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The South African Revenue Service

Lehae La SARS

299 Bronkhorst Street

PRETORIA

8000

BY EMAIL: policycomments@sars.gov.za

RE: DRAFT TAX GUIDE FOR MICRO BUSINESSES 2015/16

Provided below are SAIT's comments relating to the Draft Tax Guide for Micro Businesses 2015/16.

The comments are presented in the order of the paragraphs used in the Draft Guide. When reference is made to the 'Draft Tax Guide for Micro Businesses' we used the abbreviation 'Draft Guide'. References to a section will be to a section in the Income Tax Act, unless stated otherwise.

Comments regarding the words in the Glossary

Investment income

The meaning of the term "investment income" is provided, but the wording differs slightly from the one used in the Sixth Schedule. It uses 'derived from immovable property' whereas the Act uses the words 'derived in respect of immovable property'. The same wording, as in the glossary, is also used in paragraph 3.4.2.

Professional service

The same comment applies in respect, i.e. that the word is defined in the glossary and the definition is repeated in paragraph 3.4.2.

It is suggested the definition in the glossary be changed for both “investment income” and “professional service” to mean “investment income” and “professional service” respectively as defined in paragraph 3.4.2 of the guide.

Qualifying turnover

The same comment as was made above applies to “qualifying turnover”. It is also again defined in paragraph 3.2 where the wording used in the Act is used.

It is suggested that the definition in the glossary should again only refer to the definition in paragraph 3.2.

Turnover tax

It is suggested that this concept also be defined in the glossary. It is used in the Draft Guide, but its meaning is not adequately explained.

Comments relating to paragraph 2 - Background

The comment is made that the turnover tax replaces “a registered micro business’ liability for ... dividends tax”.

That is of course not 100% true, as the position is that the dividend is exempt in the hands of the holder of the shares in a registered micro business from the dividends tax, but where the amount of the dividend exceeds R200 000, the dividends tax will be payable and must be withheld by the company.

Comments relating to paragraph 3.1 - Who may qualify as a micro business?

The guide states that the turnover tax “is payable in lieu of any income tax, CGT or dividends tax”. Originally it also excluded VAT.

We have already indicated that it does not replace the dividends tax. At the time of the introduction of the turnover tax the relevant tax was the secondary tax on companies, but the same R200 000 exemption also applied.

The Draft Guide states that the “turnover tax regime is accordingly an option for persons conducting their business activities as ... private companies.” The law doesn’t have a ‘private company’ requirement. In the next paragraph the Draft Guide corrects this by referring to a company (as defined).

Comment on paragraph 3.2 - What is qualifying turnover?

Amount of a capital nature

The Draft Guide, in the opening paragraph mentions that qualifying turnover excludes “any amounts of a capital nature received from conducting business, for example, an amount received from the sale of equipment that was used in the business” and later on reference is made to “total receipts ... excluding capital receipts”.

The legislation uses the words “amount of a capital nature”. The Act doesn’t define the term and one can work on the assumption that the meaning should be much the same as the term used in the gross income definition (in section 1(1) of the Income Tax Act), i.e. “receipts or accruals of a capital nature”. Whilst it is accepted that the Draft Guide is not meant to be a high level technical document it is submitted that it should at least explain this concept to the readers.

In dealing with the inclusions in taxable turnover the Act states that it includes “50 per cent of all receipts of a capital nature ... any other asset used mainly for business purposes”.

The persons electing to be registered as a micro business would normally not be sophisticated business people with access to high level tax specialist or have an understanding of tax legislation. It is important that the Draft Guide then explains what the term “amount of a capital nature” would mean for a person wanting to apply to

be registered as a micro business. It doesn't have to be in tax technical terms, but should be to assist them to have a fair understanding of the concept.

Using as an example, "an amount received from the sale of equipment that was used in the business" is at best confusing. This is because, whilst it is capital in nature, it is still included in taxable turnover.

It is suggested that the Draft Guide explains the term better and use another example to illustrate the meaning.

VAT

The Draft Guide states that "any VAT charged on the supply of goods or services by the person must be included in the determination of that person's qualifying turnover." Later on it is stated that "since taxable turnover consists of all amounts not of a capital nature received by the micro business, a micro business that is a vendor for VAT purposes must include in its taxable turnover any VAT charged by it on the supply of goods or services."

