

**THE TAX COMPLIANCE BURDEN ON SMALL AND MEDIUM  
ENTERPRISES- ITS EXISTENCE AND SARS' RESPONSE THERETO**

BY

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## EXECUTIVE SUMMARY

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Small businesses have the potential to grow the economy, generate jobs and reduce poverty. However, these businesses face many constraints, including high tax compliance costs. Research has shown that the most important thing that government could do to encourage the growth of these entities would be to remove burdensome and inappropriate regulations and to make the regulatory environment friendlier to small businesses.

This study reviews research studies undertaken in South Africa in respect of the tax compliance burdens/costs faced by small business as well as what the South African Revenue Services (SARS) and the National Treasury have done since 2001 to reduce these burdens. The tax compliance burdens identified and the recommendations made in these studies are then compared with the actions taken by SARS and the National Treasury, in order to establish whether they have responded to the burdens identified in these studies.

This comparison reveals that SARS and the National Treasury have taken steps to address many of the burdens identified and are actively trying to reduce the compliance burden facing small businesses. In almost all cases, they have responded to the tax compliance burdens identified in the studies reviewed here. Examples of areas where SARS has not addressed or has only partially addressed the burden include the lack of software to assist small businesses with record-keeping and the calculation of the second provisional tax payment. However, this study did not consider whether the actions taken by SARS and the National Treasury were effective in addressing the tax compliance burden. This requires further research.

**Keywords:**

*Small businesses*  
*Tax compliance burden*  
*Taxation*  
*SARS*  
*National Treasury*

## UITVOERENDE OPSOMMING

### DIE BELASTING NAKOMINGSKOSTES VAN KLEIN EN MEDIUM ONDERNEMINGS – DIE BESTAAN DAARVAN EN SAID SE REAKSIE DAAROP

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Klein besighede het die potensiaal om die ekonomie te laat groei, werk te skep en armoede te verminder. Hierdie besighede staan egter menige beperkinge in die gesig, wat hoë belasting nakomingskoste insluit. Navorsing het bewys dat die belangrikste ding wat die regering kan doen om groei in hierdie ondernemings aan te moedig, is om die lastige en onvanpaste regulasies te verwyder en 'n meer vriendelike regulatoriese omgewing vir klein besighede te skep.

Hierdie studie hersien navorsingstudies wat in Suid-Afrika onderneem is ten opsigte van die belasting nakomingskoste waar klein besighede sowel as wat die Suid-Afrikaanse Inkomstediens (SAID) en die Nasionale Tesourie sedert 2001 gedoen het om hierdie laste te verminder. Die belasting nakomingskoste geïdentifiseer en die aanbevelings gemaak in hierdie studie word dan vergelyk met die optrede van die SAID en die Nasionale Tesourie, ten einde vas te stel of hulle het gehoor gegee aan die laste wat in hierdie studie geïdentifiseer is.

Hierdie vergelyking toon dat die SAID en die Nasionale Tesourie baie werk doen om die geïdentifiseerde las aan te spreek en aktief probeer om die nakoming van belasting wat van toepassing is op klein ondernemings te verminder. In byna alle gevalle het hulle gehoor gegee aan die nakomingslaste geïdentifiseer in die hersiene studies. Voorbeelde van die gebiede waar die SAID die las nie aangespreek het nie of slegs gedeeltelik aangespreek het, sluit in die gebrek aan sagteware om klein ondernemings te help met rekordhouding en die berekening van die tweede voorlopige belastingbetaling. Hierdie studie het egter nie oorweeg of die optrede van die SAID en die Nasionale Tesourie effektief was in die aanspreek van die nakoming van die belasting las nie. Dit vereis verdere navorsing.

***Sleutelwoorde:***

*Klein besighede*

*Belasting nakomingskoste*

*Belasting*

*SAID*

*Nasionale Tesourie*

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## ABBREVIATIONS

**Table 1: Abbreviations used in this document**

Abbreviation	Meaning
CGT	Capital Gains Tax
DTI	Department of Trade and Industry
FIAS	Financial Investment Advisory Service
IFC	International Finance Corporation
OECD	Organisation for Economic Co-operation and Development
PAYE	Pay as you earn
PWC	Price Waterhouse Coopers
RSA	Republic of South Africa
SAICA	South African Institute of Chartered Accountants
SAIPA	South African Institute of Professional Accountants
SARS	South African Revenue Services
SDL	Skills Development Levy
SBC	Small Business Corporate
SBP	Small Business Project
SEDA	Small Enterprise Development Agency
SME's	Small and Medium-sized entities
SMME	Small, Medium and Micro entities
UIF	Unemployment Insurance Fund
UNISA	University of South Africa
VAT	Value added tax

# THE TAX COMPLIANCE BURDEN ON SMALL AND MEDIUM ENTERPRISES - ITS EXISTENCE AND SARS' RESPONSE THERETO

## CHAPTER ONE

### INTRODUCTION

#### 1.1 BACKGROUND

The Small Business Project (the 'SBP') (2002:1) maintains that an appropriately regulated and institutionalised environment is the most important element of any economic growth strategy. Over-regulation can raise the cost of business entry. Regulations also act as barriers to development by keeping many businesses out of the formal sector (SBP, 2002:2-3).

Regulatory costs may or may not prevent entrepreneurship, but they do make it more difficult to start and operate a business (SBP, 2002:4). Research conducted by the South African Revenue Services (SARS) has indicated that small businesses face many obstacles, which include high compliance costs (SARS, 2009d:4). Although regulations tend to raise the costs of business entry and operation, regulations are nevertheless required (SBP, 2002: 4). Over-regulation would mean that some regulations will not be fully enforced, which would bring the law into disrepute and encourage corruption. On the other hand, under-regulation could be equally problematic (SBP, 2002:4). The argument is for better (and simpler) regulation and better enforcement of a simplified regulatory structure (SBP, 2002:4).

The South African government concurs, and has made it an important priority to make the regulatory environment friendlier to small businesses (SARS, 2008:46). This is essential, as small, medium and micro enterprises are important mechanisms for addressing the challenges of job creation, economic growth and equity in South Africa (Department of Trade and Industry (DTI), 2005:7).

Since 1994, the South African government has recognised the importance of its role in promoting an enabling environment for the creation and growth of small enterprises (DTI, 2005:3). In March 1995, the government announced a number of measures for encouraging an enabling environment. These appeared in the White Paper on the national strategy for the development and promotion of small business in South Africa, which included, inter alia:

- creating an enabling legal framework;
- streamlining regulatory conditions; and
- introducing differential taxation and other financial incentives (DTI, 2005:3).

It is necessary for government to help develop small and medium enterprises (SMEs), as these entities play an important role in meeting the country's global competitiveness challenge (DTI, 2005a:1). Another reason provided by government for supporting SMEs is that they can be seen as a means for distributing wealth and thus attaining a more equitable growth. Additionally, this is a way of addressing the challenges of job creation and stimulating economic growth (DTI, 2005:7).

In 2004, regulatory compliance ('red tape') cost South African businesses R79 billion, an amount equal to 6.5% of GDP (SBP, 2005:5). W. Abrie and E. Doussy (2006:1) identified tax compliance requirements in South Africa as a stumbling block for small businesses. According to a study carried out by the SBP in Africa (SBP, 2005:42), 45,6% of recurring compliance costs relate to tax compliance for businesses with a turnover of between R1 million to R5 million. One of government's priorities is to make the regulatory environment friendlier to small businesses to enable their development (SARS, 2008:46).

Over the past few years, the government has taken steps to reduce the tax compliance burden on small businesses (Deloitte, 2008:10). Amendments to the Income Tax Act announced in the 2008 budget speech included steps in this direction, thereby indicating that the Minister of Finance is aiming to encourage economic growth by assisting SMEs (Deloitte, 2008:3).

