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A COMPARATIVE STUDY OF TAX RELIEF MEASURES FOR SMALL, MEDIUM AND MICRO ENTERPRISES IN SOUTH AFRICA AND AUSTRALIA

by

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TABLE OF CONTENTS

ACKNOWLEDGEMENTS I

LIST OF TABLES V

LIST OF ABBREVIATIONS VI

ABSTRACT VII

OPSOMMING IX

CHAPTER 1: INTRODUCTION 1

1.1 Background and importance of the study 1

1.2 Problem statement 4

1.3 Purpose statement 4

1.4 Research objectives 4

1.5 Delineation and limitations 4

1.6 Underlying assumptions 5

1.7 Definition of key terms 5

1.8 Research design and methods 6

1.9 Brief overview of chapters 6

CHAPTER 2: TAX RELIEF MEASURES FOR SMALL, MEDIUM AND MICRO ENTERPRISES IN SOUTH AFRICA AND AUSTRALIA 8

2.1 Introduction 8

2.2 Definition of a small, medium and micro enterprise 8

2.2.1 General definition 8

2.2.2 Definitions of a small, medium and micro enterprise in terms of the South African tax legislation 9

2.2.3 Definition of a small, medium and micro enterprise in terms of the Australian tax legislation 13

2.3 Tax relief measures available in South Africa 15

2.3.1 Income tax relief 15

2.3.2 Skills development levy relief 19

2.3.3 Capital gains tax relief 20
2.3.4 Provisional tax relief 22
2.3.5 Secondary tax on companies relief 22
2.3.6 Relief on the exportation of goods 23
2.3.7 Value-added tax relief 23
2.3.8 Record-keeping relief 25
2.3.9 Relief on advance tax rulings 26
2.3.10 Venture capital companies 27

2.4 Tax relief measures available in Australia: small business entity concessions 29
2.4.1 Income tax concessions 29
2.4.2 Capital gains tax concessions 31
2.4.3 Goods and services tax concessions 33
2.4.4 Pay-as-you-go instalment concessions 36
2.4.5 Fringe benefit tax concessions 36

2.5 Tax relief measures available in Australia: venture capital tax concessions 37
2.5.1 The 1999 venture capital tax concession 38
2.5.2 The 2002 venture capital tax concession 39
2.5.3 The early stage venture capital tax concession 44

2.6 Conclusion 46

CHAPTER 3: COMPARISON OF TAX RELIEF MEASURES FOR SMALL, MEDIUM AND MICRO ENTERPRISES IN SOUTH AFRICA AND AUSTRALIA 47

3.1 Introduction 47

3.2 Comparison of tax relief measures for a small, medium and micro enterprise in South Africa and Australia 47
3.2.1 Definition of a small, medium and micro enterprise 47
3.2.2 Income tax relief: depreciation 48
3.2.3 Income tax relief: tax rate for small, medium and micro enterprises 49
3.2.4 Income tax relief: trading stock 49
3.2.5 Income tax relief: prepaid expenses 49
3.2.6 Skills development levy relief 49
3.2.7 Capital gains tax relief 50

3.2.8 Provisional tax relief 51
3.2.9 Secondary tax on companies relief 51
3.2.10 Relief on the exportation of goods....................52
3.2.11 Value-added tax and goods and services tax relief....................52
3.2.12 Record-keeping relief 53
3.2.13 Advance tax ruling relief 53
3.2.14 Pay-as-you-earn and pay-as-you-go relief 54
3.2.15 Fringe benefits tax relief 54
3.2.16 Venture capital relief....................54

3.3 Conclusion 56

CHAPTER 4: CONCLUSION 57

4.1 Introduction 57

4.2 Summary of findings 57

4.3 Conclusion 58

4.4 Summary of contributions 59

4.5 Suggestions for further research....................59

LIST OF REFERENCES....................60

LIST OF TABLES

Table 2.1 Wear and tear deduction of assets for SMMEs and non-SMMEs 17

Table 2.2: Tax rates for individuals with year-end on 28 February 2011............................18

Table 2.3 Tax rates for companies and close corporations with financial year-end between 1 April 2010 and 31 March 2011 18

Table 2.4: Tax rates for small business corporations with financial year-end between 1 April 2010 and 31 March 2011 18

Table 2.5: Tax rates for micro businesses with financial year-end on 28 February 2011 ..19

LIST OF ABBREVIATIONS

AFOF	–	Australian capital fund of funds
ATO	–	Australian Taxation Office
CGT	–	capital gains tax
ESVCLP	–	early stage venture capital limited partnership
GST	–	goods and services tax[1]
Income Tax Act	–	Income Tax Act (58/1962)
OECD	–	Organisation for Economic Co-operation and Development
PAYE	–	pay-as-you-earn
PAYG	–	pay-as-you-go
SARS	–	South African Revenue Service
Skills Development Levies Act	–	Skills Development Levies Act (9/1999)
SMME	–	small, medium and micro enterprise
STC	–	secondary tax on companies
VAT	–	value-added tax
VAT Act	–	Value-Added Tax Act (89/1991)
VCLP	–	venture capital limited partnership

[1] This is the Australian abbreviation. In South Africa, GST is used for general sales tax.

ABSTRACT

A COMPARATIVE STUDY OF TAX RELIEF MEASURES FOR SMALL, MEDIUM AND MICRO ENTERPRISES IN SOUTH AFRICA AND AUSTRALIA

by
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It has been acknowledged internationally and locally that small, medium and micro enterprises (SMMEs) play a vital role in the economic growth of a country. SMMEs enhance a country's economy by reducing unemployment and thus poverty through job creation. Unemployment in South Africa was 25,3% in the second quarter of 2010. It is thus important for the South African Government to support SMMEs in order to reduce the country's unemployment rate. SMMEs should therefore have efficient tax systems with effective tax relief measures to facilitate their establishment as well as their future development.

South Africa's tax legislation currently does contain tax relief measures for SMMEs. However, improvement is still needed due to the country's high unemployment rate. Much can be learnt from Australia as new legislation has recently been introduced in Australia which standardises the criteria for an entity to qualify as an SMME for tax purposes.

As the focus of this research was on SMMEs, the study commenced with an analysis of the definition of an SMME. Thereafter, the tax relief measures currently available in South Africa and in Australia were identified. The reasons for the implementation of these relief measures together with previous research performed were included in the discussion. Finally, the South African and Australian tax relief measures were critically compared.

As a result, this study will assist the South African Government to enhance the formation and development of SMMEs through identifying tax relief measures available in Australia, which have not yet been incorporated into South African tax legislation.

It was not possible from the information obtained in this study to determine whether the tax relief measures currently available in Australia are suitable to be implemented in South Africa. Further research should be conducted to determine whether South African SMMEs will benefit from the tax relief measures available in Australia and whether it is appropriate to include those relief measures in South African tax legislation.

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OPSOMMING

’N VERGELYKENDE STUDIE OOR DIE BELASTINGVERLIGTINGSMAATREËLS VIR KLEIN, MEDIUM EN MIKRO-ONDERNEMINGS IN SUID-AFRIKA EN AUSTRALIË

deur

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Daar word internasionaal en plaaslik erken dat klein, medium en mikro-ondernemings (KMMO’s) ’n belangrike rol in ’n land se ekonomiese groei speel. Deur werkskepping verminder KMMO’s die land se werkloosheid en dus armoede en sodoende word die land se ekonomie bevorder. Die werkloosheidsyfer in Suid-Afrika vir die tweede kwartaal van 2010 was 25,3%. Dit is dus belangrik vir die regering om KMMO’s te ondersteun om sodoende die land se werkloosheidsyfer te verlaag. KMMO’s behoort dus doeltreffende belastingstelsels te hê, met geskikte belastingverligtingsmaatreëls, om die stigting sowel as toekomstige ontwikkeling van hierdie entiteite te vergemaklik.

Suid-Afrika se belastingwetgewing bevat tans belastingverligtingsmaatreëls vir KMMO’s. Weens die hoë werkloosheidsyfer, kan dit egter nog verbeter. Suid-Afrika kan baie van Australië leer, aangesien Australië onlangs nuwe wetgewing ingestel het wat die kriteria vir ’n entiteit om as ’n KMMO vir belastingdoeleindes te kwalifiseer, standaardiseer.

Aangesien hierdie ondersoek gerig is op KMMO’s, begin die studie met ’n ontleding van die definisie van ’n KMMO. Daarna is die belastingverligtingsmaatreëls wat tans in Suid-Afrika en Australië beskikbaar is, geïdentifiseer. Die redes vir die implementering van hierdie belastingverligtingsmaatreëls sowel as vorige navorsing wat gedoen is, is ingesluit in die bespreking. Ten laaste is die Suid-Afrikaanse en die Australiese belastingverligtingsmaatreëls krities vergelyk.

Die studie behoort die Suid-Afrikaanse regering te help om die stigting en toekomstige ontwikkeling van hierdie entiteite te vergemaklik deur Australiese belastingverligtingsmaatreëls, wat nog nie in die Suid-Afrikaanse belastingwetgewing vervat is nie, te identifiseer.

Dit is nie moontlik om uit die inligting wat in hierdie studie verkry is, te bepaal of die belastingverligtingsmaatreëls wat tans in Australië beskikbaar is, geskik is om in Suid-Afrika toegepas te word nie. Verder navorsing sal kan bepaal of Suid-Afrikaanse KMMO's voordeel sal trek uit die belastingverligting wat in Australië beskikbaar is en of dit geskik is om hierdie belastingverligting in Suid-Afrikaanse wetgewing in te sluit.

CHAPTER 1: INTRODUCTION

1.1 BACKGROUND AND IMPORTANCE OF THE STUDY

In the second quarter of 2010, unemployment in South Africa was 25,3% (Statistics South Africa, 2010). Small, medium and micro enterprises (SMMEs) enhance the economy of a country and reduce unemployment and thus poverty through job creation (Smulders & Oberholzer, 2006a:1). It has been acknowledged internationally that many of the world's largest companies started as SMMEs and that innovation normally takes place within SMMEs (Barkoczy & Sandler, 2007:31). SMMEs form the majority of taxpayers and are the fastest-growing business sector in many countries (International Finance Corporation World Bank Group, 2007:9).

Half of Australia's employment is generated by SMMEs operating in the private sector (Barkoczy & Sandler, 2007:31) and more than half of South Africa's workforce is employed by the private sector (Smulders, 2008:8).

The World Bank Group did research on the informal economy in 2007 (International Finance Corporation World Bank Group, 2007:9-20). The informal economy mainly consists of SMMEs which participates in tax evasion by not contributing to paying taxes. The various types of taxes, the administration of tax, the complexity of tax legislation as well as high tax rates are all contributing to the problems experienced within a tax system. A country's economy cannot be enhanced when SMMEs participate in the informal economy. As a result, it is important to reduce the informal sector by implementing a simplified tax system for SMMEs.

Therefore it is important that the Government support SMMEs. These entities should thus have efficient tax systems to facilitate establishment as well as future development.

The enhancement of SMMEs is of great importance to the Government of South Africa (Department of Trade and Industry, 2005:3) as was appealed by South Africa's President J.G. Zuma in his state of the nation address on 3 June 2009 (Zuma, 2009). The South African Minister of Finance, Pravin Gordhan, also highlighted the importance of SMMEs in

his budget speech of 2010 (Gordhan, 2010). He announced that South Africa's approach towards creating more employment opportunities includes the encouragement of SMME development by granting additional tax relief measures to these entities.