It is not clear on what basis this statement is made. It is generally understood that for an amount to be received for tax purposes it must be received for the own benefit of the person in question. It therefore is fundamentally wrong to include output tax in the qualifying turnover. We accept that under the turnover tax the person would not be entitled to any deductions, but that does not mean that the excess of the output tax over the input tax is received by the person.

Carrying on of business activities

We agree that the phrase is not defined in the Act. The principle then is that the ordinary meaning of the phrase should be used and we agree that court precedents must be referred to. The guidelines (referred to as 'useful guidelines') comes directly from the 2008 Explanatory Memorandum. The Explanatory Memorandum continues by adding the following after these guidelines:

"The main reason for excluding these receipts is to prevent amounts, which would not normally form part of the trading income (i.e. turnover) of a micro business, from being taken into account for

purposes of determining the R1 million cap. A scenario to illustrate the need for these provisions is that of a micro business that generates a turnover of less than R1 million per annum but occasionally disposes of a rather large business asset during the year of assessment, which could disqualify it from the scope of the turnover tax system.”

As indicated earlier on in this submission, the disposal of an asset would in all likelihood be excluded from ‘qualifying turnover’ (admittedly to then later on specifically included in taxable income). We agree that carrying on business activities would require “some continuity of the ... activities” and that an amount “received from an isolated transaction” would lack the element of continuity. The problem is that it may well be part of the business activities.

The Act uses the phrase “from carrying on business activities” in the definition of ‘qualifying turnover’ and in paragraph where ‘taxable turnover’. From the reading of the Act it doesn’t appear to be a duplication. The purpose of the use of the phrase in paragraph 5 is to limit the receipts from carrying on business activities to those in the RSA.

It is suggested that this part be improved and a better example be provided of when an amount would not be from business activities.

Additional notes on the definition of “qualifying turnover”

The comment relates to instances where the qualifying turnover exceeds the R1 million amount and this is ‘nominal and temporary’. This follows on the requirement that the micro business must deregister where there are “reasonable grounds for believing that the qualifying turnover will exceed” the R1 million. The – Oxford dictionary defines nominal as follows:

“(Of a price or charge) very small; far below the real value or cost”.

The guide doesn’t explain or clarify any of this at all. It would be important for a person registered as a micro business to know what the meaning of nominal is. It is important as the requirement is that it must both be

nominal and temporary. In addition the “reasonable grounds for believing” requirement may be open to different interpretations.

The Act requires the micro business to notify SARS of these circumstances and then to apply to SARS for a decision whether the person can remain a registered micro business or not. One would expect the Draft Guide to explain how the application is to be made and what must be in it. One would presume the reasons why it is considered temporary must be included in the application.

Comments relating to Example 1

Since Mnandi’s projected qualifying turnover for the remaining period of 9 months in the 2016 year of assessment will not exceed the applicable threshold of R750 000 as determined above, Mnandi will be registered as a micro business from the beginning of the 2016 year of assessment.

Of course the ‘the applicable threshold’ refers to the R1 million and not an amount of R750 000.

The comment, in the last sentence of paragraph 3.2, that the “main reason for considering the receipts of connected persons is to ensure that the turnover tax system is only accessed by micro-enterprises that are genuinely small” should be move to paragraph 3.3.

Paragraph 3.3.1 - Connected persons in relation to a natural person

Collective investment scheme

The Draft guide, in more than one place, refers to “a portfolio of a collective investment scheme in securities or property”. The word ‘securities’ was dropped from the legislation and it is possible that the relevant Interpretation Note has not been updated with the change in the legislation.

The Draft guide should be updated with the change.

Example 2 – Qualifying turnover for connected natural persons

The example is not an appropriate one to explain the concept of connected persons. One would assume that the parties would also have difficulty rebutting the presumption of purpose (section 80G of the Income Tax Act).

The example starts out by stating that “individual A owns a block of flats and derives rental income from all occupied units and is registered as a micro business”. We agree that the rental derived in respect of immovable property would, for a natural person, constitute qualifying turnover (in other words the fact that it is investment income is irrelevant). The facts in the example then don’t provide detail of the amount of the rental derived by individual A and whether or not it includes amounts (of rental) derived from the relatives.