According to SARS, they have been working hard to reduce the administrative burden faced by small businesses (SARS, 2008b). This forms part of government's efforts to promote the growth and development of small businesses (SARS, 2008b).

The aim of this study is to evaluate the extent of the tax compliance burden on small businesses and then to outline what the National Treasury and SARS have done towards alleviating it.

## **1.2 BACKGROUND AND NEED FOR THE STUDY**

### **1.2.1 PROBLEM STATEMENT**

There is little or no academic literature available that examines what SARS and the National Treasury have done, if anything, to address the tax compliance burden faced by small businesses. This study considers whether SARS and the National Treasury have been making an effort to address the small business compliance burden. The main purpose of the study is two-fold. First, it considers the extent of the tax compliance burden/costs for small businesses by evaluating the relevant research undertaken in this area in South Africa. Secondly, the study considers the actions taken by SARS and the National Treasury (in light of the research carried out) to reduce the tax compliance burden on SMEs. This research also considers the extent to which SARS and the National Treasury have addressed the tax compliance burden or taken into account and implemented the recommendations made in these research studies.

### **1.2.2 RESEARCH OBJECTIVES**

The objectives of this study are:

- to identify and briefly analyse studies conducted in South Africa on tax compliance costs of small businesses;
- to establish what initiatives SARS and the National Treasury have introduced to reduce the tax compliance costs/burdens for small businesses;
- to compare The National Treasury and SARS' initiatives with the burdens identified in the studies to see whether there is any correlation between them;

- to determine the extent to which SARS and the National Treasury have taken into account in their initiatives the recommendations in the above studies.

### **1.2.3 IMPORTANCE AND BENEFITS OF THE PROPOSED STUDY**

According to the SBP, the single most important thing that government could do to encourage the growth of small and medium enterprises would be to remove burdensome and inappropriate regulations (SBP, 2003a:5). Government's role should be to create and implement an enabling environment by ensuring that inappropriate legislation, regulations and administrative requirements do not prevent the market from operating effectively (SBP, 2002:1).

However, research indicates that small businesses face many barriers, including relatively high tax compliance costs as a percentage of turnover (SARS, 2009d:4). This is owing to the fixed costs associated with the systems necessary for complying with the requirements of the tax system (SARS, 2009d:4). Regulations are regressive in nature, in that they place a greater burden on poorer people and smaller firms (SBP, 2005:16). By focusing on reducing the 'red tape costs' that arise from complying with regulations, the government could then designate private-sector resources for more productive uses and, in the process, improve its own administrative efficiency without encountering significant opposing interests (SBP, 2005:9).

This research study will clarify what research has been done in South Africa relating to tax compliance costs as well as establishing what steps have been taken by SARS and the National Treasury to reduce this burden. This will provide some insight into whether government's actions are in line with the research findings, and, if not, where the gaps or untouched areas are.

### **1.2.4 DESCRIPTION OF OVERALL RESEARCH DESIGN**

A literature review of the tax compliance costs for small businesses in South Africa will be carried out. Smulders (2006:6) conducted a similar review providing an overview of the

research to date in the area of tax compliance for small businesses in South Africa. The review showed what additional research was still required to better understand this burden and alleviate it where and if possible (Smulders, 2006:5). Additional studies have since been carried out and changes have occurred, so this study will update and build on the findings of Smulders' study.

Academic literature and a variety of reports and articles dealing with the impact of taxation compliance costs on small businesses in South Africa formed the foundation of Smulders' review, which aimed to ensure that as much of the available literature as possible was researched (Smulders, 2006:6). The present research will carry out a similar literature review. As the objective of the present research is essentially to find the same type of information, the same review process has been followed. Other sources (as indicated in step 2 below) will also be investigated, as well as those used in Smulders' study.

A literature review will be performed to identify changes in the taxation legislation, SARS' initiatives and other administrative procedures introduced to assist small businesses with their tax compliance costs.

The procedure will be as follows:

**Step 1:**

Smulders' study will be summarised and will form the starting point for the research.

**Step 2:**

A literature review will then be conducted based on the following sources:

1. Websites:

- SARS (<http://www.sars.gov.za>) ;
- Professional auditing firm- Deloitte (<http://www.deloitte.com>);
- The Department of Trade and Industry (<http://www.dti.gov.za>);
- The University of Pretoria library;  
(<http://www.up.ac.za/asservices/ais/eco/taxweb.htm>);
- The Business Day Real Business [net]work (<http://www.realbusiness.co.za>);
- New Business Development in South Africa - South Africa.info

([http://.southafrica.info/doing\\_business/trends/newbusiness](http://.southafrica.info/doing_business/trends/newbusiness));

- Small Enterprise Development Agency ('SEDA') (<http://www.seda.org.za>);
- Strategic Partnership for business growth in Africa ('SBP') (<http://www.sbp.org.za>);
- The *Mail and Guardian* Online (<http://mg.co.za>);
- Policy and Law Online News (<Http://www.polity.org.za>);
- South African Government Information (<http://www.info.gov.za>);
- Moneywebtax (<http://www.moneywebtax.co.za>);
- Market IQ (<http://www.marketiq.co.za>);
- [www.openjournals.net](http://www.openjournals.net);
- [www.commerce.uct.ac.za](http://www.commerce.uct.ac.za);
- World Bank and IFC websites.

2. Reports issued by research institutions, education institutions and other business institutions;
3. Newspaper articles and press releases;
4. Budget speeches.

### **Step 3:**

Review the documents found, and consolidate them into those dealing with tax compliance costs and those dealing with SARS' responses or initiatives to reduce the tax compliance costs. A table will be created showing the tax compliance burden and SARS' response. This will highlight any gaps in the research and/or SARS' initiatives.

### **Step 4:**

Summarise findings, then provide conclusions and recommendations.

## **1.2.5 DELIMITATIONS**

- The only taxes considered in this study are normal income tax (including capital gains tax, provisional tax and secondary tax on companies), VAT and employees' tax.
- Only the formal sector was considered in this study.

- Only the tax compliance costs applying to small businesses will be considered.
- Only the steps taken by SARS to address the tax compliance burden faced by SMEs are considered in this study and not the effectiveness of these steps.
- This study is limited to South Africa and the South African regulatory environment.

As this study focuses on the tax compliance costs faced by small businesses, it is necessary to define these two terms, which will be done in the next section.

## **1.3 SMALL BUSINESSES AND COMPLIANCE COSTS DEFINITIONS**

### **1.3.1 SMALL BUSINESSES**

This research is limited to the ‘tax compliance costs’ incurred by ‘small businesses’. It is therefore essential to clearly define these terms in order to clarify what is being researched here.

Many publications and institutions refer to small businesses as SMEs or SMMEs (Small, Medium and Micro Enterprises) (Abrie & Doussy, 2006:1). From an economic perspective, a number of countries, including South Africa, use various definitions of ‘small business’ in order to provide economic benefits for this type of entity. Within any one country, it is difficult to find a single definition that can be used across all government departments (Smulders, 2006:32).

SARS (2008b) maintains that it does not have one overall description for small business; instead, numerous definitions are used for different purposes:

- For Amnesty purposes, a small business is any business with a turnover of up to R10m;
- For Income Tax purposes (Section 12E of the Income Tax Act (RSA, 2008)), a Small Business Corporation (SBC) must comply with the various requirements (listed below);
- For purposes of capital gains tax, a small business is described as a business having assets with a market value of under R5 million (SARS, 2008b).