The Australian Government provides support to SMMEs through its tax system as it recognises that these entities contribute to its economy (Barkoczy & Sandler, 2007:53). New legislation has recently been introduced, which standardised the criteria for an entity to qualify as an SMME (ATO, 2010b).

Due to the importance of SMMEs and the fact that SMMEs are a large contributor towards a country's economic growth, it is important from a practical viewpoint to conduct this research. The study will assist the South African Government to enhance the formation and development of SMMEs through identifying tax relief measures available in Australia not included in the South African tax legislation. Lessons can be learnt from Australia as Australia only recently standardised its tax legislation in relation to SMMEs.

From an academic perspective, the proposed study will make two valuable contributions. Firstly, this will be the first study comparing the tax relief measures available to SMMEs in South Africa as opposed to those available in Australia. The research differs from previous research, which only focused on the tax relief measures available in either South Africa or in Australia or drawing a comparison with other countries. Leading electronic journal databases and websites, locally and internationally, were searched. The search indicated that no comparison has previously been drawn between the tax relief measures available in South Africa and in Australia for SMMEs. Secondly, this study will highlight other tax relief measures available to be implemented in South Africa to assist SMMEs in their creation and development.

SMMEs in South Africa have been researched in prior years. A literature review was conducted on the differentiated tax policies available to SMMEs and on the efficiency of these policies (Sieberhagen, 2008:1-101). Research was done on five key areas to empower SMMEs, namely streamlining taxes, streamlining entry, streamlining filing, advice and assistance and the tax relief measures available to these entities (Smulders & Oberholzer, 2006a:1-5). Section 12E of the Income Tax Act (58/1962) (Income Tax Act)

specifically deals with deductions for small business corporations. The details, requirements and concerns regarding this section were researched and discussed in detail by Smulders and Oberholzer (2006b:1-4). Chamberlain and Smith (2006:1-62) assessed the impact of taxation compliance costs on SMMEs in South Africa, the United Kingdom and New Zealand. Smulders (2007:1-130) researched the tax compliance burden for SMMEs. Various surveys were carried out in South Africa on SMMEs. The surveys most relevant to this study were on the tax compliance burden (Smulders, 2008:1-2), the annual tax compliance cost (Smulders & Stiglingh, 2008:1-18) and the impact of tax on SMME formation (Venter & De Clerq, 2007:1-17).

Earlier studies have been conducted on SMMEs in Australia. A survey was carried out on the tax relief measures available to SMMEs in the Organisation for Economic Co-operation and Development (OECD) countries. Australia was one of the countries from which a response was received when the survey was conducted (OECD, 2007:1-95). The methods used by the Australian Government to promote the development of SMMEs in terms of venture capital incentives were studied. These methods were compared with the methods used in the United States, Canada, the United Kingdom, Singapore, Malaysia and New Zealand (Barkoczy & Sandler, 2007:1-244). Pope (2008:1-8) researched the tax relief measures available to SMMEs in the United Kingdom, the United States of America, New Zealand and Australia.

A recent study was conducted by the International Finance Corporation World Bank Group (2007:1-152) on tax systems for SMMEs. This study consisted of three parts: how the tax system affects the development of SMMEs, methods to help ease tax compliance for SMMEs and how a small business tax regime can be designed. Another study was carried out on SMMEs in the United States, Ireland, South Africa and Australia. The study consisted of an explanation of the importance of SMMEs, the definition of an SMME for tax purposes and a discussion of the results of being an SMME (Arendse, Karlinsky, Killian & Payne, 2006:1-19).

The research conducted in prior years proves that there is a need to determine additional tax relief measures to be implemented in South Africa.

1.2 PROBLEM STATEMENT

SMMEs need to be expanded to enhance a country's economic growth and reduce unemployment. As a result, SMMEs need to be supported by a government through providing specific tax relief measures to these entities. Therefore, it is necessary to ascertain what different types of relief measures are available to be implemented in South Africa.

1.3 PURPOSE STATEMENT

The main purpose of this study is to critically analyse, compare and evaluate the different tax relief measures in respect of SMMEs, which are currently available in South Africa, with those in Australia.

1.4 RESEARCH OBJECTIVES

This study will be guided by the following specific research objectives:

- to critically analyse previous research studies and the literature relating to tax relief measures available for SMMEs in order to establish the theoretical construct for this study; and
- to critically compare the tax relief measures available in South Africa with those available in Australia using the theoretical construct as underpin.

1.5 DELINEATION AND LIMITATIONS

This study is limited to the tax relief measures available in South Africa and Australia.

Large entities are excluded from this study as the focus is on the tax relief measures available to SMMEs.

Farming, mining companies, exploration companies, insurance companies, recruitment companies, personal service companies and labour brokers are not included in this study

due to their specialised nature. Specific tax policies apply to these entities and are therefore not discussed.

The legislation discussed in this research proposal for South Africa is limited to the Income Tax Act, the Value-Added Tax Act (89/1991) (VAT Act) and the Skills Development Levies Act (9/1999) (Skills Development Levies Act). For Australia, the study is limited to the Income Tax Assessment Act 1997 and the Venture Capital Act 2002.

1.6 UNDERLYING ASSUMPTIONS

An **assumption** is “a condition that is taken for granted, without which the research project would be pointless” (Leedy & Ormrod, 2010:6).

In this study, it is assumed that, as there is more than one definition for an SMME, the term **small, medium and micro enterprises** (SMMEs), can be replaced by small business, small and medium enterprise, small business corporation, micro business or small business entity.

1.7 DEFINITION OF KEY TERMS

The key terms included in this study are defined below:

Compliance cost: Compliance cost includes the time spent on understanding and applying the rules, cost of compiling records and preparing tax returns, payments to experts and minor postage, telephone and travel costs to communicate with experts or the tax authorities (Smulders, 2007:59).

Small, medium and micro enterprises: The definitions in terms of the tax legislation of South Africa and Australia will be used for the purposes of this study. This term is discussed in detail in chapter 2.

1.8 RESEARCH DESIGN AND METHODS

The research design used in this study is a critical literature review. In obtaining information for the study, the research design selected is the most suitable as the aim is to acquire a proper understanding of the tax relief measures available to SMMEs in South Africa and Australia (Mouton, 2001:180).

Led by the research objectives, the existing literature was researched in detail. Numerous databases were searched to obtain the literature published on tax relief measures available to SMMEs in South Africa and Australia. The following key words were used while the search was conducted: tax, SMME, tax relief, South Africa and Australia. The reliability of the data collected was considered.

A literature review cannot develop new insights as it only summarises existing literature (Mouton, 2001:180).

1.9 BRIEF OVERVIEW OF CHAPTERS

Chapter 1 provides the background to this study and the importance of conducting the study. The problem statement, purpose statement and research objectives are defined in this chapter. In addition, the delineations, limitations, underlying assumptions, key terms and the research design and methods are also defined.

Chapter 2 commences with the definition of an SMME in terms of the South African and Australian tax legislation. Thereafter, the tax relief measures currently available to SMMEs in these countries are discussed as well as the reasons for the implementation of these relief measures. Previous research is included in the discussion.

Chapter 3 draws a comparison between the tax relief measures available to SMMEs in South Africa and Australia. The chapter identifies tax relief measures available to SMMEs in terms of the Australian tax legislation, which are not yet implemented in the South African tax legislation.

Chapter 4 summarises the findings of the research, draws a conclusion on the study as a whole and makes suggestions for future research.

CHAPTER 2: TAX RELIEF MEASURES FOR SMALL, MEDIUM AND MICRO ENTERPRISES IN SOUTH AFRICA AND AUSTRALIA

2.1 INTRODUCTION

In this chapter, the literature most relevant to this study is considered. As the focal point of this study is SMMEs, the chapter commences with the definition of an SMME in terms of the South African and Australian tax legislation. To be able to draw a comparison between tax relief measures of these two countries, the tax relief measures currently available to SMMEs in these countries are discussed as well as the reasons for the implementation of these relief measures. Previous research is also included in the discussion.

2.2 DEFINITION OF A SMALL, MEDIUM AND MICRO ENTERPRISE

2.2.1 General definition

In order to identify the different tax relief measures available to SMMEs, it is necessary to consider the exact definition of an SMME.

In determining what an SMME is, different criteria are applied. The World Bank Group (International Finance Corporation World Bank Group, 2007:50) acknowledges the following criteria: business turnover, tax paid or tax liability, number of employees, capital base, entity type, industry type and international transactions.

The OECD (2007:5) acknowledges that it is difficult to only apply one definition to an SMME for taxation purposes. Subsequently, different definitions are used for an SMME in different countries, for different types of taxes and in different tax systems.

The definition of an SMME varies between the tax legislation of South Africa and that of Australia as well as between the different types of taxes within the legislation.

To define an SMME, the applicable definitions within the tax legislation of South Africa and Australia will be used. These definitions are provided in detail below.

2.2.2 Definitions of a small, medium and micro enterprise in terms of the South African tax legislation

The following definitions exist in terms of the South African tax legislation for SMMEs and will be explained in detail below:

- small business corporation;
- micro business; and
- small business.

2.2.2.1 *Definition of a small business corporation*

Section 12E of the Income Tax Act defines a small business corporation and provides tax relief for these entities. This section was inserted in 2001 to encourage employment creation, promote skills development (Manual, 2001) and to support the incorporation of SMMEs for obtaining the advantages of a more formal business method (Smulders & Oberholzer, 2006a:3).

An entity must meet the following criteria to be classified as a **small business corporation** (Section 12E of the Income Tax Act):

- the entity must be a close corporation, co-operative or a private company;
- all the shareholders or members of the entity should be natural persons;
- the gross income of the entity should not amount to more than R14 million for the current year;
- in the past, large entities obtained advantage from SMME tax benefits by separating a full amount into smaller amounts with the consequence that the smaller amounts are less taxed than the full amount would have been (Arendse *et al.*, 2006:9). Therefore, the following rule was introduced: the shareholders or members of the entity must not hold shares nor have an interest in the equity of another company.

Exceptions are shares or interest in a:

- listed company;
- collective investment scheme in securities;
- body corporate;
- share block company;
- social co-operative, consumer co-operative or a co-operative burial society if all trading income is exclusively obtained from its members and the interest is less than 5%;
- friendly society;
- primary savings co-operative bank or primary savings and loans co-operative bank only providing banking services and the interest is less than five per cent;
- venture capital company; or
- company, close corporation or co-operative not trading and its assets' market value not being more than R5 000;

- return on investments and income from rendering personal services may not be more than 20% of total receipts and accruals. A service will not be a personal service if three or more employees are working full-time for the entity; and
- the company may not be a personal service provider.

The last two requirements were included in the tax legislation as the South African Government's objective is not to fund an SMME that is not creating jobs or contributing to the country's gross domestic product (Arendse *et al.,* 2006:13).

2.2.2.2 *Definition of a micro business*

The South African Government recognises that SMMEs enhance the country's economy and reduce unemployment and it acknowledges that the high tax compliance cost is one of the difficulties experienced by these entities. An optional simplified turnover tax system for micro businesses was introduced on 1 March 2009 to encourage entrepreneurship. This assist SMMEs to be created and developed by reducing the tax compliance burden (SARS, 2010a:6-9).

The tax compliance burden was reduced for entities with a maximum turnover of R1 million. The tax system was streamlined and only one tax is payable under the new turnover tax system, instead of income tax, capital gains tax (CGT), secondary tax on companies (STC) and value-added tax (VAT). Employee's tax and unemployment insurance fund contributions are still payable as these taxes are collected by an employer on behalf of an employee (SARS, 2010a:6-9).

