(^{64}\) Page 23 of FIAS report on South African Tax Compliance Burden for Small Business, August 2009

\(^{65}\) Foreign Investment Advisory Service 2007 Annual Report, Page 25, Business Taxation paragraph.

\(^{66}\) Page 3 of FIAS report on South African Tax Compliance Burden for Small Business, August 2009
The survey included 3429 tax practitioners from all the provinces and covered their work for clients with a turnover of up to R14 000 000, most of whom recommended the adoption of a new simplified tax regime for small businesses to reduce the compliance burden\textsuperscript{67}. Interestingly, tax professionals identified provisional tax as the ‘most burdensome’ tax for small businesses, although VAT was the most expensive and time-consuming\textsuperscript{68}.

The research found that on top of the R1 478 in registration costs, the average small business paid R7 030 in annual fees to a tax advisor for preparing, completing and submitting taxes\textsuperscript{69}. As a percentage of turnover, tax compliance costs range between 2.2% for businesses with a turnover of up to R300 000 a year and 0.1% for businesses with a turnover around R14 000 000 a year\textsuperscript{70}. Tax compliance costs therefore tend to be regressive, especially for businesses with a turnover under R1 000 000 a year. In addition, it costs small businesses an average of R36 343 for a range of related services, including accounting services\textsuperscript{71}.

It is submitted that the results of FIAS research on the compliance cost borne by the small businesses presented a compelling case for the government to introduce simplified tax legislation dedicated to small businesses.

The reality is that many small businesses are outside the income tax net either because they generate small profits or because of the inordinate compliance burden. Many were also historically marginalised. Government,
therefore, announced a small business amnesty in 2006 to encourage informal and other small businesses with a turnover of up to R10 000 000 a year to enter the tax system and regularise their tax affairs.

In addition to this outreach, SARS and National Treasury agreed to explore various options to reduce the tax compliance burden, especially for very small businesses, and to streamline the tax system for such businesses. It was therefore proposed in the 2008 Budget Review that an optional simplified tax system be implemented for businesses with a turnover up to R1 000 000 a year.

The turnover tax system came into operation on 1 March 2009\textsuperscript{72} and was introduced by the Government to encourage entrepreneurship and to create an enabling environment for small businesses to survive and grow. The turnover tax system provides for a single tax system that does away with the need to account for income tax, capital gains tax, secondary tax on companies and value added tax. The turnover tax system is optional and is available to sole proprietors, partnerships, close corporations, co-operatives and companies.

Any amount received by or accrued to or in favour of a registered micro business from the carrying on of a business in the Republic, other than investment income as defined in section 12E and remuneration as defined in the Fourth Schedule, is exempt from normal tax\textsuperscript{73}. Turnover tax is levied on a

\textsuperscript{72} Chapter 24.1 of Notes on South Africa Income Tax, Page 670

\textsuperscript{73} Section 10(1)(2J) of the Income Tax Act No. 58 of 1962.
person that is registered as a micro business during the year of assessment, in respect of its taxable turnover for that year of assessment\textsuperscript{74}.

The sixth schedule to the ITA defines a micro business as a natural person or a company where the qualifying turnover of that person does not exceed R1 000 000\textsuperscript{75}. If a micro business carries on business during the year of assessment for a period which is less than twelve months, the qualifying turnover is reduced proportionally taking into account the number of full months that it did not carry business during that year\textsuperscript{76}. A taxpayer whose taxable supplies in the period of 12 months does not exceed R1 000 000 is not liable to be registered for VAT\textsuperscript{77}. The micro business is therefore outside the VAT net.

\textbf{4.2 Anti-avoidance rule}

It is possible that businesses may try to take advantage of the turnover tax by splitting their large business into smaller components of businesses, each with a qualifying turnover of less than R1 000 000 (Income Splitting). In such instances, where these components are connected persons, the Commissioner will add together all the components for the purposes of applying the R1 000 000 limit\textsuperscript{78}. (Also refer to 2.3 dealing with SBC)

\textsuperscript{74} Section 48A of the Income Tax Act No. 58 of 1962.
\textsuperscript{75} Paragraph 2(1) of the Sixth Schedule to the Income Tax Act No. 58 of 1962
\textsuperscript{76} Paragraph 2(2) \textit{supra}
\textsuperscript{77} Section 23(1) (a) of the Value Added Tax Act No 89 of 1991
\textsuperscript{78} Section 12E(4)(a)(ii) of the Income Tax Act No. 58 of 1962
4.3 Persons excluded from the turnover tax

The following persons do not qualify as micro business and therefore cannot register for turnover tax79:

1. ‘A person holds shares or has any interest in the equity of another company other than shares described in paragraph 4 of the Sixth Schedule’.