The requirements for being an SBC for income tax purposes are as follows:

- A business having a turnover of less than R14m, over and above other qualifying criteria;
- The entity must be a close corporation, co-operative or private company registered in terms of the Companies Act;
- All the shareholders or members are, at all times during the year of assessment, natural persons;
- Shareholders or members may not hold at any time during the year of assessment any shares or interest in equity of any other company. However, shares or interest in the following entities are excluded from this requirement:
  - Listed companies;
  - A participatory interest in a collective investment scheme (see definition of company in section 1 of the Act);
  - A company contemplated in section 10(1)(e)(i);(ii) or (iii) of the Act (bodies-corporate);
  - Less than 5% of the interest in non-business co-operatives, such as consumer buy-aids, social co-operatives (such as child nursery facilities or burial societies);
  - Friendly societies;
  - Less than 5% of the interest in a primary savings co-operative bank or a primary savings and loans co-operative bank as defined in the Co-operatives Banks Act, 2007, that may provide, participate in or undertake only the following –
    - in the case of a primary savings co-operative bank, banking services contemplated in section 14(1)(a) to (d) of the above-mentioned Act; and
    - in the case of a primary savings and loans co-operative bank, banking services contemplated in section 14(2)(a) or (b) of the above-mentioned Act;
  - A venture capital company as defined in section 12J;
  - Any company, close corporation or co-operative if the company, close corporation or co-operative has not carried on any trade and owned assets with a market value exceeding R5 000 during the year of assessment (RSA, 2009; Smulders, 2006:25).

- The personal service income and investment income together must not exceed 20% of the total of all receipts and accruals (other than those of a capital nature) and all the capital gains;
- It may not be a 'personal service provider'. This means that it cannot be a labour broker without an exemption certificate, or a personal service provider (RSA, 2009;25; SARS, 2009e: 37-38)).

It would appear that in most contexts (unless otherwise defined) the terms 'SMME' and 'small business' are used interchangeably. This being the case, most references to the term 'small business' can include micro- and medium-sized businesses. The term 'SMME' therefore equates to the term 'small business'. However, there appears to be no one consistent 'small business' definition that is used relative to taxation in South Africa (Smulders, 2006:19).

For the purposes of this research, small businesses include small, medium and micro-enterprises with a turnover of R14 million or less. The definition of compliance costs will now be considered.

## **1.3.2 COMPLIANCE COSTS**

### **1.3.2.1. Regulations and compliance costs**

Regulations are made in an effort to solve social and political problems or to achieve policy objectives (SBP, 2005:10). Regulations create many consumer benefits, but they also give rise to various kinds of costs. The most important of these are compliance, administrative, efficiency and non compliance (SBP, 2005:12). As this study will focus only on compliance costs, specifically tax compliance costs, this term will now be analysed.

### **1.3.2.2. Compliance costs**

Compliance costs are defined as the cost of maintaining 'compliance' procedures (O'Regan, 2004). In turn, compliance is defined as an action in conformity with agreed procedures (O'Regan, 2004).

This includes the value of time spent by business managers and staff on understanding the rules and applying them, plus payments for the expertise of professional advisers such as consultants, lawyers and accountants (SBP, 2005:14).

Essentially, compliance costs consist of:

- efficiency costs - involving tax induced market distortions;
- operating costs of tax - costs expended by the taxpayers in complying with their tax obligations (SBP, 2003b:2).

Operating costs include:

- the all-inclusive costs of labour and time spent in dealing with all tax-related matters. These would include the time taken by a businessperson to gain the knowledge appropriate to handling complex tax obligations such as PAYE or VAT, as well as the time taken in appropriate record-keeping;
- the costs of expertise hired to ensure full tax compliance; and
- incidental costs incurred to ensure tax compliance, including the purchase of computer software, postage and deliveries (SBP, 2003b:2).

Generally speaking, all the definitions of compliance costs appear to include the following elements:

- the value of time spent by business owners/managers/staff on understanding the rules and applying them;
- record-keeping costs, which include the cost of preparing the necessary receipts and other records and costs incurred in respect of the preparation of tax returns;
- the cost of professional advisors such as consultants, lawyers and accountants; and
- incidental costs for postage, telephone and travel in order to liaise with advisors or tax authorities (FIAS, 2007: 7).

This study is concerned only with taxation compliance costs, so no further consideration will be given to the other regulation costs. According to Smulders (2006:41), as far as

small businesses are concerned, tax compliance costs generally include the cost of collecting, paying and accounting for tax on products or profits of the business, and on the wages and salaries of employees, together with the costs of acquiring the knowledge to enable this work to be done. Use of professional tax advisors constitutes one of the main costs contributing to the total cost of complying with taxation legislation.

## 1.4 OTHER IMPORTANT DEFINITIONS

**Table 2: Definitions of terms used in this document**

Term	Meaning
Personal Service Provider	<p>Essentially a company or trust that has its services rendered to clients by a connected person (usually the owner, relative or beneficiary) and:</p> <ul style="list-style-type: none"> <li>• the connected person would usually be regarded as an employee of the client; or</li> <li>• where the services must be performed mainly at the premises of the client, the connected person is controlled or supervised by the client as to the manner in which the services are rendered; or</li> <li>• where more than 80 per cent of the income of the company or trust is received from any one client during the 'year of assessment',</li> </ul> <p>except where the company or trust, throughout the 'year of assessment', employs three or more full-time employees who are, on a full-time basis, engaged in the business of the company or trust and are not connected persons (SARS, 2009d:7).</p>
Professional service	<p>A service in the field of accounting, actuarial science, architecture, auctioneering, auditing, broadcasting, broking, commercial arts, consulting, draftsmanship, education, engineering, entertainment, health, information technology, journalism, law, management, performing arts, real estate,</p>

	research, secretarial services, sport, surveying, translation, valuation or veterinary science (SARS, 2009d: 1).
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#### **1.4.1 BRIEF OVERVIEW OF CHAPTERS**

In the next chapter (Chapter Two), studies conducted in South Africa on tax compliance costs will be reviewed. The starting point will be the Smulders study. Thereafter, other studies done in South Africa on the tax compliance costs facing small businesses will be reviewed.

Chapter Three will consider the actions taken by government (which include the National Treasury and SARS) to reduce the tax compliance burden. First a brief overview will be carried out of the actions taken by SARS and the National Treasury over the years, after which some of the more significant actions will be considered in more detail.

In Chapter Four, the compliance costs identified in Chapter Two and the recommendations made in the various studies reviewed will be compared with the actions taken by government. This will provide some understanding of whether the actions taken have actually addressed the compliance costs identified.

Chapter Five concludes on the matters discussed in the previous chapters and summarises the findings on government efforts to reduce the compliance burden. This chapter also provides recommendations for further research.

## CHAPTER TWO

### LITERATURE REVIEW

#### 2 INTRODUCTION

According to Jones (2005:9), the initial once-off compliance requirements include registration for the following:

- Income tax
- Value Added Tax (VAT)
- Employees' tax (PAYE)
- Unemployment Insurance (UIF)
- Skills Development Levies (SDL).

Further, the following are recurring compliance requirements:

- Monthly PAYE/ UIF/ SDL returns
- Bi-monthly VAT returns
- Provisional Tax returns (2/3 per annum)
- Annual Company income tax returns.

Compliance with these requirements is a costly exercise which does not result in any contribution to profit (Jones, 2005:9). Although large companies may be able to afford these costs, small businesses may not, as they have limited resources, uncertain cash flows and limited knowledge of tax matters (SBP, 2003b:3).

Government's role must be to create an environment that enables small business to develop and grow and to ensure that inappropriate legislation, regulations and administrative requirements do not prevent the markets from operating effectively (SBP, 2002:1). Development in market economies is driven by the efforts of large numbers of small firms complementing large firms, co-ordinated by the market (SBP, 2002:1).