To obtain these benefits, the entity must qualify as a micro business. A **micro business** is defined in Paragraphs 2 and 3 of the Sixth Schedule of the Income Tax Act as follows:

- a micro business can be a natural person or a company. A company is defined in Section 1 of the Income Tax Act and includes the following:
    - any association, corporation or company incorporated in South Africa or a body corporate formed under South African law;
    - any association, corporation or company incorporated in a foreign country or a body corporate formed under the law of a foreign country;
    - any co-operative;
    - any association formed in South Africa to serve a specified purpose, beneficial to the public or a section of the public;
    - collective investment scheme in securities; and
    - a close corporation;
- the turnover of the entity may not be more than R1 million for the current year;
- the entity may not hold any shares nor has an interest in the equity of another company. Exceptions are shares or interest in a
    - listed company;
    - collective investment scheme in securities;
    - body corporate;
    - share block company;
    - social co-operative, consumer co-operative or co-operative burial society if all trading income is exclusively obtained from its members and the interest is less than 5%;

  - friendly society;
  - venture capital company; or
  - primary savings co-operative bank or primary savings and loans co-operative bank only providing banking services and the interest is less than 5%;
- not more than 10% of the total receipts of the entity may be earned from investment income;
- the entity may not be a personal service provider or a labour broker without an exemption certificate;
- the entity may not provide professional services;
- the total amount received from the disposal of capital assets that was used for business purposes may not exceed R1.5 million over three years;
- the year-end of the entity must be February;
- all the shareholders of a company must be natural persons;
- if the entity is a company, the shareholders may not hold shares or have an interest in the equity of another company. Exceptions are shares or interest in a
  - listed company;
  - collective investment scheme in securities;
  - body corporate;
  - share block company;
  - social co-operative, consumer co-operative or co-operative burial society if all trading income is exclusively obtained from its members and the interest is less than 5%;
  - friendly society;
  - primary savings co-operative bank or primary savings and loans co-operative bank only providing banking services and the interest is less than 5%;
  - venture capital company;
  - company not trading and its assets' market value being not more than R5 000;
  - public benefit organisation; or
  - recreational club;

- all partners in a partnership should be natural persons; and
- partners in a partnership may not be a partner of another partnership.

2.2.2.3 *Definition of a small business*

An SMME that meets the definition of a small business in terms of the Eighth Schedule of the Income Tax Act will be entitled to certain CGT relief.

An entity is classified as a **small business** if the market value of all its assets is not higher than R5 million as determined on the day of the disposal of an asset (Paragraph 57 of the Eighth Schedule of the Income Tax Act).

The tax relief measures that a small business corporation, micro business and small business can apply are discussed in 2.3. To qualify for these relief measures, different definitions need to be complied with. In this sub-section, these definitions were discussed. In the next sub-section, the definition of an SMME in terms of the Australian tax legislation is discussed.

2.2.3 Definition of a small, medium and micro enterprise in terms of the Australian tax legislation

Before 1 July 2007, separate tests were applied by SMMEs in Australia to receive income tax, CGT, goods and services tax (GST), pay-as-you-go (PAYG) and fringe benefits tax relief (Costello, 2006c). The cost incurred by the SMME in identifying and complying with the concessions cancelled the advantages received (Pope, 2008:5). Several complaints were received that the various requirements for the different concessions increased compliance cost (Costello, 2006b).

The Australian Government recognises that SMMEs make a significant contribution to its employment and economic growth. Therefore, the Australian Government has an extensive history of providing support to these entities by reducing the tax and compliance cost burden, and simplifying record-keeping and reporting requirements (Costello, 2006b).

In the 2006 budget, the Australian Government committed itself to reduce taxes for SMMEs by A$435 million over four years. As a result, more assistance was granted to these entities by streamlining definitions, aligning thresholds and reducing tax complexity and compliance cost (Costello, 2006b). These changes were introduced from 1 July 2007 (Costello, 2006c).

In reaction to the complaints received, compliance cost was reduced by introducing a single definition for an SMME with a single requirement (ATO, 2010b). Now after the change, SMMEs only need to apply one test to be able to apply for the various small business entity concessions. The relief measures are optional and only the concessions that meet the requirements of the SMME can be elected (Costello, 2006c).

For some of the relief measures, there are additional criteria to satisfy (ATO, 2010b). The relief measures are discussed in 2.4.

To qualify for the small business entity concessions, the entity needs to qualify as a **small business entity** by satisfying one of the following requirements (ATO, 2010b):

- the turnover of the entity should have been less than A$2 million in the previous year;
- the turnover of the entity should be approximately calculated as A$2 million for the current year and should have been less than A$2 million in one of the two prior years; or
- the turnover of the entity should indeed be less than A$2 million for the current year.

The threshold to qualify as a small business entity was increased from A$1 million to A$2 million for more entities to access the relief measures (ATO, 2010b).

The small business entity is obliged to keep record on how the turnover was calculated. Turnover includes all income earned, but excludes GST. The criteria for qualifying as a small business entity have to be reviewed each year (ATO, 2010b).

GST and PAYG instalment concessions (discussed in 2.4.3 and 2.4.4) cannot be used for the current year when the last option for calculating turnover was used as these concessions must be chosen earlier in the year (ATO, 2010b).

If an entity did not qualify as a small business entity during the current year, but the entity's net asset value is a maximum of A$6 million, the entity will still qualify for the CGT concessions (ATO, 2010b).

If an entity did not qualify as a small business entity during the current year, but the entity's income is less than A$10 million, the entity will still qualify for the fringe benefits tax concessions (ATO, 2010b).

If an entity is winding up its business and the entity was a small business entity during the year the entity ended its business, the entity will still qualify for the small business entity concessions (ATO, 2010b).

In this section, the different definitions for SMMEs in terms of the South African and Australian tax legislation were discussed. In the next section, the various tax relief measures available to South African entities are discussed.

2.3 TAX RELIEF MEASURES AVAILABLE IN SOUTH AFRICA

2.3.1 Income tax relief

2.3.1.1 *Income tax relief: depreciation*

Normally, wear and tear on assets can be claimed as a tax deduction in terms of Section 11(e) or 12C of the Income Tax Act.

Section 11(e) provides for a deduction on the wear and tear of machinery, plant, implements, utensils and articles. The asset must be owned by the taxpayer or acquired by the taxpayer in terms of an instalment credit agreement. The asset must be utilised in the taxpayer's trade. This deduction may be claimed over a specific write-off period

depending on the category in which the asset falls as provided by Practice Note 47 of the Income Tax Act. These write-off periods range between one and 25 years.

Section 12C provides for a deduction on the wear and tear of machinery and plant. The asset must be owned by the taxpayer or acquired by the taxpayer in terms of an instalment credit agreement. The asset must be brought into use for the first time by the taxpayer for trade purposes and must be used in a manufacturing process. The deduction may be claimed as follows: 40% of the cost in the year in which the asset is brought into use and 20% of the cost in the three subsequent years after the asset has been brought into use.

Wear and tear on the assets of **small business corporations** can be claimed as a tax deduction in terms of Section 12E(1) or 12E(1A) of the Income Tax Act. As it is recognised that the manufacturing industry is more likely to create additional jobs, the tax relief measures for small business corporations are aimed mainly at this industry (Smulders, 2007:36). This is important for the South African economy as South Africa's unemployment rate is higher than 25% (Arendse *et al.,* 2006:14).

The cost of plant or machinery owned or acquired in terms of an instalment credit agreement by a small business corporation can be deducted in full in the year in which the asset is brought into use in terms of Section 12E(1) of the Income Tax Act. The asset must have been brought into use for the first time by the small business corporation on or after 1 April 2001 for trade purposes (excluding mining or farming operations) and must be used in a manufacturing or similar process. This deduction does not apply to assets that were acquired for no consideration (Practice Note 9 of the Income Tax Act).

Where Section 12E(1) is not applicable, Section 12E(1A) of the Income Tax Act may be applicable. The acquisition date for the asset must be on or after 1 April 2005. The wear and tear deduction is as follows: 50% of the cost in the year in which the asset is brought into use, 30% in the second year and 20% in the third year. This deduction is not allowed for assets that were acquired for no consideration (Practice Note 9 of the Income Tax Act). The small business corporation can elect to claim this allowance or the allowance in terms of Section 11(e), whichever is to the best advantage of the small business corporation (SARS, 2008:29).

Table 2.1 summarises the deduction of assets for tax purposes for SMMEs and for non-SMMEs as described above by means of a comparison.

Table 2.1 Wear and tear deduction of assets for SMMEs and non-SMMEs

Type of entity	Purpose of asset	Write-off period	Legislation
Non-SMME	Manufacturing	Write-off of assets over four years, i.e. 40% in the first year and 20% in the three subsequent years.	Section 12C of the Income Tax Act
SMME	Manufacturing	Claim the full cost of the asset in the first year.	Section 12E(1) of the Income Tax Act
Non-SMME	Other than manufacturing	Claim the cost of the asset over the write-off period as provided for in Practice Note 47. These write-off periods range between one and 25 years.	Section 11(e) of the Income Tax Act
SMME	Other than manufacturing	Claim the asset over three years, i.e. 50% in the first year, 30% in the second year and 20% in the third year. Can elect to claim the asset over the write-off periods as provided for in Practice Note 47, which range between one and 25 years.	Section 12E(1A) of the Income Tax Act

An SMME that qualifies as a small business corporation can therefore claim the cost of an asset over a much shorter period compared with an entity that does not qualify as a small business corporation.

2.3.1.2 *Income tax relief: reduced tax rate for SMMEs*

Different tax rates apply to different types of entities.

If the entity is a sole proprietorship or a partnership, the individual owner or the partners will be liable to pay tax. Table 2.2 sets out the tax rates applicable to individuals whose year ends on 28 February 2011.

Table 2.2: Tax rates for individuals with year-end on 28 February 2011

Taxable income (R)	Rate of tax (R)
0–140 000	18% of taxable income
140 001–221 000	25 200 + 25% of taxable income above 140 000
221 001–305 000	45 450 + 30% of taxable income above 221 000
305 001–431 000	70 650 + 35% of taxable income above 305 000
431 001–552 000	114 750 + 38% of taxable income above 431 000
552 001 and above	160 730 + 40% of taxable income above 552 000

Source: SARS (2010b:2)

Table 2.3 specify the tax rates applicable to companies and close corporations whose financial year ends between 1 April 2010 and 31 March 2011.

Table 2.3 Tax rates for companies and close corporations with financial year-end between 1 April 2010 and 31 March 2011

Type	Rate of tax
Companies	28%
Personal service provider companies	33%
Foreign resident companies which earn income from a source in South Africa	33%

Source: SARS (2010b:1)

A **small business corporation** is subject to reduced tax rates. The tax rates as indicated in Table 2.4 are applicable to small business corporations whose financial year ends between 1 April 2010 and 31 March 2011.

Table 2.4: Tax rates for small business corporations with financial year-end between 1 April 2010 and 31 March 2011

Taxable income (R)	Rate of tax (R)
0–57 000	0%
57 001–300 000	10% of taxable income above 57 000

Taxable income (R)	Rate of tax (R)
300 001 and above	24 300 + 28% of taxable income above 300 000

Source: SARS (2010b:1)

Section 10(1)(zJ) of the Income Tax Act stipulates that amounts received by or accrued to a registered **micro business** are exempt from income tax. The only exceptions are investment income and remuneration. Therefore, all income of a registered micro business, except investment income and remuneration, will not be subject to income tax, but will be subject to turnover tax.

As a micro business grow and its taxable turnover increases, the tax rate increases to urge the micro business to maintain adequate records to move to the normal income tax system and not stay in the turnover tax system (SARS, 2010a:10). The tax rates as provided for in Table 2.5 are applicable to a micro business whose financial year ends on 28 February 2011.