2. ‘A natural person whose income from rendering of a professional service exceeds 20 per cent of his total receipts during the year of assessment’.

3. ‘A company whose investment income and income from rendering of a professional service collectively exceeds 20 percent of its total receipts during the year of assessment’.

In contrast to the SBC legislation which restricts income from rendering of personal service, turnover tax restricts income from rendering of professional service. The definitions of personal service and professional service are partly similar. The difference is that the definition of personal service restricts the number of employees to two whereas professional service does not restrict the number of employees. The effect of this provision is that if a company employs three or more employees its income from personal service can exceed 20% of its total receipts and still qualify for SBC legislation. However under turnover tax income from rendering professional service will always be restricted to 20% irrespective of the number of employees. SBC legislation is therefore more accessible than turnover tax in this respect.

79 Paragraph 3 of the Sixth Schedule to the Income Tax Act No. 58 of 1962
4. ‘A person who is a personal service provider or is a labour broker, as defined in the Fourth Schedule, other than a labour broker who has been issued with an exemption certificate’. The definition of personal service provider also excludes a company or trust that employs three or more full time employees. This means that if a company meets the definition of personal service provider but employs three or more full time employees, the company would qualify for turnover tax provided other requirements are met.

5. ‘A person who receives amounts from the disposal of immovable property used mainly for business purposes and any other assets of a capital nature other any financial instrument, in excess of R1 500 000 over a period of three years’. It is submitted that the intention of this provision is to subject such a taxpayer to capital gains tax which would not be possible under the turnover tax.

6. ‘A public benefit organisation and recreational club approved by the Commissioner in terms of section 30A of the ITA’. It is submitted that these entities already enjoy special tax treatment because they are exempt from tax.

7. ‘A person in a partnership where any of the partners is not a natural person’.

It is submitted in the Business Day report that up to the 4th of May 2010, just over 3 000 small businesses had applied for turnover tax. This is a

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significantly low number if considered against the 353 388 small businesses (refer to chapter 3.4 above) that applied for small business tax amnesty in 2007.

4.4 Calculation of turnover tax

The turnover tax is calculated by simply applying a tax rate to the taxable turnover. The applicable tax rates are fixed annually by Parliament\textsuperscript{83}. The taxable turnover consists of the turnover (excluding amounts of a capital nature) of the business with a few inclusions and exclusions (see paragraph 4.5 and 4.6 below).

Small businesses registered for turnover tax are taxed on the taxable turnover of the business without any allowable deductions. Small businesses will therefore be liable for tax even if losses are incurred. SARS submits that the registration of small businesses into turnover tax will save small businesses time and money, however this is not the case as turnover tax might save time but could cost small businesses due to higher taxes\textsuperscript{84}.

It should be noted that micro businesses at the higher end of the turnover range incur a higher tax burden. It is submitted that this is done to encourage micro businesses to maintain sufficient accounting records to migrate to the normal income tax system.

\textsuperscript{83} Section 48B of the Income Tax Act No 58 of 1962.
4.5 Inclusions in Taxable Turnover

Turnover tax is levied on taxable turnover. Taxable turnover is the total amount received in cash by a business for the year of assessment from carrying on business activities excluding amounts of a capital nature less any amounts refunded to any person by the registered micro business\textsuperscript{85}. The accrual system does not apply under the turnover tax system. Income accrued to the small business but not yet received in cash is not to be included in taxable turnover. The taxable turnover is to be reduced by any amounts refunded to any person by the registered micro business in respect goods or services supplied by the registered micro business with effect from 1 March 2011\textsuperscript{86}.

The following are to be included in taxable turnover\textsuperscript{87}.

1. ‘The turnover tax system includes 50\% of all receipts of a capital nature from the disposal of immovable property used for business purposes and any other asset used for business purposes’. One of the objectives of turnover tax system is to simplify the tax compliance process for small businesses. (Refer to paragraph 4.1 of this Chapter) A micro business registered for turnover tax is not subject to capital gains tax. This inclusion provisions brings into taxable turnover, proceeds from disposal of capital assets that would otherwise be subjected to capital gains tax. The micro business will however not be subject to the detailed intricate provisions of the Eighth Schedule to the ITA and this simplifies the compliance process.