Even though regulations affect the entire private sector, they tend to weigh more heavily on smaller firms. That is to say, regulation costs impose disproportionately on SMEs because they do not have the administrative capacity to absorb them easily (SBP, 2003b:3). According to the SBP (2003c:3), the OECD report *From red tape to smart tape* distinguishes three approaches to reducing the administrative burden on small businesses:

- active assistance to small businesses, to help meet the administrative compliance needs of regulations;
- exemption or modification of the regulations themselves to make them less onerous for SMEs; and
- establishment of specific mechanisms to ensure that regulatory design takes better account of the needs and concerns of small businesses when establishing new compliance burdens.

According to the SBP, the third approach is the most promising (SBP, 2003c:3). Additionally, in reducing compliance costs, there would be benefits and savings for the government both in monetary terms and in less bureaucracy for the public sector (SBP, 2003c:4). The SBP has argued that government should focus on removing barriers faced by small businesses (SBP, 2003c:5).

As mentioned above, government (in the form of the National Treasury and SARS) has taken steps to reduce the compliance burden (SARS, 2008b). The remainder of this literature review will take into account studies on the compliance costs (specifically tax compliance costs) faced by small businesses. The following chapter will look at the steps taken by SARS and the National Treasury to reduce this burden. The former will help towards understanding the types of tax compliance burdens faced by small businesses, while the latter will show what actions have been taken by SARS and the National Treasury to reduce the tax compliance burden and whether these actions were based on and/or took into account the burdens identified in this study.

## 2.1 THE SMULDERS STUDY: TAXATION COMPLIANCE BURDEN FOR SMALL BUSINESSES IN SOUTH AFRICA

As mentioned above, the objective of the Smulders study (2006) was to provide an overview of what had been researched in the area of tax compliance costs for small businesses in South Africa. It is therefore a useful starting point for the present research study. In fact, one of the objectives of that study was to ensure that there was no duplication of research efforts (Smulders, 2006:56).

The following is a list of studies reviewed and a summary of the key aspects considered. Only those aspects that relate to the taxes dealt with in this study were considered:

1. *Owners' perception of factors that constrain the survival and growth of small, medium and micro agri-businesses in KwaZulu-Natal, South Africa* by Clover, TA. & Darroch, M.A.G. (Clover & Darroch, 2005).
  - Only agri-business SMMEs in KwaZulu-Natal were studied.
  - The VAT registration process was considered too complex for small businesses.
  - Owners also stated that SMMEs not registered for VAT could charge lower prices in comparison with their competitors who had registered as VAT vendors.
  
2. *SMME Facilitation Programme (Report Version)* by the South African Revenue Services (SARS, 2004)
  - A list of compliance, administration and regulatory burdens experienced by SMMEs was prepared and documented in this study. The following are a few of the burdens mentioned in the study:
    - Absence of a constant definition for SMMEs and lack of co-ordination in government policy;
    - VAT is considered to be one of the most burdensome taxes for SMMEs;
    - Specific administrative burdens, which include too many procedures in filing for tax, too many forms to complete if they are to function as a formal business entity, the generally time-consuming nature of tax, complexly-written tax codes and the high frequency of submitting tax returns.

- Although the tax compliance issues and their proposed solutions were listed in this report, the study does not take into account the actual extent of these burdens. The size of the burden is not backed up by concrete monetary evidence, but is interested merely in reference groups that are documenting their compliance burdens. This study therefore does not generate its own empirical data.
3. *Counting the cost of red tape for business in South Africa* by SBP (SBP, 2005)
- Taxes emerged as the most time-consuming and troublesome set of regulations by far. A significant portion of the perceived troubles associated with tax and related regulations relates to the cost of complying with tax paperwork.
  - Tax compliance costs are a relatively more important component of the regulatory burden for small rather than large firms. The 'red tape costs' incurred in complying with tax-related regulations are noticeably more proportional to turnover than regulatory compliance in general.
  - VAT was found to be the single most troublesome regulation for all but the largest firms.
  - If analysed by firm size, responses on the most troublesome regulations reveal that VAT has the most troublesome set of regulations for the smallest categories of firm sizes with less than 100 employees, but is replaced by SARS tax administration as the most troublesome regulation for firms with more than 100 employees.
  - The broad focus of the study, which was not only on SMMEs, potentially caused the dilution of the analysis of many possible tax problems experienced specifically by SMMEs.
  - The study was not focused solely on tax compliance, and thus did not delve as deeply as possible into this issue.
4. *Measurement of Value Added Tax Act and Regional Services Councils Act - induced administration burdens for South African small businesses* by Upstart Business Strategies (Upstart Business Strategies, 2004), commissioned by the Department of Trade and Industry.

- The measurement of VAT-related administrative burdens showed that companies that have to comply with VAT have to deal with structural (record-keeping and tax return) and once-off administrative burdens (registration for taxes, communication with SARS, inspections by the Commissioner, notification of changes and deregistration of VAT). This leads to the conclusion that enterprises are more focused on annoyances than on real administrative burdens in terms of money spent on complying with legislation.
- It was much more expensive to outsource record-keeping and completion of tax returns than to do this in-house.
- The use of advanced tax software for record-keeping and calculating VAT could significantly reduce the administration burden.
- It was found that once-off burdens like the registration of VAT, communication with SARS, inspections by the Commissioner, notifications of change and deregistration for VAT were not the greatest contributors to the total compliance cost of VAT. Instead, these were the structural or recurring burdens.

5. *The status of Tax Management and Administration Skills Manufacturers: Gauteng 2005- Report 1* by UNISA (UNISA, 2005)

- SMEs in the manufacturing sector in Gauteng were the focus of this study.
- Most SMEs maintain that the burden of complying with the tax regulations has increased over the past three years.
- SMEs show a strong preference for tax consultants and tax update courses or seminars when it comes to informing staff on tax matters.
- The cost of taxation was further illustrated by the fact that almost one out of every four full-time administrative staff members employed by the establishments dealt with tax matters. In order to save costs, certain of the establishments could choose to outsource part of the tax work. However, 21% of the respondents stated that some previously outsourced tax functions were no longer extant, owing to the high cost of carrying them out.

6. *The impact of taxation in SME retailers in Gauteng 2006- Report 2* by UNISA (UNISA, 2006a).

- This study investigated the impact of taxation on the SMEs in the retail sector.
- This study found that the majority of SMEs performed all tax functions internally, except for customs and excise duties.
- On average, SARS takes 7 minutes to answer incoming calls and it takes approximately three telephone calls, on average, to effectively address tax enquiries.
- It takes SARS approximately 10 weeks (54 working days) to return refunds on VAT, while it takes approximately 15 weeks to return refunds on tax returns.

7. *The organisational impact of taxation on small, medium and micro-establishments in the business services sector in Gauteng- Report 3 by UNISA (UNISA, 2006b).*

- SMEs in the business-services industry were the focus of this study.
- It was found that it takes SARS approximately eight minutes to answer incoming calls and, on average, five telephone calls are required to address tax enquiries effectively.
- It takes SARS just more than a month to respond to written correspondence and eight weeks to process tax returns.
- It takes SARS approximately ten weeks to return refunds on VAT and 13 weeks to return refunds on tax returns.
- Less than half the business services handled by SMEs deal with income tax functions internally, while most outsource this function.
- The majority of SMMEs outsource the bulk of their tax function.

8. *Recent finding on tax-related regulatory burden on SMMEs in South Africa by D. Chamberlain and A. Smith (Chamberlain & Smith, 2006).*

- The study found that we could still improve on our knowledge of the tax compliance burden.
- The study confirmed that the tax compliance burden for SMMEs is significant.
- Two cautionary notes from international experience were highlighted in this study:
  - Reducing the burden of tax compliance is unlikely to result in significant development of the SMME market in the short term. It is more likely to be a catalyst or facilitator of development rather than a driver of growth.