Table 2.5: Tax rates for micro businesses with financial year-end on 28 February 2011

Taxable turnover (R)	Rate of tax (R)
0–100 000	0%
100 001–300 000	1% of taxable turnover above 100 000
300 001–500 000	3% of taxable turnover above 300 000
500 001–750 000	5% of taxable turnover above 500 000
750 001 and above	7% of taxable turnover above 750 000

Source: SARS (2010b:1)

From the above, it is clear that the tax rates for an SMME qualifying as a small business corporation or a micro business are much lower compared with other entities.

2.3.2 Skills development levy relief

In terms of Section 3 of the Skills Development Levies Act, all entities are required to pay a skills development levy of 1% on the total remuneration paid by an employer to its employees.

Section 4(b) of the Skills Development Levies Act determines that an employer with a maximum annual payroll expense of R500 000 is exempt from paying the levy.

In an SMME facilitation programme performed by SARS in 2004, it was found that the skills development levy is, together with VAT, the most difficult tax for SMMEs to comply with (Smulders, 2007:73).

This relief measure was therefore introduced to provide tax relief for SMMEs by reducing the compliance cost for entities with a payroll not exceeding R500 000 (SARS, 2005). It is acknowledged that this tax exemption improved the economic environment for SMMEs (Smulders & Oberholzer, 2006a:1). This relief measure was also introduced to encourage SMMEs to hire employees (Arendse *et al.,* 2006:9).

2.3.3 Capital gains tax relief

The Eighth Schedule of the Income Tax Act determines that a natural person or a special trust who disposes of an asset has to include the capital gain at a rate of 25% in his/her taxable income and another person at a rate of 50%. Paragraph 5 determines that a natural person and a special trust receive an annual exclusion of R17 500 per year. This annual exclusion was included in the Income Tax Act to reduce compliance cost and simplify tax administration by ignoring small gains and losses (SARS, 2001).

A **special trust** is a trust that was created exclusively for the assistance of a person with a mental illness or a severe physical disability with the consequence that the person cannot earn enough income to survive (Section 1 of the Income Tax Act).

Paragraph 57 was included in the Eighth Schedule of the Income Tax Act to provide tax relief to persons who invested their funds in a business to prepare for their retirement (SARS, 2001).

CGT relief is available to a **small business** that sells an active business asset (Paragraph 57 of the Eighth Schedule of the Income Tax Act). An active business asset includes immovable property to the extent that it was used for trade purposes and movable

property that was used or held solely for trade purposes. An active business asset excludes financial instruments and assets from which annuity income, rental income, foreign exchange gain or royalty income is derived.

This relief is only available to the following natural persons:

- the owner of a sole proprietorship that qualifies as a small business;
- a partner in a partnership that qualifies as a small business; and
- a person having a direct interest of at least 10 per cent of the equity in a company that qualifies as a small business.

A maximum aggregate capital gain of R750 000 may be disregarded during the person's life. The asset, interest in the partnership or interest in the company should have been held for a minimum period of five years prior to disposal. The natural person should have been involved in the functioning of the business and should be at least 55 years of age. The disposal of the asset should be a result of ill-health, infirmity, superannuation or death. Subsequent to the first asset being sold, all other assets which form part of the small business, must be sold within 24 months.

Where a natural person owns multiple sole proprietorships, or has more than one interest in a partnership or more than one interest in 10% of the equity of a company, all these small businesses will be subject to the disregarding of the capital gain. The market value of the assets of all the small businesses together must, however, be below R5 million.

CGT relief is available to a **micro business** in terms of paragraph 57A of the Eighth Schedule of the Income Tax Act. The capital gain or loss realised by a micro business on the disposal of immovable property may be disregarded to the extent that it was used for trade purposes. The capital gain or loss realised by a micro business on the disposal of movable property mainly used for trade purposes may be disregarded in full.

This relief measure was introduced to simplify capital gains in terms of the turnover tax system, because normal micro businesses do not have significant capital assets (SARS, 2010a:15).

From the above, it is evident that normally an entity pays 25% or 50% CGT when an asset is disposed of. However, a small business receives an exemption of R750 000 if certain criteria are met and a micro business is exempt from CGT for certain assets. An SMME qualifying as a small business or a micro business therefore pays less CGT as opposed to an entity not qualifying as a small business or a micro business.

2.3.4 Provisional tax relief

Normally entities are obliged to make three provisional tax payments. Individuals and trusts with a maximum taxable income of R50 000 and companies and close corporations with a maximum taxable income of R20 000 only need to make two provisional tax payments (Accountancy SA, 2010).

If the taxable income of a company or close corporation is a maximum of R20 000, or R50 000 for another person, no interest will be charged on the outstanding provisional tax amount (Section 89quat(2) of the Income Tax Act).

A survey was conducted by Venter and De Clerq (2007:15), in which respondents were asked what method they would choose to reduce the tax compliance burden. Most entities chose that penalties and interest charged should be lowered (Venter & De Clerq, 2007:16). As a result, this relief measure where certain SMMEs do not pay interest on their outstanding provisional tax amount reduces the tax compliance burden for those entities.

2.3.5 Secondary tax on companies relief

South African resident companies are liable to pay STC at a rate of 10% on the net dividends declared (Section 64B(2) of the Income Tax Act). Net dividends declared are dividends declared by the company less dividends received by the company (Section 64B(3) of the Income Tax Act).

A **micro business** will be exempt from STC to the extent that its dividends declared do not exceed R200 000 (Section 64B(5)(l) of the Income Tax Act).

2.3.6 Relief on the exportation of goods

A person who is interested in exporting goods from South Africa is required to register as an exporter with the South African Revenue Service (SARS). There is no obligation to register if the following criteria are met (SARS, 2008:68):

- only non-commercial goods are exported;
- each shipment's value is below R20 000; and
- not more than three exportations are made per year.

2.3.7 Value-added tax relief

2.3.7.1 *Value-added tax relief: registration*

An entity is liable to register for VAT if its taxable supplies for 12 months exceeded R1 million or if it is expected that its taxable supplies for the next 12 months will exceed R1 million (Section 23 of the VAT Act). An SMME with taxable supplies less than R1 million does therefore not need to register for VAT and is thus not liable to pay VAT.

A supply of goods or services on which VAT should be levied is referred to as a taxable supply (Section 1 of the VAT Act).

The threshold was increased to R1 million to align the VAT threshold with the new turnover tax system (SARS, 2010a:7).

Micro businesses are not allowed to register for VAT (Section 23(8) of the VAT Act). As VAT is transaction-based and demands persistent record-keeping, VAT is the most burdensome tax to adhere to (SARS, 2010a:18). Entities registered for VAT should therefore be able to comply with the requirements of the normal tax system (SARS, 2010a:18). As a result, the VAT compliance burden for a micro business is reduced.

2.3.7.2 *VAT relief: accounting basis*

A person registering for VAT can register for VAT on either the invoice basis or on the payment basis. VAT is accounted for in terms of the invoice basis on the first of the date on which an invoice is delivered or a payment is made or received. VAT is accounted for in terms of the payment basis when a payment is made or received.

If the person is registered on the payment basis and the supply of goods or services is R100 000 or more, the person must account for VAT on that specific supply on the invoice basis (Section 15(2A) of the VAT Act). This was included in the VAT Act to prevent the following situation for significant transactions (SARS, 1997:16). A vendor supplying goods or services accounts for VAT on the payment basis and the purchaser accounts for VAT on the invoice basis. As an invoice was issued, the purchaser can claim the full amount of VAT. As no payment was received, the seller does not account for output VAT. Sometimes these transactions were planned to obtain a VAT refund.

Only certain persons may register on the payment basis. One of the persons that may register on the payment basis is a natural person or an unincorporated body of persons with only natural persons as members and with the total value of the taxable supplies not exceeding R2,5 million for 12 months (Section 15(2)(b) of the VAT Act).

From the above, it is evident that only certain SMMEs may register for VAT on the payment basis. SMMEs registered on the payment basis with taxable supplies each of R100 000 or less will not need to account for VAT on the invoice basis.

2.3.7.3 *VAT relief: tax periods*

VAT is paid according to each tax period for which an entity is registered. Category A to F provides for the different tax periods that exist in terms of the VAT Act.

Category A provides for a two-month period ending on the last day of January, March, May, July, September and November (Section 27(1) of the VAT Act). Entities not falling within Category C, D, E or F, fall in Category A (Section 27(2) of the VAT Act).

Category B provides for a two-month period ending on the last day of February, April, June, August, October and December (Section 27(1) of the VAT Act). Entities not falling within Category C, D, E or F, fall in Category B (Section 27(2) of the VAT Act).

Category C provides for a one-month period ending on the last day of each month (Section 27(1) of the VAT Act). Entities with taxable supplies of more than R30 million for 12 months, fall in Category C (Section 27(3) of the VAT Act).

Category D provides for a six-month period ending on the last day of February and August (Section 27(1) of the VAT Act). Farmers with taxable supplies less than R1.5 million for 12 months, fall in Category D (Section 27(4) of the VAT Act).

Category E provides for a 12-month period ending on the entity's year-end (Section 27(1) of the VAT Act). Companies and trust funds whose activities consist solely of the letting of fixed property or movable goods or the administration or management of connected persons, fall in Category E. The connected persons must all be registered for VAT and must be allowed to deduct the amount of VAT in full. Tax invoices must be issued and payments must all be made at year-end (Section 27(4A) of the VAT Act).

Category F provides for a four-month period ending on the last day of June, October and February (Section 27(1) of the VAT Act). Entities with taxable supplies of R1.5 million or less, fall in Category F (Section 27(4B) of the VAT Act).

As a result, SMMEs may submit less VAT returns compared with normal entities. This was brought into the VAT Act to minimise the VAT compliance burden and cash flow consequences for SMMEs (Smulders & Oberholzer, 2006a:2).

2.3.8 Record-keeping relief

A taxpayer carrying on a trade should retain for at least five years all the following records relevant to his/her returns submitted (Section 73A of the Income Tax Act):

- ledgers;
- cash books;

- journals;
- cheque books;
- bank statements;
- deposit slips;
- paid cheques;
- invoices;
- stock lists;
- all books of account; and
- electronic representations of information.

In terms of Paragraph 14 of the Sixth Schedule of the Income Tax Act, a micro business is required to retain only the following records:

- amounts received;
- dividends declared;
- assets with a cost price exceeding R10 000; and
- liabilities exceeding R10 000.

From the above, it is clear that the compliance cost for a micro business is reduced as the entity may retain fewer records.

2.3.9 Relief on advance tax rulings

An advance tax ruling states how the Commissioner interprets and applies a specific provision of the tax law. Binding private rulings, binding class rulings and binding general rulings are the three existing types of advance tax rulings. To provide feedback to a taxpayer regarding a specific transaction, a binding private ruling is issued. To provide feedback to a class of persons regarding a specific transaction, a binding class ruling is issued. The commissioner may exercise his/her discretion regarding general issues and issue a binding general ruling (SARS, 2009a:2).

The application fee for a binding private ruling or a binding class ruling is R10 000. The application fee for a binding private ruling made by a **small business corporation** is only R2 500 (SARS, 2009b:7).

An SMME applying for a binding private ruling will therefore save on the application fees.