\textsuperscript{85} Paragraph 5 of the Sixth Schedule to the Income Tax Act No. 58 of 1962
\textsuperscript{86} Paragraph 5 \textit{supra}
\textsuperscript{87} Paragraph 6 \textit{supra}
2. ‘The turnover tax system includes investment income as defined in section 12E other than dividends, in respect of a company’. The reason for the exclusion of dividends is that dividends are currently exempt from income tax in terms of 10(1)(k) of the ITA. In future, with the introduction of dividend withholding tax, dividends paid to non-resident companies will be subject to dividend withholding tax. It is therefore expected that dividends will in future be included in taxable turnover in order to tighten the revenue collection process.

3. ‘Where a micro business had claimed any allowances in terms of the ITA in the preceding year of assessment that are required to be included in the income of a taxpayer in the following year of assessment, the turnover tax system includes these allowances in the taxable turnover’. However these allowances are limited to the extent that they exceed the balance of any assessed loss it is prevented from carrying forward in terms of section 20 of the ITA. Examples of these allowances are provision for doubtful debt allowance in section 11(j) and the section 24C allowance on future expenditure. Both these allowances are required to be added back to taxable income in the subsequent year of assessment. This provision will fall away for years of assessment commencing on or after 1 March 2011. It is submitted that the assessed loss becomes available when the taxpayer deregisters from the turnover tax system and reverts to the normal tax system. (Refer to 4.15 for a discussion on assessed losses)
4.6 Partnerships

Partnerships are taxed on a flow-through basis in that the taxable income of the partnership will be taxed in the hands of each partner based on the profit sharing ratio according to the partnership agreement. It is important to look at the collective turnover of the partnership to ensure that only micro businesses access the turnover tax system. The qualifying turnover of a partnership as a whole must not exceed R1 000 000 for the year of assessment in order for each individual partner to qualify for turnover tax.88

4.7 Exclusions from Taxable Turnover

1. ‘Any amounts that are exempt from normal tax in terms of section 10(1)(y), 10(1)(zA), 10(1)(zG) and 10(1)(zH) of the ITA’. A government grant would not be included in the taxable turnover of the micro business.

2. ‘The turnover tax system excludes investment income as defined in section 12E of the ITA from taxable turnover, in respect of a natural person’. This relates to investment income received by sole proprietorships and partnerships. This investment income will be taxable in the hands of individual recipients. There are two main reasons for this exclusion. Firstly individuals are granted exemptions for dividends and interest income. The turnover tax system therefore allows for annual tax exemptions for interest and dividends that are currently granted to individuals. Secondly businesses operated by individuals are not distinct or separate legal entities from the same individuals who operate them.

88 Paragraph 3(g)((iii) of the Sixth Schedule to Income Tax Act No 56 of 1962
89 Paragraph 7 supra
3. ‘The turnover tax system excludes from taxable turnover, any amount received by that registered micro business, where that amount accrued to it prior to its registration as a micro business and that amount accrued was subject to tax in terms of the ITA’. If this amount received was to be included in turnover tax, this would amount to double taxation which is not intended by the introduction of turnover tax.

4. ‘Any amount received by a registered micro business from any person by way of a refund in respect of goods or services supplied by that person to that registered micro business’.

4.8 Capital Gains Tax (CGT)

A taxpayer that chooses turnover tax is specifically exempt from capital gains tax. However the turnover tax system requires inclusion of 50 percent of the proceeds from the disposal of immovable property to the extent that it was used for business purposes and 50 percent of receipts of a capital nature from the sale of any other assets used mainly in the business in the taxable turnover. (Refer to paragraph 4.5 of this Chapter)

A typical small business does not normally have substantial capital assets and as such the small business is not subjected to the Eighth Schedule of the ITA. The Inclusion of capital receipts is simplified as noted above.

In order to avoid abuse of this simplified CGT provision in the turnover tax, a person is disqualified from turnover tax if the receipts from the disposal of

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capital assets exceed the amount of R1 500 000 in a three year period that covers the year of assessment during which the capital proceeds were received and the immediately preceding two years of assessment\(^{93}\).

### 4.9 Secondary Tax on Companies (STC)

A taxpayer that chooses turnover tax becomes exempt from secondary tax on companies to the extent that their dividend distributions do not exceed R200 000 a year\(^ {94}\). Any excess is subject to secondary tax on companies.

### 4.10 Payroll Taxes

A taxpayer that chooses turnover tax is not specifically exempt from employee’s tax, unemployment insurance fund contributions and the Skills Development Levy. However businesses whose employees are exempt from employee’s tax are not required to register for employee’s tax. Businesses with payroll of up to R500 000 a year are not required to register for Skills Development Levy but are required to register for Unemployment Insurance Fund. The taxpayers opting for turnover tax however will have to register for PAYE, UIF and SDL anyway in order to remit UIF payments.

