

20 September 2013

Judge D. Davis and Prof. M. Lester
Davis Tax Review Committee

BY E-MAIL: vpillay@sars.gov.za; taxcom@sars.gov.za

Dear Judge Davis and Prof Lester

RE: CALL FOR COMMENT: IMPACT OF TAX ON SMALL BUSINESSES GROWTH IN SOUTH AFRICA

Thank you for the opportunity to contribute commentary and assist in developing the debate on the taxation of small businesses and their tax compliance costs.

Set out below, is the consolidated responses to the three questions posed during the meeting held on 20 August 2013 to discuss the impact of the tax system on small businesses. These responses were developed from both an internal review as well as from consultations with stakeholders and industry. The commentary reflects the collective view of stakeholders and industry role players consulted with.

1 WHAT SHOULD THE DEFINITION OF “SMALL BUSINESS” ACUTALLY BE?

No single consistent definition of “small business” is contained in any of the tax statutes administered by SARS. Furthermore, determining whether a business qualifies for the small business tax concessions that are available in South Africa requires a business to review each tax statute and the corresponding criteria to qualify as a small business. Although the reasons for these different definitions are understandable, it is submitted that they do complicate compliance considerably and this ultimately leads to increased compliance costs.

Overall, it appears that turnover is arguably the dominant qualifying criterion used in determining whether a business qualifies for a small business tax concession, because the majority of the small business tax concessions use turnover as their primary criterion for qualification. It is therefore suggested that a small business should be defined and classified according to its turnover limit.

The definition of an SBC could be used as the basis for the “small business” definition as it utilizes turnover as one of its criterion for qualification. It is therefore encouraging that the turnover limit for the Small Business Corporation (SBC) regime was increased to R20 million for the 2013/14 year of assessment. Despite this increase it is suggested that this limit be aligned

to the BEE Codes of Good Practice on Broad-Based Black Economic Empowerment which uses a R50 million limit for “Qualifying Small Enterprises”. Thus a small business could be defined using the current SBC definition but with the turnover limit being R50 million.

However, the SBC definition requires that not more than 20 per cent of the total receipts and accruals consist collectively of investment income and personal service income. Although the reasoning for this is understood, it still our view that these service industry businesses that currently don’t qualify for the SBC regime can play a role along with other small businesses in taking over some of the functions required of the state including, among others, the contribution to the economic wealth of this country through job creation - should they qualify for SBC tax regime, they could grow faster and thus employ more people sooner. Small businesses are critical players that can assist the Government with its aim of creating 5 million jobs in the next 10 years as stipulated in its “New Growth Path”.

Thus we suggest that a **small business** be defined using the definition of the "Small Business Corporation" as a basis but the current definition of SBC should amended to allow for a turnover limit of R50 million and the definition should also be extended to cover "personal services" as well; perhaps it could be limited to instances where a small business operation is conducted with at least one non-connected employee. Furthermore, the small business definition should include all forms of business types – that is, it should not be limited to companies and close corporations.

A **micro business** should be defined as any business with a turnover of a R1 million or less and the service businesses should once again be included in this definition. A lawyer/accountant, (small practice) earning the same that a mechanic/hairdresser is earning should be entitled to pay tax on the same basis as both have the capability of creating additional jobs which is key objective for the government of South Africa.

These definitions may appear to be over simplified, but drastic measures are needed if the South African government is serious about reaching its employment creation targets in 2022. These simplified definitions are clear and easy to understand, allowing for easy interpretation by a small business and also reducing the need for costly external assistance. This in turn will also help reduce the compliance burden faced by small businesses.

2 WHAT TAX TABLE SHOULD BE USED TO TAX THESE SMALL BUSINESSES?

The current tax tables appear to be sufficient to encourage entrepreneurs to start their own businesses. To further encourage entrepreneurship, the following tax rates could be considered:

R 0 - 250 000 taxable income taxed @ 0%

R 250 000 to R 500 000 taxable income taxed @ 7%

R 500 000 to R 750 000 taxable income taxed @ 14 %

R 750 000 to R 1000 000 taxable income taxed @ 21 %

Any amount over R1 000 000 taxable income taxed at 28%

These tables need to be adjusted on yearly basis to take into account inflation.

3 WHAT INCENTIVES AND ALLOWANCES SHOULD BE INTRODUCED TO ASSIST SMALL BUSINESSES?

Before the tax incentives are discussed, it must be stated that in order to ultimately assist small businesses with their administrative and compliance cost burden, the tax treatment and the accounting treatment for small businesses should, as far as possible, be aligned.

Operational simplicity should also be achieved. Small businesses cannot afford to spend a whole day completing forms and trying to understand complex legislation. Submission of forms and changes to legislation should also be kept to a minimum. Small businesses with a lower net profits should only be required to submit very simple tax returns, some commentators have suggested the possibility of them not being required to submit a tax return subject to some confirmation from a registered auditor.

On the tax incentive side, it is suggested that the SBC regime be retained taking the above considerations into account as it appears to be received favourably by small business as they have indicated that this incentive assists them in running/expanding their businesses and/or employing more staff.