2.3.10 Venture capital companies

In 2008, it was declared by the then Minister of Finance, Trevor Manuel, that the biggest growth problem of SMMEs is to obtain equity finance (SARS, 2010c). Equity helps SMMEs to survive downturns and enables SMMEs to reinvest surplus cash instead of using the cash for debt payments. In assisting SMMEs to draw small investors and investment skills, section 12J of the Income Tax Act was introduced to provide tax relief in respect of equity investments made in venture capital companies (SARS, 2010c).

If a natural person, a listed company or a controlled group company acquires shares in a venture capital company, the expenditure actually incurred may be deducted from income (Section 12J(2) of the Income Tax Act). A controlled group company is a company in which at least 70% of shares are being held by the controlling group company. This group is referred to as a group of companies (Section 1 of the Income Tax Act).

The maximum amount per year allowed to be deducted by a natural person is R750 000. The total number of deductions allowed over a natural person’s lifetime is limited to R2.25 million (Section 12J(3)(a) of the Income Tax Act).

Companies are allowed to deduct actual expenditure incurred up to a maximum of 40% of the value of the equity shares (including shares that are held by all companies that form part of the same group of companies) held in the venture capital company (Section 12J(3)(b) of the Income Tax Act).

The venture capital company is required to issue a certificate to the investor certifying the amounts invested and disclosing the fact that the commissioner has approved the venture

capital company. This certificate should accompany the claim for the deduction (Section 12J(4) of the Income Tax Act).

A **venture capital company** will be approved by the commissioner if the following criteria are met (Section 12J(5) of the Income Tax Act):

- the company is a resident of South Africa;
- the only goal of the company is to administer investments made in qualifying companies. The company should, however, not control any qualifying companies. A company will be a qualifying company if the following criteria are met:
  - the company is a resident of South Africa;
  - the company is not a controlled group company;
  - the company's tax matters are in place;
  - the company is not listed;
  - the company is not carrying on any of the following trades:
    - dealing in or renting immovable property, except for a hotel keeper;
    - banking, insurance, money-lending or hire-purchase financing;
    - financial or advisory services;
    - gambling;
    - trading in liquor, tobacco, arms or ammunition;
    - franchisee; or
    - trade is carried on mostly outside the Republic; and
  - investment income is not more than 20% of gross income;
- the company is not listed;
- the company is not a controlled group company;
- the company's tax matters are in place; and
- the company is licensed in terms of the Financial Advisory and Intermediary Services Act (37/2002).

Tax relief in the form of a deduction is thus available for investments made in SMMEs.

In this section, the tax relief measures available to SMMEs in South Africa were discussed. In the next section, the tax relief measures available to SMMEs in Australia are discussed.

2.4 TAX RELIEF MEASURES AVAILABLE IN AUSTRALIA: SMALL BUSINESS ENTITY CONCESSIONS

2.4.1 Income tax concessions

2.4.1.1 *Income tax concession: simpler trading stock rules*

Trading stock is anything acquired or manufactured that is available for sale (ATO, 2010b).

Normally an entity is obliged to conduct a stocktake at year-end. The physical quantities of stock on hand are ascertained to determine the value of each item of stock. If the closing stock value exceeds the opening stock value, the change is included in income. If the opening stock value exceeds the closing stock value, the change is deducted from income (ATO, 2010b).

A **small business entity** can choose not to perform a stocktake to account for the change in its trading stock. To qualify, the change between the trading stock value at the beginning of the year and the trading stock value at year-end should be A$5 000 or less. The small business entity must record how the estimated trading stock value as at year-end was calculated (ATO, 2010b).

2.4.1.2 *Income tax concession: simpler depreciation rules*

Normally an entity can claim an immediate deduction on assets with a cost price less than A$100. A depreciation calculation for all other assets should be performed per asset and should be based on the asset’s useful life using the prime cost method or the diminishing value method (ATO, 2010b).

A **small business entity** can claim an immediate deduction on assets with a cost price less than A$1 000. Most of the entity’s remaining assets can be grouped together and one

depreciation calculation may be performed for all the assets in one group using the diminishing value method. Assets with a useful life shorter than 25 years are grouped together and depreciation is calculated using a rate of 30%. Assets with a minimum useful life of 25 years are grouped together and depreciation is calculated using a rate of 5% (ATO, 2010b).

The following assets cannot be grouped together and depreciation should be calculated separately for each asset over its useful life: assets rented, assets leased, horticultural plants, software, buildings, structural improvements, investments in Australian films, research and development (ATO, 2010b).

2.4.1.3 *Income tax concession: immediate deductions for prepaid expenses*

A prepaid expense is an expense incurred in the current year for goods or services that will not fully realise in the current year (ATO, 2010b).

An entity must deduct prepaid expenses over the years the expense relates to (ATO, 2010b).

Prepaid expenses incurred in the current year by a **small business entity** that relate to services for 12 months or less and are realising in the next year, can be deducted in full in the current year. This applies to business and non-business expenses (ATO, 2010b).

2.4.1.4 *Income tax concession: entrepreneurs' tax offset*

Companies in Australia pay tax at a rate of 30% (ATO, 2009a).

Entities with a total turnover of less than A$50 000 will receive a tax offset of 25% on their income tax liability. The tax offset is phased out when the total turnover exceeds A$50 000. The tax offset stops when the entity's total turnover reaches A$75 000 (ATO, 2010b).

2.4.2 Capital gains tax concessions

CGT is not a separate tax, but forms part of income tax and is paid on capital gains made (ATO, 2010b). The capital gain or loss for each CGT event should be determined whereafter the net capital gain or loss for the year should be determined and included on the taxpayer's income tax return (ATO, 2010c).

CGT exemptions are available to small business entities. To qualify for these concessions, at least one of the following criteria must be met (ATO, 2010b):

- the entity is a small business entity;
- the entity does not carry on business, but the asset is used by a small business entity connected to the first-mentioned entity;
- the person is a partner in a partnership qualifying as a small business entity. The asset relates to an interest in an asset of the partnership or an asset owned by the person used in the partnership; or
- just before the CGT event occurs, the net value of all CGT assets do not exceed A$6 000 000. To calculate the net value of the CGT assets, all liabilities relating to the assets are deducted from the market value of these assets.

To qualify for the CGT concessions, the asset must meet the requirements of the active asset test. An active asset is a tangible or intangible asset held by the entity and ready to be used for business purposes. If the asset is owned for longer than 15 years, the asset should have been an active asset for 7,5 years. If the asset is owned for a shorter period than 15 years, the asset should have been an active asset for half of the period of ownership (ATO, 2010b).

If the asset consists of company shares or a trust interest, certain additional criteria must be met. The active assets should consist of 80% of the assets kept by the company or trust. If shares are hold by an individual in a **company**, the individual must be entitled to at least 20% of the dividends, capital distributions or voting rights. If an interest is hold by an individual in a **trust**, the individual must be entitled to at least 20% of the distributions of income or capital. These individuals are classified as CGT concession stakeholders. If the company shares or the trust interest is hold by a non-individual, all the CGT concession

stakeholders should hold a combined interest of 90% in the company or trust (ATO, 2010b).

These CGT requirements were included in the tax legislation as the Australian Government's objective was not to fund an SMME that is not creating jobs or contributing to the country's gross domestic product (Arendse *et al.,* 2006:13).

The CGT exemptions currently available to small business entities are discussed below.

2.4.2.1 *CGT concessions: 15-year exemption for a small business*

A sole trader or a partner in a partnership who is older than 55 years and who retires or is permanently disabled and sells an asset that was held for 15 years can elect to exempt the asset from CGT (ATO, 2010b). No tax is therefore payable on the capital gain made.

2.4.2.2 *CGT concessions: CGT 50% active asset reduction*

Normally, entities pay tax on the full amount of the capital gain. If a small business entity sells an active asset, only 50% capital gains tax is payable (ATO, 2010b). An active asset is defined in 2.4.2.

2.4.2.3 *CGT concessions: CGT retirement exemption*

To qualify for this CGT retirement exemption, the person must be a sole trader or a partner in a partnership and must be older than 55 years when choosing to use this exemption. If the person was younger than 55 years when choosing to use this exemption, the amount should have been paid into a superannuation fund or retirement savings account. The maximum total exemption over the person's life amounts to A$500 000 (ATO, 2010b).

2.4.2.4 *CGT concessions: CGT rollover*

If a replacement business asset is bought or improvements are made to an existing business asset, the capital gain from the sale of the business asset may be rolled over to a

later year. This means one may defer one's capital gain to a later year. Capital gains tax becomes payable when the roll-over conditions are not met, the asset is sold, the asset ceases to be an active asset or the asset becomes trading stock (ATO, 2010b).

2.4.3 Goods and services tax concessions

An entity registered for GST is obliged to include GST in sales prices and may claim GST included in purchase prices for business expenses. Australian GST levied at 10% is similar to South African VAT levied at 14% (ATO, 2010a).

When an entity's turnover is a minimum of A$75 000, the entity is obliged to register for GST. An entity may register voluntarily for GST if its turnover is below A$75 000 (ATO, 2010a).

2.4.3.1 *Accounting for GST on a cash basis*

Normally entities registered for GST need to account for GST on the accrual basis. GST must be paid on taxable sales when the invoice is delivered or the payment is received, whichever event occurs first. GST credits can be claimed on goods and services purchased when the invoice is delivered or payment is made, whichever event occurs first (ATO, 2010a).

To be able to claim GST on purchases exceeding A$82.50 (including GST), a valid tax invoice must be kept by the entity (ATO, 2010a).

Certain entities may elect to account for GST on the cash basis. This means that GST may be accounted for in the tax period when the cash on a sale is received and that GST may be claimed in the tax period the purchase is paid for.

Any of the following requirements should be met for an entity to be able to account for GST on the cash basis (ATO, 2010a):

- the entity is a **small business entity** or the GST turnover is a maximum of A$2 million;

- the income tax of the entity is accounted for on a cash basis;
- the Australian Taxation Office (ATO) decided that the entity may account for GST on the cash basis in spite of the entity's turnover; or
- the entity is a charitable institution or a government school.

2.4.3.2 *Paying GST by instalments*

Normally, entities should report GST monthly, quarterly or annually. GST is reported either through an activity statement or an annual GST return. Business tax liabilities and entitlements are reported in an activity statement. Actual GST and the difference between GST instalments and actual GST are reported in an annual GST report (ATO, 2010a).

An entity with a GST turnover of less than A$75 000, may report GST monthly, quarterly or annually. An entity with a GST turnover from A$75 000 to A$19 999 999, may report GST monthly or quarterly. An entity with a GST turnover of A$20 million or more, must report GST monthly (ATO, 2010a).

There are three reporting options available for entities that report GST quarterly (ATO, 2010a).

The first option is to pay and report GST on sales, GST on purchases, total sales, exports, GST-free sales, capital purchases and non-capital purchases quarterly.

The second option is to pay GST quarterly and report GST on sales, GST on purchases and total sales quarterly. Exports, GST-free sales, capital purchases and non-capital purchases are reported annually in an annual GST information report.

The third option is to pay GST quarterly and report GST on sales, GST on purchases, total sales, exports, GST-free sales, capital purchases and non-capital purchases annually. The amount of the instalments is calculated by the ATO and is based on the net GST amount most recently communicated and a gross domestic product adjustment.

The following criteria should be met by an entity to elect the third option (ATO, 2010a):

- the entity is a **small business entity** or the GST turnover is a maximum of A$2 million;
- the entity does not currently submit its GST activity statement monthly;
- an activity statement was submitted by the entity for at least two quarters or four months;
- all prior activity statements have been submitted; and
- the entity was not in a net GST refund position in the prior year.

Quarterly payments for September, December, March and June must be made before 28 October, 28 February, 28 April and 28 July respectively. Each quarter, 25% of the annual GST liability must be paid. If the due date is on a weekend or public holiday, the entity is allowed to only report on the next business day (ATO, 2010a).