- Potentially negative consequences could be set in motion by well-meaning policy. On the one hand, a high compliance burden on specific firm types acts as a restraint for entrepreneurs in growing their businesses beyond a certain level. On the other hand, improving the tax regime for particular types of firms has resulted in entrepreneurs opting for company types that do not suit their businesses.

9. *Doing business in 2007: how to reform*, by The World Bank and International Finance Corporation (World Bank & International Finance Corporation, 2006).

- South Africa is placed 74<sup>th</sup> in terms of the ease of tax payment (Smulders, 2006:58-89).

In addition to the above, this study recommended that the following further research studies be carried out:

- Survey of tax practitioners to identify the principal time and cost burdens on 'formal' small businesses associated with preparing and filing tax returns for the most common business taxes, the procedures for paying taxes and going through tax inspections or audits, including, inter alia, fines and other tax-related payments.
- Survey of the 'formal' small businesses, per sector, to establish the actual compliance cost per tax and per function underlying each tax (for example, inter alia, registration and payment) (Smulders, 2006:95).

Such research was subsequently carried out and will be reviewed, along with other research studies, in the next section.

## **2.2 REVIEW OF OTHER STUDIES ON TAX COMPLIANCE COSTS CONDUCTED IN SOUTH AFRICA**

A variety of other literature relating to tax compliance costs for small businesses was reviewed. The following additional studies were reviewed:

1. *Tax compliance obstacles encountered by small and medium enterprises in South Africa*, by Abrie, W. & Doussy, E. (Abrie & Doussy, 2006);

2. *A three sector comparative study of the impact of taxation on small and medium enterprises*, by Venter, JMP and De Clerq, B (Venter & De Clerq, 2007);
3. *Tax compliance burden for small businesses: A survey of tax practitioners*, by FIAS (FIAS, 2007);
4. *Formal SMME tax compliance survey report*, by Citizen Surveys and Professor Rajen Govender (Citizen Surveys & Govender, 2008);
5. *Tax compliance costs for small businesses in South Africa: Web survey of tax practitioners, provincial data analysis*, by FIAS (FIAS, 2008);
6. *Paying taxes 2009: The global picture*, by The World Bank, IFC and PWC (World Bank, IFC and PWC, 2008);
7. *Doing business 2010: South Africa*, by The World Bank and IFC (World Bank, IFC, 2009).

The following studies were considered but will not be reviewed in this study:

- *Tax compliance burden for small, medium and micro establishments in the business services industry*, by Venter, JMP. & De Clerq, B. (the significant findings of the study have already been covered in study number two above);
- *Doing business 2009: South Africa*, by The World Bank and IFC (the type of business studied would not qualify as small business for the purposes of this study);
- *Doing business 2008: South Africa*, by The World Bank and IFC (as the type of business studied would not qualify as small business for the purposes of this study).

The follows aspects of each study will be considered:

1. Objective of the study;
2. Type of business covered;
3. The area of tax compliance measured;
4. The respondents and methods used to determine the area of compliance;
5. The findings of the study in relation to tax compliance;
6. Recommendations to reduce the compliance burden (if any).

## **2.2.1 A three-sector comparative study of the impact of taxation on small and medium enterprises**

### **▪ The objective of the study**

- To determine how the sectors in which an enterprise operates and the size of the enterprise affects the management and administration of the taxes, duties and/or levies for which it is responsible;
- To compare the value of the tax functions and the use of tax advice in business decisions in SMEs in three different sectors: the manufacturing, retail and business services sectors in Gauteng;
- To assess whether the three sectors have different preferences for various tax measures to reduce the taxation administration burden (Venter & De Clerq, 2007:116).

### **▪ The type of business covered**

Small and medium enterprises in the manufacturing, retail and business services sectors in Gauteng were the focus of the study. Small enterprises were defined as enterprises with between 20 and 50 employees. Medium enterprises were defined as enterprises with between 51 and 200 employees (Venter & De Clerq, 2007:119).

### **▪ The area of tax compliance measured**

The study focuses on the impact of taxation on the administration and management of small and medium enterprises in three sectors in Gauteng (Venter & De Clerq, 2007:117).

### **▪ The respondents and the method used to determine the area of compliance**

An interviewer-administered telephonic interview approach was used to collect data from the sample of small and medium manufacturing, retail and business services enterprises operating in Gauteng. This was supplemented by a self-administered approach for respondents who preferred to receive, complete and return the questionnaire by fax (Venter & De Clerq, 2007:123).

The Bureau of Market Research's Register of Business Services Establishments, its Register of Manufacturers and its Register of Wholesalers and Retailers were used as a frame for selecting sample units (Venter & De Clerq, 2007:123).

- **The findings of the study in relation to tax compliance**

The larger the enterprise, the greater its capacity to administer the employees' tax function. Most small and medium manufacturing enterprises elect to outsource their responsibility for managing income tax, whereas the majority of business services enterprises do this internally. The majority of small retail enterprises prefer to outsource, whereas the majority of large retailers prefer to have the tax function performed in-house. (Venter & De Clerq, 2007:128-129).

When asked for their main reasons for outsourcing the tax function, most SMEs across the different sectors indicated lack of time. A large proportion of SMEs also indicated that they outsourced on account of insufficiently skilled tax staff (Venter & De Clerq, 2007:130-131). Many SMEs do not use the support programmes available to them, because they are unaware of the different incentives (Venter & De Clerq, 2007:132).

When asked to determine what they would prefer when it came to reducing tax compliance burdens, small manufacturing enterprises would prefer a reduction in tax rates, whereas small retail and business services enterprises would prefer a reduction in penalties and interest (Venter & De Clerq, 2007:133).

- **Recommendations**

No recommendations were made in this study.

## **2.2.2 Tax compliance obstacles encountered by small and medium enterprises in South Africa**

- **The objective of the study**

The aim of this study was to report on the obstacles encountered by small business entities when they try to comply with tax requirements, and to suggest solutions (Abrie & Doussy, 2006:2).

- **The type of business covered**

This study focused on small and medium enterprises in the manufacturing sector in Gauteng. Small enterprises were defined as enterprises with between 20 and 50 employees. Medium enterprises were defined as enterprises with between 51 and 200 employees. Very small enterprises (those with fewer than 20 employees) were not considered (Abrie & Doussy, 2006:4).

- **The area of tax compliance measured**

This research project was conducted on the tax function in the manufacturing SMEs in Gauteng. The primary research was carried out by means of a survey of small and medium enterprises operating in South Africa. This was supported by a review of the available literature on tax compliance for small and medium businesses worldwide, along with a survey conducted among a sample of SMEs operating in Gauteng (Abrie & Doussy, 2006:4).

- **The respondents and the method used to determine the area of compliance**

The primary research involves a survey, which was conducted using a combination of self-administered questionnaires sent to respondents via email or fax, and face-to-face personal interviews. A review of the literature on tax compliance worldwide, but particularly in South Africa, was also conducted in order to interpret the results of the primary research (Abrie & 2006:4).

- **The findings of the study in relation to tax compliance**

Compliance entails a vast amount of administration, and SMEs could be liable for up to 11 different taxes (Abrie & Doussy, 2006:1). More than half of the respondents were unaware of the tax incentives available to them (Abrie & Doussy, 2006:6).

Most SMEs elect to perform routine tax functions internally when the rules generally stay the same, as in the case of employees' tax, and they outsource the more complicated functions like annual income tax. The outsourcing of these functions carries cost implications. SMEs indicated that, based on the average monthly cost of outsourcing some of their tax functions, outsourcing costs them R13 445 per annum for small enterprises and R21 426 per annum for medium enterprises. In addition, small enterprises pay an average of R8 451 per annum for managing and administering tax functions/ responsibilities and medium enterprises pay an average of R11 311 (Abrie & Doussy, 2006:7-8).