### 4.11 Value Added Tax (VAT)

The compulsory VAT registration threshold is currently at a turnover of R1 000 000. The turnover limit for registration as a micro business is also R1 000 000. (Refer to paragraph 4.1 above) If a person is deregistered from being a micro business because turnover has exceeded the R1 000 000 limit,

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\(^{93}\) Paragraph 3(e) *supra*.

\(^{94}\) Section 64B(5)(l) of the Income Tax Act No 58 of 1962
that person shall become a VAT vendor from the date that deregistration takes effect.\textsuperscript{95}

A taxpayer registered for the turnover tax must notify SARS within 21 days of its “qualifying turnover” exceeding R1 000 000 for the “year of assessment”, or where there are reasonable grounds to believe that the amount will be exceeded. The business will then be deregistered from the turnover tax, unless SARS is of the view that the excess will be small and temporary.\textsuperscript{96}

When a vendor deregisters from the VAT system, the vendor is required to pay exit VAT on the lesser of cost or market value of asset held before deregistration.\textsuperscript{97} VAT vendors that apply to de-register from the VAT system because they are to register as micro businesses, are allowed to pay the exit VAT over a period of six months.\textsuperscript{98}

Where a vendor deregisters from the VAT system in order to register for turnover tax, a further relief is granted by way of a deduction of R100 000 from the consideration determined under section 10(5)(a) of the VAT Act.\textsuperscript{99} If the consideration determined is less than R100 000, the consideration will be deemed to be NIL. This is an equivalent of R12 281 in the exit VAT that will be payable. On the other hand, if a person was deregistered as a VAT vendor in order to register for the turnover tax and subsequently re-registers for VAT, the value of assets in respect of which VAT input credits can be claimed on re-registration will be reduced by R100 000.

\textsuperscript{95} Section 23(9) of the VAT Act No 89 of 1991
\textsuperscript{96} Paragraph 10 of the Sixth Schedule to the Income Tax Act No. 58 of 1962
\textsuperscript{97} Section 8(2) and 10(5) of the VAT Act No 89 of 1991
\textsuperscript{98} Section 8(2C) supra
\textsuperscript{99} Section 10(5A) supra
\textsuperscript{100} Section 10(5A) supra
If a micro business deregisters from turnover tax and registers as a VAT vendor, that business will have to account for VAT on amounts received after becoming a vendor (even if the supply was made when the business was still a micro business) 101. This requirement is in place because those amounts would not have been included in the taxable turnover of the micro business (Taxable turnover excludes amounts accrued but not actually received by the micro business102)

The above is a transitional arrangement provided for by the VAT Act in respect of micro businesses deregistering from turnover tax and becoming VAT vendors. This arrangement seeks to levy VAT on receipts received post deregistration but relating to supplies made whilst the vendor was still registered for turnover tax.

Where a person is deregistered from turnover tax and registers as a vendor, any value added tax paid on expenditure it incurred while it was a registered micro business may not be deducted by that vendor as input tax103.

Small businesses are affected by the impact of BEE requirements that they are compelled to meet if they want to do business with private and bigger corporations, governmental and quasi-governmental bodies. In practice, small businesses are required to register for VAT when dealing with private and bigger corporations, governmental and quasi-governmental bodies. It is

101 Section 78(A) of the Value Added Tax Act No 89 of 1991.
102 Paragraph 5 to the Sixth Schedule of the Income Tax Act No. 58 of 1962
submitted that these requirements are hardly appropriate for small businesses.

4.12 Payments of turnover tax

Under the current normal tax system, the Fourth Schedule to the ITA requires taxpayers to submit first and second provisional tax payments. The third payment is optional for taxpayers who want to top up their payments in order to avoid interest on under-payment\textsuperscript{104}.

A micro business is not subject to provisional tax. In terms of the turnover tax system, registered micro businesses are required to submit two interim payments\textsuperscript{105}.

The first interim payment must be based on an estimate of the taxable turnover of the small business for the year of assessment and amounts to 50\% of the turnover tax payable on the estimate\textsuperscript{106}. This estimate must not be less than the taxable turnover for the previous year of assessment unless SARS accepts a lower estimate\textsuperscript{107}. The payment must be submitted to SARS within six months from the beginning of the year of assessment.