The difference between the total instalments paid and the GST liability for the year is paid or claimed annually (ATO, 2010a).

The entity may only make two GST instalments if the entity is a production business or an author, inventor, performing artist, production associate or sportsperson and the net income (income less deductions) in its latest return was a minimum of A$1 million (ATO, 2010a).

Six-monthly payments for March and June should be made before 28 April and 28 July. By 28 April, 75% of the annual GST liability should be paid and 25% of the annual GST liability should be paid by 28 July (ATO, 2010a).

2.4.3.3 *Annual apportionment of GST input tax credits*

Normally, where something was bought partially for business use and partially for private use, an apportionment must be made as only the business part may be claimed as a GST input. This should be done on each activity statement where GST credits include a part for private use (ATO, 2010b).

Small business entities can choose to account for the private portion on GST credits annually and not on each activity statement where GST credits include a part for private use. The full GST credit can be claimed and one adjustment can then be made after year-end for the private part of all GST credits (ATO, 2010b).

If an entity pays GST in instalments or report GST annually, this relief measure may not be elected (ATO, 2010b).

2.4.4 Pay-as-you-go instalment concessions

Entities should withhold PAYG on payments made to employees. Entities are obliged to make PAYG instalments to the ATO quarterly, twice a year or annually (ATO, 2010b).

To save **small business entities** the time in calculating PAYG payments, entities that make a PAYG payment every quarter can choose to make payments calculated by the ATO (ATO, 2010b).

2.4.5 Fringe benefit tax concessions

An entity is obliged to pay fringe benefits tax to the ATO if car-parking benefits are provided to employees (ATO, 2010b).

Entities will be exempt from paying fringe benefits tax on car-parking benefits provided to employees if the following requirements are satisfied (ATO, 2010b):

- the entity was a **small business entity** in the prior year. If the entity was not a small business entity, but its total income was less than A$10 million, the exemption may still apply;
- the entity is not a government body, a listed public company or a subsidiary of a listed public company;
- the parking place is not a commercial parking place;
- the parking place is owned, leased or controlled by the entity;

- the car is parked at the parking place for a minimum of four hours per day between 7am and 7pm;
- the car is owned, leased or controlled by the employee or the entity gave the car to the employee;
- the parking is supplied as part of the employees' employment;
- the car is parked at or close by the employee's main place of employment;
- the car is used by the employee to travel between his/her residence and work; and
- there is a commercial parking place within a one-kilometre radius from the employer's parking place and a payment must be made at the commercial parking place if the car is parked there for an entire day.

This section discussed the tax concessions available to small business entities in terms of the Australian tax law. The next section discusses the venture capital tax concessions available in Australia.

2.5 TAX RELIEF MEASURES AVAILABLE IN AUSTRALIA: VENTURE CAPITAL TAX CONCESSIONS

SMMEs in Australia encountered problems with regard to equity funding (Barkoczy & Sandler, 2007:34). As Australia needed to stay competitive, the venture capital tax concession was established to encourage investors to invest in high-risk, start-up or developing entities in Australia as these entities normally struggle to draw investors through the usual trading methods (ATO, 2009b).

A limited partnership approach is used by Australia (Barkoczy & Sandler, 2007:27). The partners can benefit from limited liability, flow-through tax treatment and losses not being locked in at entity level (Barkoczy & Sandler, 2007:27-28).

The venture capital concessions consist of the 1999 venture capital tax concession, the 2002 venture capital tax concession and the early stage venture capital tax concession (ATO, 2009b). These are explained in detail below in the next section.

2.5.1 The 1999 venture capital tax concession

To improve Australia's tax system, the Review of Business Taxation was appointed by the Australian Government to "make recommendations on the fundamental design of the business taxation system, the processes of ongoing policy-making, drafting of legislation and the administration of business taxation" (D'Ascenzo, 1999).

Due to a lack of venture capital funding, the 1999 venture capital tax concession was introduced after a recommendation by the Review of Business Taxation to encourage foreign investors to invest in Australian firms by providing an exemption to these investors (Barkoczy & Sandler, 2007:71). Tax relief is provided to certain pension or retirement funds that are not residents of Australia when an investment in certain Australian entities is disposed of (ATO, 2009b).

The entity in which the investment is made is referred to as a resident investment vehicle. For an entity to qualify as a **resident investment vehicle**, the following requirements must be met (ATO, 2009b):

- the entity is a company or a trust;
- the entity is a resident of Australia;
- the total assets of the entity do not exceed $50 million; and
- the entity's main business is not property development or land ownership.

The entity making the investment is referred to as a venture capital entity. If the following criteria are met, the entity will qualify as a **venture capital entity** (ATO, 2009b):

- the entity is a foreign superannuation fund;
    - the fund is a provident, benefit, superannuation or retirement fund that continues indefinitely;
    - the fund is formed in a foreign country;
    - the fund was formed for the benefit of non-Australian residents; and
    - the main management and control of the fund is performed outside Australia;

- the entity is a non-resident of Australia throughout the time the investment is hold and is a resident of Canada, France, Germany, Japan, the United Kingdom or the United States of America;
- the entity is tax exempt in its country of residence;
- the entity is registered with Innovation Australia (the Board);
- the entity is making an investment in a resident investment vehicle;
- the entity had the investment for at least 12 months; and
- by holding the investment, the entity was at risk.

A share or interest hold by the venture capital entity in the resident investment vehicle is the venture capital equity (ATO, 2009b).

A venture capital entity disposing of its venture capital equity in a resident investment vehicle may ignore all the revenue and capital gains or losses made (ATO, 2009b).

2.5.2 The 2002 venture capital tax concession

The 1999 venture capital tax concession was introduced to exempt foreign investors from tax on Australian investments in an equal way as they are exempt from tax on comparable investments owned in their residence country. Foreign investment did not expand and the objective was thus not achieved (Barkoczy & Sandler, 2007:74). Therefore, the 2002 venture capital tax concession was introduced by the Australian Government in 2002 to extend the Australian industry by raising capital for high-risk, start-up or developing entities that experience difficulty in attracting investment through the usual trading methods by encouraging foreign investments (ATO, 2009b).

Two new venture capital investment vehicles were introduced, namely a venture capital limited partnership (VCLP) and an Australian capital fund of funds (AFOF) (ATO, 2009b).

The limited partnership was chosen by Australia as the venture capital investment vehicle due to its popularity internationally as these entities are taxed on a flow-through basis and the investors have the benefit of limited liability (Barkoczy & Sandler, 2007:77).

An investment should meet the following requirements to qualify as an **eligible venture capital investment** (ATO, 2009b):

- the investment consists of shares, units, options, warrants or convertible notes that are all equity interests. The investment should not be a debt interest;
- the investment is at risk. The entity to which the investment belongs does not have an agreement to the maintenance of the value of the investment or the return on the investment;
- if the investee is a **company**, it should be an Australian resident, more than 50% of the employees should mainly work in Australia and more than 50% of the assets should be situated in Australia for 12 months. If the investee is a **unit trust**, it should trade in Australia, the main management should be in Australia or more than 50% of income or capital beneficiaries should be Australian residents, more than 50% of the employees should mainly work in Australia and more than 50% of the assets should be situated in Australia for 12 months;
- the investee company should meet at least two of the following criteria: more than 75% of its assets should mainly not be used in ineligible activities, more than 75% of its employees should mainly not be employed in ineligible activities or 75% of income should not be derived from ineligible activities. Property development, land ownership, banking, providing capital, factoring, securitisation, leasing, insurance, construction and investments earning interest, rent, dividends, royalties or lease payments are all ineligible activities;
- the investment should not be invested in another company by the investee;
- the investee company should have a registered auditor;
- if the investee company is an early stage venture capital limited partnership (ESVCLP), the ESVCLP's total assets should not be more than A$50 million. If the investee company is not an ESVCLP, the entity's total assets should not be more than A$250 million. This is referred to as the permitted entity value test. An ESVCLP is defined in the next sub-section;
- the investee company's shares are unlisted; and
- the total amount invested in the entity by the partnership should not be more than 30% of the partnership's committed capital. The amount the partner is required to

contribute to the partnership is the partner's committed capital. The total of the committed capital of all the partners is the partnership's committed capital.

A **VCLP** obtains and advances capital to invest in high-risk, start-up entities. The VCLP is a partnership and not a corporate limited partnership. A limited partnership is not a tax-paying entity, but the partners in the partnership are taxed on their part of the interest in the partnership on a flow-through basis. A corporate limited partnership is a tax-paying entity and is taxed like a company (ATO, 2009b).

A VCLP needs to register with Innovation Australia (the Board). A limited partnership that satisfies the following criteria will qualify for registration as a VCLP (ATO, 2009b):

- the partnership was formed under the Australian law or under the law of a foreign country which has a double tax agreement with Australia;
- all the general partners of the partnership must be Australian residents or residents of a foreign country which has a double tax agreement with Australia. A partner whose liability in connection with the partnership is not limited is a general partner;
- the VCLP must be obliged to exist for five to 15 years in terms of the partnership agreement;
- the total committed capital of the partnership must be a minimum of A$10 million;
- the investment should qualify as an eligible venture capital investment;
- the business of the partnership is only to make investments; and
- the debt of the partnership only consists of permitted loans.

A **permitted loan** is a loan made to a venture capital investee by a VCLP, ESVCLP or AFOF, which meets one of the following requirements (ATO, 2009b):

- the repayment term of the loan is six months where the VCLP, ESVCLP or AFOF does not have an eligible venture capital investment in the company or unit trust; or
- where the VCLP, ESVCLP or AFOF holds an equity interest in the company or unit trust, the equity interest is a minimum of 10% of the company or unit trust's total interest.

An **AFOF** obtains and advances capital to invest in high-risk, start-up entities directly or through a VCLP or through an ESVCLP (defined in 2.5.3). An AFOF will be treated as a limited partnership and not as a corporate limited partnership (ATO, 2009b).

The AFOF should be registered with Innovation Australia (the Board). To qualify for registration, certain requirements should be met (ATO, 2009b):

- the partnership must have been incorporated in Australia;
- every general partner must be an Australian resident;
- the partnership must be obliged to exist between five and 20 years in terms of the partnership agreement;
- the AFOFs only trade is to make investments;
- the debt of the AFOF only consists of permitted loans; and
- the investment should satisfy one of the following criteria:
    - the investment is in a VCLP;
    - the investment is in an ESVCLP;
    - the investment is an eligible venture capital investment in a company or unit trust in which a VCLP or an ESVCLP owns an eligible venture capital investment; or
    - the investment is in a company or unit trust and qualifies as an eligible venture capital investment except for the location in Australia and permitted entity value tests.

A partner in a partnership will be an **eligible venture capital partner** if the partner meets any of the following criteria (ATO, 2009b):

- the partner is a tax-exempt foreign resident of any foreign country. An entity will be a tax-exempt foreign resident if all of the following criteria are met:
    - the entity is a non-Australian resident;
    - the entity is not a general partner of a VCLP or an ESVCLP; and
    - in the entity's residence country, the entity is exempt from paying tax;

- the partner is a foreign venture capital fund of funds whose committed capital in the partnership is not more than 30% of the partnership's committed capital. A foreign venture capital fund of funds can consist of a **limited partnership**. The limited partnership should not have been formed in Australia. All general partners in the partnership should be non-Australian residents. The partnership should not be a general partner of a VCLP or an ESVCLP. A foreign venture capital fund of funds can consist of an **entity that is not a limited partnership**. The entity should not have been formed in Australia and should be a non-Australian resident. The entity should be taxed in its country of residence on a flow-through basis. The entity should not be a general partner of a VCLP or an ESVCLP; or
- the partner is a taxable foreign resident whose committed capital in the partnership is less than 10% of the partnership's committed capital.