The facts then refers to a ‘registered sole proprietor’ – we are not sure what this refers to.

Another question is what it means when it is stated that “A is responsible for payment of all the businesses’ staff wages and salaries.” It may be relevant to the issue of whether or not the main reason or one of the main reasons for the relatives carrying on business activities in the way that the relative does is to ensure that the qualifying turnover of that person (“A”) does not exceed the amount of R1 million.

The example doesn’t really deal with the other requirement (business activities that should properly be regarded as forming part of the business activities carried on by that person). It is only the fast food business that acquires goods from A.

It is suggested that a better example be used to explain this issue.

Paragraph 3.3.2 - Connected persons in relation to a company

We have already commented on the ‘collective investment scheme in securities or property’ term.

The Draft Guide explains that a “connected person in relation to a company means –

- any other company that would be part of the same group of companies as that company if the shareholding requirement in the definition of “group of companies” was “more than 50 per cent” instead of “at least 70 per cent” of the equity shares”.

In the aid of simplicity it is suggested that this term be explained by using less technical terms. An example may be the appropriate way to do so.

Paragraph 3.4.2 - Limitation on investment and professional service income

Comments on sub-paragraph (a) Investment Income

It is stated in footnote 37 that the “provision of serviced accommodation at a guesthouse is seen to give rise to rental income from immoveable property which is investment income as defined. The room rate is a daily fixed periodical return, the guest is a tenant or occupier of the room and the guesthouse owner is a landlord.”

This would of course only be relevant if the person is not a company, but we are not sure that this interpretation is correct. The fact that the accommodation is serviced may well mean that it is not rental income.

In sub-paragraph (b) (Professional services) it is stated that the activities of ‘bed and breakfast establishments or guesthouses’ will not be considered to be professional services. We agree with that interpretation.

Comments on sub-paragraph (b) Professional services

The Draft Guide states that when “the rendering of a service ... ancillary or incidental to any business activity (is) not considered a professional service ancillary or incidental”.

As this is a critical issue for a person wanting to apply to be registered as a micro business, it is suggested that some indication must be given of when a service would be considered to be ancillary or incidental to professional service.

3.5 Special rules relating to partnerships

Partnerships are taxed on a flow-through basis

Paragraph 3.6 - Taxable turnover (paragraph 5)

We refer you to our previous comments relating to the comment that where a micro business is a vendor for VAT purposes its taxable income must include “any VAT charged by it on the supply of goods or services.”

Example 4 – Determination of turnover tax liability (Natural persons)

We agree that the amount received for the services performed in Lesotho must be excluded from taxable turnover as it is derived from carrying on business activities outside South Africa (paragraph 5) and is subject to normal tax.

The tax treatment is a bit more complex as one would have to consider the treaty between the RSA and Lesotho and this amount would in all likelihood have been subject to the Lesotho withholding tax.

Example 5 – Determination of turnover tax liability (Company)

The statement that the “credit sales figure refers to outstanding debtors” is confusing. In the last sentence before the amounts it is stated the “amounts below relate to amounts received” and one would then interpret the term ‘credit sales’ to refer to sale on credit, but received before year end. It would be more appropriate to refer to and provide the amount of the debtors outstanding at the beginning or end of the year.

Paragraph 3.9.3 - Voluntary VAT registration

The comment that “the compulsory registration threshold for VAT was revised upwards from a total value of taxable supplies of R300 000 to R1 million” may not be relevant as it was done before 2012 referred to earlier in the paragraph.

Annexure A – Quick test to see if a business qualifies for turnover tax

This is very useful, but the use of words like “do you declare” don’t belong in a quick test. The intention is not to use the form as a form to be submitted to SARS, but rather to assist the person in understanding whether or not application can be made to be registered as a micro business.

The word ‘declare’ must be removed from the questions.

Final comment

The guide makes no reference to any amount received by or accrued to or in favour of a small, medium or micro sized enterprise from a small business funding entity.

As the purpose of introducing these entities was to specifically provide funding to entities that may well be a small, medium or micro sized enterprise it is suggested that the Draft Guide also refers to this. It should then explain its impact on the qualifying turnover and taxable turnover.

Please don’t hesitate to contact us if you have any questions with regard to our comments.

Sincerely

PJ Nel