The second interim payment will also be based on an estimate of the taxable turnover for the year of assessment and a calculation of the turnover tax payable on the estimate\textsuperscript{108}. The payment, equal to the amount of turnover tax payable on the estimate, less the first interim payment, must be submitted to SARS on or before the last day of the year of assessment.

\textsuperscript{104} Paragraph 23A(1) of the Fourth Schedule to the Income Tax Act No 58 of 1962
\textsuperscript{105} Paragraph 11 of the Sixth Schedule to the Income Tax Act No 58 of 1962
\textsuperscript{106} Paragraph 11(1) \textit{supra}
\textsuperscript{107} Paragraph 11(2) \textit{supra}
\textsuperscript{108} Paragraph 11(4) \textit{supra}
Where the estimate of the taxable turnover for the second interim payment is less than 80 per cent of the actual taxable turnover for the year of assessment, additional tax, equal to 20 percent of the difference between the tax payable on 80 per cent of the actual taxable turnover for the year of assessment and the tax payable on that estimate, will be charged\textsuperscript{109}. The additional tax may be waived where the taxpayer can satisfy the Commissioner of SARS that he had no intention to evade or postpone the payment of provisional tax\textsuperscript{110}. The decision by the Commissioner of SARS whether to waive the penalty or not is subject to objection and appeal\textsuperscript{111}.

In addition to the above additional tax, the Commissioner for SARS may impose administrative penalties in respect of non-submission of the estimate of turnover tax\textsuperscript{112}. These administrative penalties range from R250 to R16 000 per month.

Where the taxpayer fails to make a payment that is due or where SARS is not satisfied with the amount of the interim payment that was made, SARS may estimate the interim payments that are due and issue an assessment of the amount of turnover tax payable\textsuperscript{113}.

A final annual tax return with the actual amount of taxable turnover for the year of assessment must be submitted to SARS. A further payment will be

\textsuperscript{109} Paragraph 11(6) of the Sixth Schedule to the Income Tax Act No 58 of 1962
\textsuperscript{110} Paragraph 11(7) supra
\textsuperscript{111} Paragraph 11(8) supra
\textsuperscript{112} Section 75B of Income Tax Act No 58 of 1962
\textsuperscript{113} Paragraph 12(1) of the Sixth Schedule to the Income Tax Act No 58 of 1962
necessary where the assessed turnover tax on the actual taxable turnover for the year of assessment exceeds the interim payments that were made\textsuperscript{114}.

Where the taxpayer fails to submit the annual tax return, or where SARS is not satisfied with the final return submitted, SARS may estimate the taxable turnover for the year of assessment and issue an assessment for turnover due on the estimate, less the interim payments received\textsuperscript{115}. Interest, at the rate prescribed by SARS from time to time is charged on all late payments and underpayments.

4.13 De-registration from turnover tax

The deregistration of small business from turnover tax can be classified in to two categories i.e. voluntary deregistration and compulsory deregistration

Voluntary deregistration\textsuperscript{116}

It can happen that the turnover tax system is no longer beneficial to the small business. This can happen where the small business finds itself in the assessed loss situation. A taxpayer in the assessed loss position is better off in the normal tax system rather than turnover tax in terms of tax burden. This is because this taxpayer is not able to utilise the assessed loss in the turnover tax system. The small business has the option to de-register from the turnover tax system. The small business can however only de-register after it has been in the turnover tax system for 3 years or more\textsuperscript{117}. The business which de-registers from the turnover tax system is not allowed to re-register for a period

\textsuperscript{114} Paragraph 11 of the Sixth Schedule to the Income Tax Act No 58 of 1962
\textsuperscript{115} Paragraph 12 supra
\textsuperscript{116} Paragraph 9 supra
\textsuperscript{117} Paragraph 9(3) supra
of three years. It is submitted that this requirement does not simplify the tax compliance process for small businesses. However it does prevent indiscriminate changes to take unintended advantage of the system.

Compulsory deregistration\textsuperscript{118}

This occurs where the small business no longer qualifies for turnover tax. An example is where the qualifying turnover of the small business from carrying business activities exceeds R1 000 000 and the small business cannot prove to the satisfaction of SARS that the excess turnover will be small and temporary. The small business is required to notify SARS within 21 days from the date on which it no longer qualifies for turnover tax\textsuperscript{119}. It should be noted that this further complicates the tax compliance process for small businesses.

4.14 Connected persons

If the Commissioner is satisfied that a connected person carries on business that should be regarded as forming part of business activities carried on by a micro business, the total amounts received by a connected person shall be included in the qualifying turnover of that micro business\textsuperscript{120}.