Before recommending that the turnover tax should be scrapped (and these businesses merely be incorporated into the SBC regime) we suggest thorough empirical research be done to determine the effectiveness of this concession as it has failed to capture the informal market for which it was originally intended and it is also not as simple as it was originally intended.

Overall, with the primary objective – job creation – in mind, we suggest that future tax incentives focus on this objective. The proposed introduction of the Employment Tax Incentive for young and inexperienced workers is thus welcome and will also assist and encourage small businesses to employ these workers. To further encourage employment, a company tax rebate

could be considered. A company would effectively get a tax rebate based on the number of employees that it employs. SARS would be able to check the details of the rebate against the PAYE records of the company.

The rebate could be structured as follows:

<u>Employees employed</u>	<u>Rebate</u>
10 or less	R3 500
11 – 50	R5 000
More than 50	R7 500

Currently, the immediate change that would assist most small businesses is the streamlining of the VAT registration process and allowing all small businesses to register for VAT on the payment basis. The current system puts the small business under severe cash flow pressure and in certain cases leads to the closure of many small businesses.

Alternatives or further suggestions to assist small businesses would be to:

- Allow additional tax incentives during the start-up phase - giving small businesses the opportunity to thrive and succeed in the most critical phase in order to improve the chance of their ultimate survival;
- Increase the SDL threshold to at least R1 million;
- Increase the VAT threshold to at least R2 Million;
- Allow a small business to be covered under the Workmen’s Compensation Act without contribution if the wage bill is under R1 million;
- Increase the amount of taxable income from R1 million to R2 million for determining whether the second provisional tax return is underestimated or not;
- Keep changes to tax law and operational compliance obligations to a minimum.
- Use information already available by eliminating duplicate reporting obligations to various Government departments (SARS, CIPC and StatsSA) and automate the transmission of this information. The aim is to introduce a “one-stop-shop” sign in for government departments such which would reduce the time and costs of dealing with these government departments;
- Improve communication with small businesses and their tax practitioners as this will assist in reducing a key barrier to high tax compliance costs;
- Institute taxation as a subject in all High Schools in South Africa so that by the time the individuals leave school they understand the concept of taxation, the importance of

paying taxation and how to calculate tax for themselves as an individual earning a salary or as a small business owner;

- Provide complimentary workshops (by SARS or tax practitioners) for small businesses in order to train them in being tax compliant and to understand the more complex matters/procedures of taxation.

4 CONCLUDING REMARKS

Quote from a small business owner:

"I feel that the art of entrepreneurship is being oppressed by red tape and administration. This makes it very difficult for small business to have a competitive edge. I counted and just in my business I need to submit on a yearly basis round about 45 statutory documents and forms. For small business owner that is not trained and competent in the administration of a business this is a huge amount of work that needs to be correctly submitted to the various stake holders with severe penalties and interest imposed if there is no compliance on their regulation".

The primary criteria for taxing small businesses is "simplification". Complicated tax systems risk high evasion, corruption and ultimately less investment in South Africa. The time available for tax compliance within small businesses is limited and currently it requires an excessive amount of time either by the owner of the small business or by a tax practitioner explaining to the small business owner what is required to be tax compliant. This implies that anti-avoidance rules should be relaxed, exclusion lists should be reduced, definitions should be simplified and more training (for small businesses and SARS officials) should be provided to make compliance for these businesses less complicated. Risk assessment tools (such as small business industry benchmarks and third party data matching technology) could be used to detect non-compliance and SARS resources should be used for these purposes to prevent erosion of the tax base.

It is suggested that all small business initiatives (and perhaps even training) be centralised so that small businesses know where to go as a starting point for assistance – of whatever nature, be it tax, financial or business related. Having a myriad of different institutions offering assistance and training just complicates matters even further for small businesses, so unifying this assistance and having SARS act as the facilitator to small business growth can only bode well in the endeavour to strengthen the business culture in South Africa. Creating a database of private and public small business donors, advisors, trainers and financial service providers will create a network of opportunities for small businesses that

currently is non-existent or decentralised. This integrated approach to small business assistance should give rise to benefits that will outweigh the potential costs involved as first hand access to these businesses and their needs should be forthcoming.

As mentioned above, tax incentives and allowances for small businesses should be limited but those that are available should be effective. At the present point in time, the biggest single change to make life easier for small businesses, both administratively and from a cash flow perspective would be to allow the cash basis for VAT reporting (linking accounting and tax treatment).

In order to increase the compliance of small businesses, an effort must be made to improve the confidence of the taxpayer in the governance surrounding the budgeting and spending of the collected revenue.

SAIT is committed to further thought and research on this matter and in this regard, SAIT representatives will be visiting the UK Office of Tax Simplification in October to evaluate any progress that they have made on these matters. SAIT representatives will also be meeting with Professor Chris Evans from the University of New South Wales in October. Prof. Evans is part of a team of academics working with the Australian Institute of Chartered Accountants and its members to identify key factors underpinning the tax system complexity and it will also measure the costs that complexity imposes upon taxpayers, develop complexity indices that can test new policy measures and monitor improvements to the system. A similar team should be established in South Africa to undertake similar assignments and to review the results from the Australian research from a South African perspective.

Many of the points we have raised will obviously require further clarification and analysis and we remain available should you require further assistance in this regard.

Yours sincerely,

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