When the eligible venture capital investment is disposed of, revenue profits are exempt from income tax, revenue losses may not be deducted from income and capital gains and losses may be disregarded (ATO, 2009b).

These tax relief measures are available to (ATO, 2009b):

- eligible venture capital partners in a VCLP and where the VCLP made the investment;
- eligible venture capital partners in an AFOF where the AFOF is a partner in a VCLP, which made the investment;
- eligible venture capital partners in an AFOF where the AFOF made the investment; and
- eligible venture capital investors making the investment.

VCLP, AFOF and venture capital investors should register with Innovation Australia (the Board) (ATO, 2009b).

2.5.3 The early stage venture capital tax concession

In October 2004, the Australian Government indicated its continuous assistance for the venture capital industry by committing to an evaluation of this industry (Costello, 2006a). As a result, this concession was introduced to expand activity in the venture capital sector and to promote the growth of new SMMEs, especially entities whose focal point is technology by making it easier for them to obtain capital (Costello, 2006a). This concession builds on the previous two concessions (Costello, 2006a).

The venture capital tax concessions were broadened to also provide tax relief for Australian residents and a new investment vehicle was introduced, namely the ESVCLP (ATO, 2009b). The investor will receive a complete tax exemption on capital and revenue gains (Costello, 2006a).

An ESVCLP obtains and advances capital to invest in high-risk, start-up entities. The ESVCLP is a limited partnership and not a corporate limited partnership (ATO, 2009b).

A limited partnership that satisfies the following criteria will qualify as an ESVCLP (ATO, 2009b):

- the partnership was formed under the Australian law or under the law of a foreign country which has a double tax agreement with Australia;
- all the general partners of the partnership must be Australian residents or residents of a foreign country which has a double tax agreement with Australia;
- the ESVCLP must be obliged to exist for five to 15 years in terms of the partnership agreement;
- the total committed capital of the partnership must be between A$10 million and A$100 million;
- the committed capital of a partner in the partnership can be a maximum of 30% of the partnership's committed capital;
- the investment should qualify as an eligible venture capital investment;
- the investment should adhere to the partnership's approved investment plan;
- the only trade of the partnership is to make investments;

- the debt of the partnership only consists of permitted loans;
- the partnership should not hold an investment where the investee company's total assets are more than A$250 million;
- the partnership must assure Innovation Australia (the Board) that the investment plan of the partnership is suitable; and
- the partnership must assure Innovation Australia (the Board) that the partnership has the essential resources to enforce the investment plan.

As the benefit is only for investments owned in small entities, the A$250 million divest requirement was included to avoid an ESVCLP still benefiting from investments owned in entities that were previously small, but have expanded significantly (Barkoczy & Sandler, 2007:89).

All the partners of an ESVCLP are exempt from paying tax on their share of the income derived from the partnership or the disposal of their share in the ESVCLP (ATO, 2009b).

If the following requirements are satisfied, capital gains and losses relating to the investment may be ignored (ATO, 2009b):

- the ESVCLP is registered with the Board;
- if the partner in the partnership is a general partner, the general partner is either an Australian resident or a resident of a country which has a double tax agreement with Australia;
- the CGT event relates to a venture capital investment; and
- the investment was owned for at least 12 months.

If the following criteria are met, income derived from the investment will be exempt from tax (ATO, 2009b):

- the ESVCLP should be registered with the Board;
- if the partner in the partnership is a general partner, the general partner should either be an Australian resident or a resident of a country which has a double tax agreement with Australia; and

- the ESVCLP should own the investment.

The capital exemptions are available to the following entities (ATO, 2009b):

- partners in a limited partnership that is registered as an ESVCLP;
- eligible venture capital partners in an AFOF that invested through an ESVCLP; and
- eligible venture capital investors.

The income exemptions are available to the following partners (ATO, 2009b):

- partners in a limited partnership that is registered as an ESVCLP; and
- partners in an AFOF that invested through an ESVCLP.

2.6 CONCLUSION

This chapter discussed the definition of an SMME in terms of the South African tax legislation as well as the Australian tax legislation. The chapter also discussed the tax relief measures currently available to SMMEs in these countries. The reasons for the implementation of these relief measures as well as the research thereon were included in this literature review.

CHAPTER 3: COMPARISON OF TAX RELIEF MEASURES FOR SMALL, MEDIUM AND MICRO ENTERPRISES IN SOUTH AFRICA AND AUSTRALIA

3.1 INTRODUCTION

The purpose of this study, namely to draw a comparison between the tax relief measures available to SMMEs in South Africa and in Australia, will be achieved in this chapter.

An extended literature review is the most appropriate research method for this study as no new information is collected, but the existing literature as discussed in Chapter 2 is critically analysed, compared and evaluated.

3.2 COMPARISON OF TAX RELIEF MEASURES FOR A SMALL, MEDIUM AND MICRO ENTERPRISE IN SOUTH AFRICA AND AUSTRALIA

3.2.1 Definition of a small, medium and micro enterprise

In terms of South African tax legislation, as discussed in 2.2.2, there are currently three definitions for an SMME, namely a small business corporation, micro business and small business. An entity should be tested against all three definitions to determine whether the entity qualifies for tax relief.

In terms of Australian tax legislation, as discussed in 2.2.3, there is simply one definition for an SMME, namely a small business entity. An entity should only be tested against one definition to determine whether the entity qualifies for tax relief.

The definitions for a small business corporation, micro business and small business in terms of South African tax legislation each has a lot of different complex requirements. To qualify as a small business entity in terms of Australian tax legislation, there is only one requirement in terms of the definition to meet, namely the entity's turnover should be less than A$2 million in the prior year or current year. It is thus much easier for an Australian

entity to determine if it will qualify for tax relief than for a South African entity, as it only has to apply one definition and one requirement in terms of that definition.

Before 1 July 2007, Australia's tax legislation had different definitions for an SMME. Research showed that the different criteria that were applied increased compliance cost. To reduce compliance cost, a single definition for an SMME with a single requirement was introduced.

The criteria available to qualify for the South African tax relief measures vary between the different types of taxes, despite the fact that some of the criteria are similar. The taxation of SMMEs is inconsistently implemented by SARS as each tax has a separate purpose. It is acknowledged that the various definitions make compliance difficult (Smulders & Stiglingh, 2008:355). An SMME facilitation programme presented by SARS in 2005 acknowledged that the time spent by small entities on tax compliance increased due to the existence of different definitions for South African SMMEs (Chamberlain & Smith, 2006:34).

The South African Government should therefore consider including in the South African tax legislation a single definition for an SMME, instead of three, as well as a single requirement in terms of the definition, instead of many complex requirements.

3.2.2 Income tax relief: depreciation

Depreciation relief in terms of South African tax legislation was discussed in 2.3.1.1 and in terms of Australian tax legislation in 2.4.1.2.

Both South Africa and Australia provide that certain assets may be written off over a shorter period or even immediately for SMMEs.

Australia provides additional relief where only one depreciation calculation can be performed for a group of assets instead of a separate calculation for each asset. There is no similar relief available in South Africa and it should be considered to include a similar relief measure in the South African tax legislation to reduce compliance cost.

3.2.3 Income tax relief: tax rate for small, medium and micro enterprises

In South Africa, the tax rate for SMMEs is lower than for non-SMMEs (discussed in 2.3.1.2). In Australia, SMMEs receive a tax offset on their income tax liability (discussed in 2.4.1.4). SMMEs in both countries will thus pay less tax than normal entities.

3.2.4 Income tax relief: trading stock

A small business entity in Australia can choose not to perform a stocktake to account for the change in trading stock where the movement is A$5 000 or less (discussed in 2.4.1.1). No similar relief is available in South Africa and it should be considered to include a similar relief measure in the South African tax legislation.

3.2.5 Income tax relief: prepaid expenses

In terms of the Australian tax legislation as discussed in 2.4.1.3, a small business entity may deduct prepaid expenses in full in the year in which the expense was incurred instead of over the years to which the expense relates to.

In terms of Section 23H of the South African Income Tax Act, prepaid expenses may be deducted in full in the year in which the expense was incurred if all the goods are supplied or services are rendered or the full benefit is received within six months after year-end or the total prepaid expenses do not exceed R80 000. This South African relief measure is not only available to SMMEs, but is available to any entity that meets the requirements.

The South African Government should consider including a relief measure in the South African tax legislation that only applies to SMMEs similar to the Australian tax legislation.

3.2.6 Skills development levy relief

A skills development levy exemption is available in South Africa to employers with an annual payroll not exceeding R500 000 (discussed in 2.3.2). No skills development levy is payable in terms of Australian legislation.

3.2.7 Capital gains tax relief

Both South Africa and Australia provide CGT relief to SMMEs. Two relief measures are available in South Africa (discussed in 2.3.3) and four in Australia (discussed in 2.4.2).

The definition of an active asset differs between the two countries. Both countries require the asset to be used for business purposes. Different rules apply in South Africa for immovable and movable property, with certain inclusions and exclusions. Any asset, tangible or intangible, can be an active asset in terms of Australian law, but a time period in which the asset should have been held is included in the definition.

According to South African law, a person older than 55 years may disregard the capital gain made where an active business asset is sold, which was held for at least five years. The disposal should have been a result of ill-health, infirmity, superannuation or death. The maximum capital gain that may be disregarded is R750 000.

Australia has two similar relief measures. The first relief measure requires the person to be at least 55 years, which is the same age in terms of South African law. The asset should have been held for 15 years, which is a longer period than the South African requirement of five years. The disposal should have been a result of the person retiring or the person becoming permanently disabled, which is similar to the South African requirement of ill-health, infirmity, superannuation or death. There is no restriction on the amount that may be disregarded as in South Africa.

The second relief measure in terms of Australian legislation relates to a person older than 55 years, which is the same age as the South African requirement. The person should be a sole trader or a partner in a partnership. In South Africa, the person may be a sole trader, a partner in a partnership or the person should hold a direct interest of at least 10% of the equity in a company. The maximum capital gain that may be disregarded is

R3 261 766 (A$500 000 x 6.523531818[2]), which is much more than the South African amount of R750 000.

If an active asset is sold by a small business entity in Australia, only 50% of the capital gain is taxable. There is no similar tax relief measure available in South Africa, but all capital gains on any asset are included in the taxpayer's taxable income at a rate of either 50% or 25%, regardless whether the taxpayer is an SMME or not. Therefore, it is not necessary to include a similar relief measure in the South African legislation as all capital gains are paid for at a reduced rate and not only on certain assets for SMMEs.

Roll-over relief is dealt with in Paragraphs 65 and 66 of the Eighth Schedule of the Income Tax Act. Paragraph 65 deals with involuntary disposals and Paragraph 66 deals with reinvestments in replacement assets. These relief measures are available to any entity that meets the requirements of the specific paragraph and not only to SMMEs. The South African Government should consider including a relief measure in the South African tax legislation that only applies to SMMEs similar to the Australian tax legislation.

It is not possible to determine from the above comparison which country's CGT relief measures are more beneficial, but it can be determined through future research.

3.2.8 Provisional tax relief

Certain SMMEs in South Africa are exempt from paying a third provisional tax payment and interest on outstanding provisional tax amounts (discussed in 2.3.4). No similar exemption exists in terms of Australian legislation.