4.15 Key Considerations

As mentioned above, the turnover tax system is an option available to a small business taxpayer. In other words, the small business taxpayer can choose whether to register for the turnover tax or to remain in the current tax system. The following are some of the factors to be considered by a small business taxpayer when choosing whether or not to use the turnover tax system:

\textsuperscript{118} Paragraph 10 of the Sixth Schedule to the Income Tax Act No 58 of 1962
\textsuperscript{119} Paragraph 10(1) \textit{supra}
\textsuperscript{120} Paragraph 13 \textit{supra}.
1. Assessed loss vs. taxable income position.

‘Section 20(1) of the ITA provides that in determining the taxable income derived by any person from carrying on any trade, there shall be set off against the income so derived by such person, any balance of assessed loss incurred by that taxpayer in any previous year’.

If the micro business is in a large assessed loss position it may not be a desirable option to choose turnover tax system over the normal tax system. The taxpayer should rather remain in the current tax system. The reason for this is that section 20(1) of the ITA provides for set off of assessed loss in determination of taxable income and not taxable turnover.

The benefit of the assessed loss is therefore lost under the turnover tax system. It is submitted that the assessed loss becomes available when the taxpayer deregisters from the turnover tax system and reverts to the normal tax system. The micro business will however be required to have carried on trade during the period it is registered for turnover tax in order for the assessed loss to be available when it reverts to the normal tax system. The carrying on of trade requirement is not applicable to individuals and trusts\textsuperscript{121}. The position of a company is not favourable.

If the business is liable for less tax after taking expenses into account, then it can register or remain registered in the current income tax system instead of being registered for the turnover tax.

\textsuperscript{121} Section 20(2A) of the Income Tax Act No 58 of 1962
It is submitted in the Moneyweb-tax article that taxpayers who are in a taxable income position do not necessarily earn a tax saving by switching to turnover tax system\textsuperscript{122}. This can be illustrated with a small retail business generating a profit amounting to 20% of turnover.

The turnover tax compares to income tax as follows: (personal tax rates – 2010 year of assessment)

| Turnover | Profit | Turnover tax | Income tax | (Saving) 
Dissaving |
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<td>R750 000</td>
<td>R150 000</td>
<td>R20 500</td>
<td>R18 504</td>
<td>R1 996</td>
</tr>
<tr>
<td>R1 000 000</td>
<td>R200 000</td>
<td>R38 000</td>
<td>R31 004</td>
<td>R6 996</td>
</tr>
</tbody>
</table>

In most instances (in the above table), the taxpayer is in a taxable income position but turnover tax exceeds income tax.

It is submitted that the small businesses do their calculations carefully before they opt for the turnover tax system.

2. Record keeping

If the current tax system requires large volumes of records to be kept and this becomes more and more burdensome, it is best to change to the

\textsuperscript{122} Moneyweb-tax, 24 March 2008
turnover tax system. The turnover tax system does not require voluminous records such as proof of expenditure to be maintained. This is because the taxpayer does not claim any expenditure and is therefore not required to keep purchase invoices as proof of expenditure incurred.

The small business is required to retain a record of the following\textsuperscript{123}:

- Amounts received during the year,
- Dividends declared during the year of assessment,
- Each asset at the end of the year of assessment with a cost price of more than R10 000, and
- Each liability at the end of a year of assessment exceeding R10 000.

3. Compliance costs

The current tax system has more compliance requirements than the turnover tax system. This translates into higher compliance cost compared to the turnover tax. Under the turnover tax system, qualifying small businesses will only need to submit two interim returns and a final return for assessment. This represents a huge saving in time and costs relating to the current provisional tax, income tax and VAT systems, which requires businesses to submit an average of 10 returns\textsuperscript{124}. One of the costs that are likely to be incurred in the current tax system is that of hiring a tax practitioner. It is submitted that although SARS is available at no cost, small businesses tend to source tax practitioners for assistance because of trust. The turnover tax system is simpler and may not necessary require the services of a tax practitioner.

\textsuperscript{123} Paragraph 14 of the Sixth Schedule to the Income Tax Act No 58 of 1962
\textsuperscript{124} SouthAfrica.info, 6 March 2009
4. VAT registration

It is common practice that large businesses and government departments prefer to deal with businesses registered for Value Added Tax. VAT registration and compliance thereof may indicate a measure of formality and compliance culture to some of these businesses. As indicated above a business registered for turnover tax is not entitled to register for VAT. A small business taxpayer will therefore have to consider its clients in terms of whether they deal with businesses not registered for VAT in deciding on whether to switch from the current tax system to turnover tax.