More than half of the SMEs are of the opinion that the burden of complying with tax regulations has increased during the past three years. Only 33.3% of SMEs made use of the SARS e-filing system (a system which enables taxpayers to complete and submit some forms electronically and to make electronic payments), the main reason being concern about security/ confidence (Abrie & Doussy, 2006:7- 8).

When asked what they would prefer in order to reduce the compliance burden, SMEs showed the greatest preference for reduced tax rates, reduced penalties/ interest charged by SARS and a SARS helpdesk (Abrie & Doussy, 2006:9).

- **Recommendations**

This study recommends that the South African Government consider the following:

- It could reduce the number of taxes SMEs have to administer. For every type of tax, there is usually an additional form or forms to be filled in. Reducing the number of taxes automatically reduces the number of forms. This in turn makes it easier to train staff to administer compliance with the tax liability, because less has to be taught and less known.

- SARS could reduce compliance requirements.
- The law could be streamlined and simplified.
- Additional tools could be made available to SMEs to assist them in administering taxes. In this regard, the possibility of providing free software packages to taxpayers to calculate tax liability could also be considered (Abrie & Doussy, 2006:11).

### **2.2.3 Tax compliance burden for small businesses: A survey of tax practitioners**

#### **▪ The objective of the study**

The objective of the survey is to identify and measure the tax compliance burden for small businesses in South Africa (FIAS, 2005:20).

#### **▪ The type of business covered**

Small businesses in South Africa (any business with a turnover limit of less than R14 million (FIAS, 2005:7)) were the focus of this study. They were deemed to include small, medium and micro-enterprises (FIAS, 2005:108).

#### **▪ The area of tax compliance measured**

The study focused on the cost of compliance with taxation regulations for small businesses (FIAS, 2005:7). The time and costs involved in most of the significant processes in complying with tax laws and regulations were investigated in order to establish what the average compliance costs were and whether there was an undue burden on enterprises with a smaller turnover. The following significant procedures in complying with the above-mentioned tax laws and regulations were investigated in the study:

- Registration;
- Preparation, completion and submission of tax returns;
- Objections and alternative dispute resolutions (ADR); and
- Audit, inspections and written queries from SARS (FIAS, 2005:20).

▪ **The respondents and the method used to determine the area of compliance**

The survey was conducted throughout South Africa among accountants and bookkeepers registered with the South African Institute of Chartered Accountants ('SAICA'), the South African Institute of Professional Accountants ('SAIPA') or the South African Institute of Certified Bookkeepers ('SAICB'). An electronic internet-based questionnaire was used as the research instrument (FIAS, 2005:10).

▪ **The findings of the study in relation to tax compliance**

The significant findings of this study are as follows:

- One of the major concerns raised by tax practitioners was that the registration process is complicated and cumbersome (FIAS, 2005:71).
- Tax practitioners on average charged their small clients R7 030 per annum to ensure that their tax returns (for income tax, provisional tax, value added tax and employees' tax) were prepared, completed and submitted as required by SARS (FIAS, 2005:29). Furthermore, tax practitioners charged on average R12 185 for assisting their small business clients with their accounting and bookkeeping functions in addition to the tax fees (FIAS, 2005:35).
- Tax practitioners regarded provisional tax as the most burdensome. Registering for VAT takes the longest (FIAS, 2005:21). VAT is also the most costly tax for which to register (FIAS, 2005:22).
- It was also found that capturing and processing errors made by SARS and the time taken to correct these errors were the most burdensome aspect of both income tax and employees' tax (FIAS, 2005:55-59).
- From the VAT perspective, tax practitioners regarded the period taken to register as a VAT vendor and to be notified of such registration as the most burdensome aspect of VAT (FIAS, 2005:57). Penalties and interest incorrectly raised by SARS were the most burdensome aspects of provisional tax from the tax practitioners' perspective (FIAS, 2005:56).

▪ **Recommendations**

Tax practitioners regard a special simplified tax regime for small businesses to be the single most effective reform if the compliance burden for income tax, provisional tax and employees' tax is to be reduced. From the VAT perspective, a higher mandatory VAT registration threshold is regarded as the single most effective reform to reduce the compliance burden (FIAS, 2005:81).

Other recommendations made to simplify the tax system are as follows:

- Tax returns reduced to one page with a two-page explanation brochure;
- Establish a reasonable tax threshold below which no tax return (PAYE, VAT, income tax, etc.) has to be submitted and where no tax is payable;
- Exempt first-time offenders from penalties and interest and give them some insight into their mistakes;
- Provide workshop courses for taxpayers at accessible venues (FIAS 2005:82).

Further suggestions were:

- More should be done to assist taxpayers in understanding their responsibility and the consequences of non-compliance; for instance, first-time offenders should be required to attend courses instead of having to raise a harsh penalty;
- Tax education should be made compulsory in the high-school curriculum, and the element of pride in paying taxes and being tax compliant should be demonstrated.

#### **2.2.4 Formal SMME tax compliance survey report**

##### **▪ The objective of the study**

The objective of this study was to investigate:

- the time and cost burdens for formal SMMEs when registering for Income tax, VAT and PAYE;
- the time and cost burdens for formal SMMEs when filing returns for Income tax, VAT and PAYE;
- Additional issues relating to :
  - access to SARS;
  - the penalties and interest payable for non-compliance;

- and various aspects of formal SMME interaction with SARS.

This study also focused on identifying:

- how many of the formal SMMEs kept their own books;
- how many of them used formal/informal tax practitioners;
- the importance to the formal SMME of the relationship with the tax practitioner;
- the extent and level of involvement of the tax practitioner in the business;
- concepts of a simplified tax regime for SMMEs, such as:
  - what it would constitute;
  - what aspects needed simplification;
  - where it was most needed;
- whether or not it was possible to separate accounting from tax costs;
- what specifically could be done to lighten the compliance burden for formal SMMEs (Citizen Surveys & Govender, 2008:19-20).

- **The type of business covered**

SMMEs in the formal sector of the South African economy were the focus of the study (Citizen Surveys & Govender, 2008:22). For the purpose of this study, this included any business enterprise whose turnover was greater than R70 000 and less than R14 million per annum. Formal SMMEs were further defined as small business enterprises which were registered for and were paying tax (Citizen Surveys & Govender, 2008:17).

- **The area of tax compliance measured**

The purpose of the study was to investigate the overall costs of tax compliance for formal SMMEs in South Africa. Tax compliance costs were defined as all those costs incurred in the course of ensuring proper compliance with relevant tax regulations. These costs included the following:

- the costs incurred in the course of record-keeping, which includes all costs associated with compiling and organising receipts and records;
- the costs incurred in the preparation and submission of all relevant tax returns;

- the value of time taken by the small business staff in ensuring proper compliance, including visits to tax offices;
- the costs incurred for the services of tax practitioners, accountants and other consultants who may have either ensured compliance and/or addressed disputes with SARS;
- all other costs incurred in the course of ensuring compliance, including incidental and travel costs (Citizen Surveys & Govender, 2008:6).

▪ **The respondents and the method used to determine the area of compliance**

The sample size for the study was fixed at 1000 cases, and the requirement was for the sample to be drawn so that it ensured an adequate basis for generalisability to the national population of formal SMMEs. To ensure the extraction of the sample with due to consideration of the two key stratification variables (annual turnover and provincial location), a sampling cluster of 90 sample clusters was established, composed of a matrix of five turnover bands by nine provinces by two firm categories. The realised sample was extracted by employing equal probability selection methods for sampling and within each cluster. Following the conclusion of the fieldwork, the sample obtained was re-weighted to ensure national representivity (Citizen Surveys & Govender, 2008:6).

