*By Frans Krause*

# Different business entities and tax

I often see tax rate comparisons between different business entities (companies, trusts and individuals) indicating a 28% company tax rate. This, however, is not entirely accurate; although the rate is 28%, there is also a 15% dividend tax that must be deducted before the income is paid out to shareholders (*Table 1*).

**Table 1: The correct comparison.**

| | |
|---|---|
| Taxable income | R1 000 |
| Company tax 28% | R280 |
| Available for dividends | R720 |
| Tax on dividends 15% | R108 |

In this scenario the total tax (R280 + R108 = R388) for companies amounts to 38,8%, which is lower than the 45% for trusts. The average tax rate for individuals younger than 65 years (at a taxable income of R2 500 000) is 38,7%, which is approximately the same as the 38,8% for companies.

The average tax rate for individuals will not exceed the tax rate for trusts. Trusts are taxed at a flat rate, currently set at 45%, and individuals on a sliding scale starting at 18% and peaking at a marginal rate of 45%. Individuals also receive rebates, which is set at a R14 067 primary rebate for taxpayers under 65 years, R21 780 for taxpayers between 65 and 75 years, and R24 354 for taxpayers over 75 years.

## Capital gains tax

The higher inclusion rate for capital gains tax (CGT) poses another disadvantage for companies and trusts, with current figures set at 80% for companies and trusts, while individuals pay 40% – the annual CGT exclusion of R40 000 only applies to individuals (*Table 2*).

This translates into tax on a capital gain of R100 000 for an individual at the maximum marginal tax rate of 45% of R10 800 (10,8%), R36 000 (36%) for trusts and R31 920 (31,9%) for companies at the total company tax rate of 38,8%.

It is clear that trusts are not tax efficient business entities, while companies are slightly more tax efficient.

**Table 2: An example of capital gains tax.**

| | Individuals | Companies and trusts |
|---|---|---|
| Capital gain | R100 000 | R100 000 |
| Exclusion | R40 000 | 0 |
| | R60 000 | R100 000 |
| Inclusion rate | 40% | 80% |
| Inclusion in taxable income | R24 000 | R80 000 |

## Turnover tax

The turnover tax for micro enterprises, including small farming enterprises, is set at a very low rate, even when considering that the rate applies to gross income and not net income, as is the case with standard income tax.

*Table 3* serves as illustration of turnover tax and standard tax on net income at different rates of net income.

**Table 3: Turnover tax and standard tax on net income at different net income rates.**

| At net income rates of | **5%** | **10%** | **20%** | **5%** |
|---|---|---|---|---|
| Turnover | R1 000 000 | R1 000 000 | R1 000 000 | R500 000 |
| Net income | R50 000 | R100 000 | R200 000 | R25 000 |
| Turnover tax | R14 150 | R14 150 | R14 150 | R1 650 |
| Standard income tax for taxpayers under 65 years | R0 | R3 933 | R22 265 | R0 |
| Tax difference standard minus turnover tax | -R14 150 | -R10 217 | +R8 115 | -R1 650 |

Micro enterprises with a turnover below R1 000 000 may find it prudent to consider turnover tax. However, businesses with low net income margins, as indicated by the examples, are advised not to use this form of tax. Businesses suffering losses from time to time may be better off with standard income tax, as assessed losses do not result in a tax liability and are carried forward.

Taxpayers choosing turnover tax may still register for value-added tax (VAT).

## Partnership *en commandite*

I often recommend that a partnership *en commandite* is used as a tax efficient business entity. This is a partnership between a company, the disclosed partner, and individuals as the undisclosed partners. The advantage is that partnerships are not tax entities and the income due to the partners are therefore taxed at the tax rate applicable to each partner. This provides some scope for tax planning as the taxable income is paid to the partners who then pay lower tax rates.

The most important aspect of a partnership *en commandite* is that all acts are in the name of the company in order to promote limited liability. The undisclosed partners must remain anonymous, except in cases where it's necessary to reveal a partner's identity.

But how often are partnerships *en commandite* used as a business entity? The answer is simple: often. Due to its anonymous nature, most people are under the impression that they are doing business with a company, therefore few people know that a partnership *en commandite* is used.

Farmers can consult with an attorney to find out more about the partnership *en commandite* as business entity. SF

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