4.16 Conclusion

The turnover tax system has simplified the tax compliance process in that the small business will now be responsible for payment of one turnover tax and not VAT and STC. However the turnover tax has its own challenges. The turnover tax system might save time and money spent on compliance activities but it is going to cost small businesses due to higher taxes, especially for the small businesses who are making losses (refer 4.4).

Turnover tax is less accessible compared to SBC in that income from rendering professional service is always restricted to 20% irrespective of the number of full time employee employed. (Refer to 4.3 (3) above)

Given that the turnover tax was first implemented on 1 March 2009, very limited information has been reported on its effectiveness. To date, just over 3 000 small businesses have applied for turnover tax system (Refer 4.3 above). However this is expected to improve with time given the simple nature of turnover tax system.
Venture Capital Incentive for small business legislation aimed at facilitating access to finance for small businesses in high tech industries is discussed in the following chapter.
Chapter 5

Venture Capital Incentive for Small Business

5.1 Introduction

Access to finance is one of the major challenges to the economic growth of small businesses. This is particularly the case in the mining exploration, high technology and related sectors. The Minister of Finance acknowledged that small and medium sized entrepreneurial companies in high technology and junior mining exploration companies required support in obtaining better access to equity finance\(^\text{125}\). The government has implemented a tax incentive for investors in mining exploration and related industries, through a Venture Capital Company (VCC) regime\(^\text{126}\).

The VCC is intended to be a marketing vehicle that will attract retail investors by bringing together small investors and concentrating investment expertise in favour of the small business sector. Investors in the form of individuals and listed companies have been able to claim income tax deductions in respect of the expenditure incurred in the acquisition of VCC shares as from 1 July 2009.

Under normal circumstances if a taxpayer acquires shares in a company, the taxpayer is not allowed to claim a deduction for tax purposes for the expenditure incurred in acquiring the shares as such expenditure is regarded as being of a capital nature\(^\text{127}\). However section 12J of the ITA provides for deductions in respect of expenditure incurred by a natural person, a listed

\(^{125}\) The 2008 Budget Speech.

\(^{126}\) Section 12J of the Income Tax Act No 58 of 1962

\(^{127}\) Section 11(a) supra
company or a controlled group company in relation to a listed company, in acquisition of venture capital company shares.

In essence the VCC regime does not have a direct tax implication for small businesses because the income tax deduction is available to investors in small businesses via the approved Venture Capital Company. The small business company benefits indirectly by having access to equity finance that would otherwise not have been available.

The VCC regime will end on 12 June 2021 at which time the regime will be evaluated for its effectiveness. A decision will then be made as to whether is should be continued\(^\text{128}\).

5.2 The operation of the Venture Capital Company

The qualifying investors will invest in an approved VCC in exchange for investor certificates. The investors will then be able to claim tax deductions in respect of their investments in an approved VCC.

The qualifying investors are natural persons and listed companies. Unlisted companies are not permitted as qualifying investees because the government does not want individuals to route their investment through companies and thereby overcome the R750 000 cap on deduction (discussed below).

In terms of section 12J of the ITA, individuals will qualify for a 100% deduction of the amount invested in an approved VCC in exchange for newly issued shares only. The deduction allowed to individuals will be capped at R750 000

\(^{128}\) Section 12J(11) of the Income Tax Act No 58 of 1962
for any year of assessment in which the investment is made. The deduction is further limited to a lifetime deduction of R2 250 000 for individuals\textsuperscript{129}.

The approved VCC will in turn, invest in qualifying investee companies in exchange for qualifying shares. The qualifying investee companies are small and medium companies in the high tech sector and junior mining companies\textsuperscript{130}.

A listed company qualifies for 100\% deduction of amounts invested in a VCC. However this 100\% deduction is only available to the extent that the listed company’s investment, together with the investments of its group companies, does not exceed 40\% of the equity shares of the VCC. A listed company is permitted to invest in more than 40\% of the shares of the VCC but it will not get a deduction in excess of the 40\%\textsuperscript{131}.

5.3 Who is a qualifying investee?

An entity that meets all the following requirements will qualify as an investee company\textsuperscript{132}:

1. ‘The company must be a South African resident’.

2. ‘The company must be an unlisted company or a junior mining company’. A junior mining company may however be listed on the Alternative Exchange Division of the Johannesburg Stock Exchange.