▪ **The findings of the study in relation to tax compliance**

The key findings relating to the allocation and completion of tax and compliance-related tasks:

- The majority of small businesses relied on in-house expertise to complete general record-keeping and bookkeeping, preferring to outsource primarily when the required tasks tended to be tax and specialised tax tasks.
- About one third of small businesses were entirely dependent on external expertise to complete all relevant tasks.
- About 10% of small businesses employed a combination of in-house and external expertise to accomplish necessary tasks.
- The principle reason for not outsourcing was the availability of appropriate expertise within the enterprise, with this being true for proprietary limited enterprise. Sole

proprietors and partnerships did not outsource as extensively as the other two types of business and reported being unable to afford such outsourcing (Citizen Surveys & Govender, 2008:69).

- The primary reason for outsourcing was the highly specialised nature of the tax field. Close corporations were the most likely to outsource for this reason, while sole proprietors and partnerships were likely to do so because of the difficulty of keeping abreast of changes in tax law and rules (Citizen Surveys & Govender, 2008:51-52).
- In terms of the internal cost of compliance, that is, the cost to the enterprise in terms of the time taken to prepare, complete and submit tax returns, the following were observed:
  - Income and provisional tax placed the lowest and second-lowest burden respectively on enterprises in terms of the time required for their completion and filing.
  - The highest burden was employees' tax, which accounted for almost half of the total time spent per annum on all taxes.
  - VAT made the highest demand on time, consuming roughly one third of all the time taken per annum on all taxes.
  - Enterprises in the lowest turnover category (less than R70 000 per annum) spent a disproportionately greater amount of time accomplishing all the required activities for filing the tax returns for which they were registered. This corresponded to the lowest rates of outsourcing observed earlier, meaning that the burden of these tasks inevitably fell on resident capacity. Furthermore, given that these enterprises were small, it was likely that resident capacity was very low, thereby further increasing the time needed to accomplish the required tasks (Citizen Surveys & Govender, 2008:60).

The following conclusions were drawn from the analysis of the role and costs of external consultants:

- Tax practitioners undoubtedly played an important role in the affairs of these businesses, featuring in the tax and associated tasks of around 45% of small businesses.
- SMMEs were more likely to hire professional services in matters relating to tax than they were for general accounting and record-keeping.

- The reliance on tax practitioners was lowest in sole proprietary and partnership businesses, with a significant portion of these getting by on their own, even when it came to specialised tax tasks. However, dependency increased with correspondingly higher degrees of interaction with SARS, as in the cases of, inter alia, lodging appeals, petitioning for waiver of interest and penalties.
- Close corporations were the most dependent on tax practitioners, mainly because of a greater tax requirement than that of sole proprietary businesses, coupled with the lesser availability of in-house expertise as compared with proprietary limited businesses.
- Proprietary limited businesses were the least dependent on tax practitioners, preferring instead to absorb as many tax tasks and functions in-house before outsourcing them.
- About half of small businesses that outsourced were unable to indicate the specific costs incurred (Citizen Surveys & Govender, 2008:69).

#### ▪ **Recommendations**

Respondents were requested to provide suggestions on the specific measures that SARS could take to improve compliance. The responses were organised into clusters. The final five clusters identified were as follows:

- SARS access and service levels;
- tax policy, thresholds and penalties;
- simplification of rules, procedures and materials;
- SARS outreach and facilitation;
- communication and media (Citizen Surveys & Govender, 2008:82).

The suggestion most frequently cited for improving compliance related to issues of access to SARS and the nature and quality of service it provided to small businesses:

- Businesses prioritised the location of SARS offices, indicating a need to have them closer to where the businesses were located.
- In general, there was a need to increase overall levels of service from SARS, specifically with respect to the efficiency of VAT refunds (the delays had significant cash-flow implications for SMMEs, particularly in the lowest turnover categories).

- Businesses also requested that more SARS officials could be at hand to address their issues, and wanted direct access to assessors.

SMMEs made various suggestions on tax policy and penalties and interest:

- One tenth indicated a need for reducing current tax rates.
- Just fewer than 5% suggested reducing rates for penalties and interest.

One sixth of all businesses indicated the need to simplify rules, procedures and materials:

- Procedures for registration should be simpler and more easily accomplished.
- Tax forms should be shortened to enable quick completion.

In terms of communication and media, SARS could also improve compliance by:

- increasing the amount of information on tax that it provided to SMMEs;
- improving its communication with small businesses;
- increasing the levels of advertising in the media.

#### **2.2.5 Tax compliance costs for small businesses in South Africa - Web survey of tax practitioners' provincial data analysis**

This report is based on the same data as that used in the study above entitled *Tax compliance burden for small businesses: A survey of tax practitioners in South Africa*. However, this report focuses more on the differences between the nine provinces in South Africa (FIAS, 2008:1). Therefore the objective of this study, the type of business covered, the area of tax compliance measured, and the respondents and the methods used to determine the area of compliance would be the same as for that study.

##### **▪ The findings of the study in relation to tax compliance**

There appears to be considerable variation in tax compliance costs per province. In the case of 'costs' (based on prices charged by practitioners to their SMME clients), costs are higher in urban provinces, where fees are relatively higher than in rural areas.

There is also considerable variation in time indicators, and it is not always an urban/rural divide. Rather, it appears that some SARS provincial offices are more efficient than others, and this varies by tax and by procedure. However the rural provinces often rate well as far as communication with tax practitioners goes.

SARS' services standards are relatively new and are, perhaps, ambitious at times. There are many areas in which SARS offices are not yet meeting the goals set by the SARS Services Standards as set out in the SARS Service Charter (FIAS, 2008:30).

#### ▪ **Recommendations**

No recommendations were made in this study.

### **2.2.6 Paying taxes 2009: The global picture**

#### ▪ **The objective of the study**

- To measure the ease of paying taxes for companies all over the world;
- To be able to compare the tax systems of different countries on a consistent basis (World Bank, IFC & PWC, 2008: 48);
- To provide insights and data, which could assist the tax reform process (World Bank *et al*, 2008:7).

#### ▪ **The type of business covered**

Tax-related information on a standard case study company was gathered in 181 economies. This company is regarded as a 'modest-sized' company (World Bank *et al*, 2008: 87). It has the following constraints:

- It is a limited liability, taxable company;
- Operations started on 1 January 2006;
- It operates in the largest business city;
- It is 100% domestically-owned with five owners who are natural persons;
- It had start-up capital of 102 times income per capita at the end of 2006;

- It performs general industrial and commercial activities. Specifically, it produces ceramic flower-pots and sells them at retail. It does not participate in foreign trade and does not handle products subject to a special tax regime, for example, alcohol or tobacco.
- It owns two plots of land, one building, machinery, office equipment, computers and one truck. Another truck is leased.
- It does not qualify for investment incentives or any benefits other than those relating to the age or size of the company;
- There are 60 employees- 4 managers, 8 assistants and 48 workers;
- It has a turnover of 1050 times income per capita;
- It made a loss in the first year of operation;
- It has a gross margin (pre-tax) of 20%;
- 50% of its net profit was distributed to the owners as a dividend at the end of the second year;
- One of the plots of land was sold at a profit during the second year;
- It has annual fuel costs for its trucks, which are equal to twice its income per capita;
- It is subject to a series of other detailed assumptions on expenses and transactions to further standardise the case (World Bank *et al*, 2008: 88).

Based on the definitions above, it would seem unlikely that this ‘modest sized’ company would qualify as a small business and would therefore most likely not be applicable to small businesses in South Africa.