3.2.9 Secondary tax on companies relief

A South African micro business is exempt from STC to the extent that the dividend declared does not exceed R200 000 (discussed in 2.3.5). No STC exists in terms of the

[2] The average exchange rate between South African rand and Australian dollar for the six months 1 January 2010 to 30 June 2010 was 6.523531818 (ABSA, 2010). This period was chosen as it represented the most recent data and an average was used for the comparison to be more realistic.

Australian legislation, but withholding tax is payable on dividends declared. However, there is no withholding tax relief available to SMMEs in Australia.

3.2.10 Relief on the exportation of goods

Certain South African SMMEs do not need to register as an exporter with SARS (discussed in 2.3.6). No similar relief measures are currently available in Australia.

3.2.11 Value-added tax and goods and services tax relief

GST in Australia is levied at 10% (discussed in 2.4.3) and is similar to VAT in South Africa, which is levied at 14% (discussed in 2.3.7). The Australian rate is thus much lower than the South African rate.

3.2.11.1 *Registration thresholds*

Registration thresholds are provided for in both the South African and Australian tax legislations. The Australian GST registration threshold is R489 265 (A$75 000 x 6.523531818[3]). This is much lower than South Africa's VAT registration threshold of R1 million. More South African SMMEs than Australian SMMEs benefit from this.

3.2.11.2 *Payment and cash basis*

Australia's cash basis is similar to South Africa's payment basis. Both countries allow certain SMMEs to register on these bases.

South African legislation stipulates that a natural person or an unincorporated body of persons, with only natural persons as members, with total taxable supplies not more than R2.5 million for 12 months, may register on the payment basis.

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[3] The average exchange rate between South African rand and Australian dollar for the six months 1 January 2010 to 30 June 2010 was 6.523531818 (ABSA, 2010). This period was chosen as it represented the most recent data and an average was used for the comparison to be more realistic.

All small business entities in Australia may account for GST on the cash basis.

More SMMEs may register on this basis in terms of the Australian tax legislation than in terms of the South African tax legislation due to South Africa's extra requirements.

3.2.11.3 *Submitting VAT returns*

Normally, South African entities submit VAT returns every month or every two months. South African SMMEs may submit VAT returns every six months or every four months.

Australian entities normally submit VAT returns monthly, quarterly or annually. Small business entities are allowed to pay GST quarterly and report GST annually.

SMMEs may thus submit less VAT returns than non-SMMEs in both countries.

3.2.11.4 *Annual apportionment of GST input tax credits*

The Australian tax legislation determines that small business entities may account for the private part on GST credits annually instead of on each activity statement. South Africa does not have a similar tax relief measure. The South African Government should consider including a similar tax relief measure into the South African legislation.

3.2.12 Record-keeping relief

An SMME in South Africa may retain fewer records than a non-SMME (discussed in 2.3.8). No similar record-keeping relief is available in terms of the Australian legislation.

3.2.13 Advance tax ruling relief

A South African SMME saves R7 500 on the application fees for an advance tax ruling (discussed in 2.3.9). No similar relief is available in Australia.

3.2.14 Pay-as-you-earn and pay-as-you-go relief

PAYG in Australia is similar to pay-as-you-earn (PAYE) in South Africa.

Small business entities in Australia will save time by choosing to make payments that were calculated by the ATO (discussed in 2.4.4). No PAYE relief is available to SMMEs in terms of the South African legislation and therefore the South African Government should consider including PAYE relief measures for SMMEs in the South African tax legislation.

3.2.15 Fringe benefits tax relief

Small business entities in Australia are exempt from paying fringe benefits tax on car-parking benefits provided to employees (discussed in 2.4.5). No fringe benefits tax relief is available in South Africa and therefore the South African Government should consider including tax relief on fringe benefits for SMMEs in the South African tax legislation.

3.2.16 Venture capital relief

It is internationally acknowledged that venture capital investments are a substantial part of a country's economic growth as the venture capital market encourages economic development, innovation and entrepreneurship and reduces unemployment. As SMMEs play a significant role in the economy of a country, SMMEs should have access to capital to support entity growth. Most SMMEs depend a great deal on venture capital funding. It is therefore important for a country to support SMMEs by developing its venture capital market, otherwise business opportunities may be lost as products and technologies would be invented in another country (Barkoczy & Sandler, 2007:13).

SMMEs struggle to obtain finance due to a variety of reasons (Barkoczy & Sandler, 2007:32-33). Financial institutions are unwilling to lend money to entities without sufficient security, business records and a financial history. SMMEs are risky entities for which financial institutions charge a funding premium with the outcome of greater borrowing costs. Regular repayments must be made for which constant cash flow might be problematic. SMMEs are often created by innovative entrepreneurs that do not have the

necessary knowledge to manage the business and obtain capital. SMME owners might not want to introduce new shareholders for the fear of losing control of the entity and not being able to develop their concepts as planned. It is difficult for investors to determine the potential of an SMME and to rely on their reports due to a lack of strict financial reporting requirements. SMMEs are not listed on formal markets, which increases the cost in selecting these entities as investments and increases the difficulty for investors to exit these investments.

Both South Africa and Australia provide venture capital relief to investors as both countries acknowledge the importance of SMMEs and venture capital funding. Venture capital relief in terms of South African legislation was discussed in 2.3.10 and in terms of Australian legislation in 2.5.

Two categories exist for venture capital relief, namely front-end incentives and back-end incentives (Barkoczy & Sandler, 2007:45-46). **Front-end incentives** give investors tax relief (deductions or tax credits) for making a qualified investment. Investors benefit from this relief measure, regardless of the investment being successful or not. Therefore, this relief measure can be easily abused. **Back-end incentives** give investors capital gains tax and income tax relief when exiting their investments. Investors only benefit from this relief measure if the investment is successful. This incentive carries more risk for the investor and less risk for the government.

South Africa uses front-end incentives as the investor may deduct the investment's acquisition cost. The investor is assured of the benefit as the deduction does not depend on whether the investment is successful or not.

Australia uses back-end incentives to reward successful investments by exempting eligible investors from capital gains and income tax when exiting their investments. The Australian Government benefits from this back-end incentives, because the cost of providing the tax relief is postponed until the investment is successful. Also, the cost of providing the tax relief is indirectly recovered from the successful SMME in the form of more tax from the SMME or PAYG from the extra employees (Barkoczy & Sandler, 2007:182).

No back-end incentives are provided in Australia to unsuccessful investors. This may impact negatively on attracting investors. The incentives only decrease an investor's tax liability and not the investor's risk. If investors are not able to claim losses as a tax relief measure for unsuccessful investments, they are at a disadvantage in comparison with investors who can claim the loss in another country. There are thus no incentives in place in Australia for every phase of an SMME's financial shortages (Barkoczy & Sandler, 2007:182-186).

Australia is currently using flow-through entities for their venture capital relief measures. A vehicle that suits a country's economy and is well-known by investors will play a significant role in drawing foreign investors. Flow-through entities are thus a wise structure to use in a country as this structure is internationally well-known by investors (Barkoczy & Sandler, 2007:186).

As the private sector is the best to select possible growth areas in a country's economy, it is well-suited to enable investors to select these areas and not limit the types of activities that SMMEs are allowed to engage in too much as done by Australia (Barkoczy & Sandler, 2007:188-189). South Africa is currently restricting the types of trades.

South Africa does not use back-end incentives similar to Australia. The front-end incentives currently used might attract more investors as the investor is assured of the tax benefit, regardless whether the investment is successful or not. Based on the information obtained, it is not necessary for the South African Government to change to back-end incentives as the front-end incentives are more beneficial for investors. South Africa should, however, consider not restricting the types of trades that qualify for the tax relief.

3.3 CONCLUSION

In this chapter, a comparison was drawn between the tax relief measures currently available to SMMEs in South Africa and in Australia. Tax relief measures available in terms of the Australian tax legislation, but not currently available in South Africa's tax legislation were identified.

CHAPTER 4: CONCLUSION

4.1 INTRODUCTION

SMMEs are an important element in the economic growth of a country as they enhance a country's economy and reduce unemployment and thus poverty through job creation. It is therefore important for a government to assist SMMEs in their formation and development by providing tax relief measures to these entities.

There are many different criteria an SMME should comply with to obtain tax relief in South Africa. These relief measures, the reasons for their implementation and previous research performed were discussed in detail in Chapter 2. New legislation was recently introduced by the Australian Government to simplify and standardise the criteria for an entity to qualify as an SMME. Therefore, the objective of this study was to draw a comparison between the tax relief measures currently available to SMMEs in South Africa and in Australia. This was accomplished in Chapter 3.

This chapter summarises the findings and conclusions of the study and specifies the areas where future research is required.

4.2 SUMMARY OF FINDINGS

The definition of an SMME varies between the tax legislation of South Africa and that of Australia as well as between the different types of taxes within the legislations.

In terms of the South African tax legislation, there are currently three definitions for a SMME, namely a small business corporation, micro business and small business, with each one having many different complex requirements that should be met to qualify for tax relief. In terms of Australian tax legislation, there is only one definition for an SMME, namely a small business entity, and this definition has only one requirement that should be met to qualify for tax relief. The Australian tax legislation is thus much easier to comply with.

Tax relief in South Africa is available on the following: depreciation, tax rate, skills development levy, CGT, provisional tax, STC, exportation of goods, VAT, record-keeping and advance tax rulings. Tax relief in Australia is available on the following: trading stock, depreciation, prepaid expenses, tax payable, CGT, GST, PAYG and fringe benefits tax. Different tax relief measures thus exist in terms of the South Africa tax legislation and the Australian tax legislation.

Both countries provide depreciation, tax payable, CGT and VAT (GST in Australia) relief. Only Australia provides trading stock, prepaid expenses, PAYG (PAYE in South Africa) and fringe benefits tax relief. Only South Africa provides skills development levy, provisional tax, STC, relief on the exportation of goods, record-keeping and advance tax ruling relief.

Both countries provide tax relief when a venture capital investment is made. These relief measures differ substantially between the two countries. South Africa uses front-end incentives, while Australia uses back-end incentives. It is not necessarily essential for the South African Government to change to back-end incentives as the front-end incentives are more beneficial for investors.

4.3 CONCLUSION

In a South African survey performed by Smulders and Stiglingh (2008:369), it was found that tax compliance increases if the size of an entity decreases, which results in SMMEs being at a serious competitive disadvantage. They concluded that the South African Government must consider altering the tax system for SMMEs to highlight that it is committed to simplify tax and cut down compliance cost for SMMEs.

The tax relief measures available to SMMEs in South Africa are extremely complicated and the criteria the SMME must comply with are very narrow, which seriously restrict eligibility (Arendse *et al.,* 2006:17).

Most of the tax relief measures were included in the Australian legislation to reduce compliance cost for SMMEs. As the compliance cost is still high for South African SMMEs,

the South African Government should consider including the relief measures available in Australia, but not available in South Africa as identified in Chapter 3.

4.4 SUMMARY OF CONTRIBUTIONS

This study identified tax relief measures available to SMMEs in Australia, which are not currently available in South Africa. This information can be used to expand the SMME sector. SMMEs will benefit from more tax relief measures with less complex requirements. The Government and South Africa will benefit from a lower unemployment rate and a stronger economy.

4.5 SUGGESTIONS FOR FURTHER RESEARCH

This study only draws a comparison between the tax relief measures available in South Africa and Australia. It is not possible from the information obtained to determine whether the tax relief measures currently available in Australia are suitable to be implemented in South Africa. Further research can be conducted to determine whether South African SMMEs will benefit from the tax relief measures available in Australia and whether it is suitable to include these relief measures in South African legislation.

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