3. ‘The company’s tax affairs must be in order’. This must be evidenced by a tax clearance certificate issued by SARS. SARS will

\textsuperscript{129} Section 12J(3) of the Income Tax Act No 58 of 1962
\textsuperscript{130} Section 12J(1) \textit{supra}
\textsuperscript{131} Section 12J(3)(b) \textit{supra}
\textsuperscript{132} Section 12J(1) \textit{supra}
not issue a tax clearance certificate if the taxpayer has an outstanding tax return or owes taxes.

4. ‘The company must not be a controlled group company in relation to a group of companies contemplated in paragraph (d)(1) of the definition of connected person in section 1 of the ITA’.

5. ‘The sum of the investment income derived by the company must not exceed 20% of its gross income for the year of assessment’.
The reason for this provision is that the VCC regime as small business initiatives is intended for creation of employment and economic growth in general. Investment income is generally passive in nature and does not lead to creation of employment and economic growth. (Refer to a discussion of turnover tax above)

6. ‘The company must not carry on any of the following impermissible trades’:

6.1 Dealing in or renting immovable property

6.2 Financial service activities

6.3 Provision of financial and advisory services

6.4 Operating a casino’s

6.5 Manufacturing, buying or selling liquor

6.6 Trading as a franchise

6.7 Any trade carried on mainly outside the Republic.

A VCC can be regarded as an investment manager that invests the funding provided by the venture capitalist (individuals and listed companies) into new companies that are unable to raise equity or loan finance. As an investment manager, the VCC will probably charge a management fee to cover the costs
of managing the capital investment by venture capitalists. The VCC will in addition earn interest which is essentially for providing expertise needed to successfully manage the venture capitalists’ investment.

The minimum investment required for a venture capital company that invests in a small and medium-sized entrepreneurial company is R50 000 000 and the minimum investment required for a venture capital company that invests in a junior mining company is R250 000 000. However these investments may not be made in a single small or medium sized company as the ITA requires venture capital company’s investments to be varied and accordingly sets out specific requirements for the venture capital company’s investment portfolio. As the purpose of section 12J of the ITA is to encourage the investment of the venture capital companies in small enterprises, these requirements ensure that venture capital companies invest in small start up companies.

5.4 Conclusion

Generally companies are not allowed deduction of expenditure actually incurred in the acquisition of shares unless they are share-dealers. It is submitted that the venture capital incentive legislation will be effective given that it allows for deduction of expenditure actually incurred in the acquisition of shares.

Venture capital incentive for small business will facilitate access to finance by small businesses in mining and other high tech industries. In time we will be able to assess the effectiveness of venture capital incentive legislation.
Chapter 6

Conclusion

The Minister of Finance has during the period 1994 to date, introduced a number of small business initiatives. The small business tax initiatives considered in this study included SBC legislation (s12E) (chapter 2), small business tax amnesty (chapter 3), turnover tax (chapter 4), venture capital incentive for small businesses (chapter 5).

The SBC has lowered the tax burden for some small businesses because of its low tax rates. (Chapter 2.4) The accelerated tax allowances applicable in the SBC legislation have contributed to an improved cash slow position for small businesses. (Chapter 2.4) The SBC legislation has improved the compliance culture of some small businesses and this achieves the objectives of both SARS and the National Treasury.

The small business tax amnesty has managed to bring some informal small businesses into the tax system because 353 388 applications were processed by SARS in 2007. (Chapter 3.6) It is submitted that this has eliminated the risk of non-compliance for some small businesses. This has increased the taxpayer base for SARS which is of benefit to the National Treasury. The amnesty levy collected by SARS also improved the revenue collected by the National Treasury. (Chapter 3.4) The VDP has recently been introduced to provide a further opportunity to all business to voluntarily disclose their previous defaults. (Chapter 3.6)

The turnover tax system has reduced the tax compliance burden for small businesses in that the small business has an option to file one tax return for
turnover tax only, but does not eliminate the necessity for employees’ tax returns. (Chapter 4.10) To date the interest in the turnover tax system has been very low represented by just over 3 000 applications. (Chapter 4.3) The major downfall for turnover tax system on small businesses has been the levying of tax on the turnover of the business, meaning that that businesses will have to pay taxes even if they are incurring losses. (Chapter 4.4) It is submitted that this benefits SARS and the National Treasury because their revenue continues to improve.

Venture capital incentive for small business is an effective piece of legislation in that it facilitates access to finance by small businesses in mining and other high tech industries.

It is submitted that given the challenges of small business tax legislation discussed above, the government still has a lot to do in order to simplify the tax process for small businesses and facilitate the economic activity in the small business sector. One action the government can take is to modify the small business tax legislation such that it is available to all small businesses irrespective of their nature.
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