#### ▪ **The area of tax compliance measured**

The study involves gathering information on the total taxes and mandatory contributions that must be paid in a given year. This includes all government-mandated taxes and contributions that have an impact on the financial statements, including corporate income tax, capital gains tax and employees’ tax (World Bank *et al*, 2008: 88).

The information is used to generate three indicators relating to the number of payments, the time taken to comply with its tax affairs and the total tax cost. This information is then equally weighted to produce an overall ranking for each country for the ease of paying taxes (World Bank *et al*, 2008: 87).

- **The respondents and the method used to determine the area of compliance**

Tax advisors from PWC provided the technical tax data for their economies, or in countries in which PWC had no presence. This information was provided by other advisors, and was based on the case study facts and assumptions as well as the tax rules applying for the year 1 January to 31 December 2007 (World Bank *et al*, 2008: 87).

- **The findings of the study in relation to tax compliance**

- Countries ranked high in terms of the ease of paying taxes generally have less complex taxes and simpler administrative processes for paying and filing tax returns.
- The administrative aspects of a tax system are almost equal in importance to tax rates when it comes to tax reforms (World Bank *et al*, 2008: 7).
- South Africa was one of the countries noted for eliminating taxes in 2007/8 (World Bank *et al*, 2008: 9).
- The ease of paying taxes rankings of South Africa is as follows:
  - Ease of paying taxes: 23;
  - Tax payments (number per year): 16;
  - Time to comply (time to record, file and pay): 73;
  - Total tax rate: 51 (World Bank *et al*, 2008: 75).

- **Recommendations**

No recommendations were made in this study.

## 2.2.7 Doing businesses 2010 – South Africa

- **The objective of the study**

- To present quantitative indicators on business regulations and protection of property rights that can be compared across 183 economies;

- A set of regulations that affect 10 stages of the life of a business's are measured. These indicators are then used to analyse economic outcomes and to identify whether any reforms have worked and why (World Bank & IFC, 2009:1).

- **The type of business covered**

Tax-related information on a standard case study company is gathered in 183 economies. The company is a medium-sized business that went into operation last year. Tax practitioners were asked to review the company's (TaxpayerCo) financial statements and a standard list of transactions that the company had completed during the year. They were then asked how much in taxes and mandatory contributions the business had to make, as well as the process for doing so (World Bank & IFC, 2009:32). As this company is a medium-sized business, it would seem unlikely that it would qualify as a small business for the purposes of this study.

- **The area of tax compliance measured**

The study involves gathering information on the total taxes and mandatory contributions that must be paid in a given year at all levels of government. This includes all government-mandated taxes and contributions that impact on the financial statements, including corporate income tax, capital gains tax and employees' tax. A range of standard deductions and exemptions are also measured (World Bank & IFC, 2009:32).

- **The respondents and the method used to determine the area of compliance**

The respondents were tax practitioners in 183 economies. The information provided was based on the facts and assumptions in the case study (World Bank & IFC, 2009:32).

- **The findings of the study in relation to tax compliance**

- South Africa is ranked 23rd overall in terms of paying taxes (World Bank & IFC, 2009:33).

- The number of hours required to prepare, file tax returns and pay taxes has decreased from those in the 2008 survey (350 hours) to the 2010 survey (200 hours) (World Bank & IFC, 2009:33).
- The number of tax payments per year has also decreased from 11 in the 2008 survey to nine in the 2010 survey, while the total tax rate has also decreased from 37.1% in the 2008 survey to 30.2% in the 2010 survey (World Bank & IFC, 2009:33).
- One of the reforms introduced in South Africa to ease the tax burden was the abolition of stamp duty (World Bank & IFC, 2009:50).

#### ▪ **Recommendations**

No recommendations were made in this study.

#### **2.2.8 Conclusion on compliance costs**

The purpose of this study was to identify what research had been carried out on the area of tax compliance costs for small businesses and then to look at steps taken by SARS and the National Treasury to reduce the burden imposed as a result of these costs. Various studies on the compliance costs of small businesses were reviewed to provide insight into the type of burden imposed on small businesses as a result of these costs. In the next chapter, steps taken by SARS and the National Treasury to reduce the compliance burden will be reviewed. These steps, as well as the research findings on the tax compliance costs presented in this chapter will be summarised in the form of a table in Chapter 4

## CHAPTER THREE

# STEPS TAKEN BY THE NATIONAL TREASURY AND SARS TO REDUCE THE COMPLIANCE BURDEN

### 3 INTRODUCTION

In the previous chapters, the costs and impact of the tax compliance burden on small businesses were discussed. In the current section, the focus will be on the measures taken by SARS and the National Treasury (i.e. the government) to reduce the compliance burden for small businesses.

The government has recently been taking steps to reduce the tax compliance burden of small businesses (Deloitte, 2008:10). According to SARS (2008b), over the past five years, SARS and the National Treasury have undertaken a number of schemes and initiatives to address some of the core challenges facing small businesses. A few of these initiatives are as follows:

- Tax reforms for small businesses were introduced in 2001 in the form of Section 12E of the Income Tax Act (the Small Business Corporation regime). However, only 35 000 companies classifiable as small business corporations in terms of this legislation have accessed this.
- Category F for the quarterly filing of VAT returns has also been accessed by only 1 280 vendors, according to SARS' records.
- Of all the applicants for Small Business Tax Amnesty, almost 80% were already registered with SARS. It is therefore evident that the level of compliance in this segment is very low.
- The Small Retailers VAT Package (SRVP) was introduced in 2004 to assist small businesses in VAT record-keeping and calculation. However, according to records, only 57 vendors are registered under this scheme.
- The VAT threshold for registration has increased to R1 million from 1 March 2009 (SARS, 2008b).

In this section, a more detailed review of the seven-year period from 2004 - 2010 will be conducted. A brief review will also be done for the period between 2001 and 2003. This will help identify actions taken by SARS and the National Treasury to reduce the burden.

### **3.1 REVIEW OF ACTIONS TAKEN BY SARS AND THE NATIONAL TREASURY FROM 2001 - 2009**

#### **3.1.1 2001 - 2003**

In 2001, SARS planned to introduce both electronic filing to allow for the electronic submission of tax returns and call-centres to deal with taxpayers' queries (National Treasury, 2001:66). It was also proposed that qualifying small businesses that invest in manufacturing assets be allowed an accelerated depreciation allowance (National Treasury, 2001:79).

SARS planned to focus on the compliance burden in 2002. This included reviewing the application of the penalty provision in an attempt to ease the burden on first-time offenders, simplifying tax forms and reducing the number of returns that must be filed. Additional investigations into the small retailers VAT package were to begin in 2002 (National Treasury, 2002:85).

The turnover limit for qualifying as a small business corporation was increased from R3 million to R5 million in 2003. In 2003, it was also proposed that small businesses receive a double deduction for the first R20 000 of start-up costs (National Treasury, 2003:86).

#### **3.1.2 2004**

The 2004 year once again focused on improving administration and easing tax compliance. The following fiscal and administrative measures were made in support of small businesses:

- A tax guide for small businesses was published by SARS.

- In order to reduce the compliance burden, SARS reviewed the application of the penalty provisions, introduced colour-coded tax forms and reduced the number of returns that had to be filed for different taxes.
- If taxpayers were not satisfied with the services provided at the SARS branch offices, they could seek advice from the Service Monitoring Office.
- SARS now has formal and informal dispute resolution; as well as being less formal and adversarial, informal dispute is more cost-effective.
- Small businesses registered as individuals were allowed to register on the payment basis if sales were less than R2.5 million per annum (National Treasury, 2004:94-95).

In the same year, SARS undertook to review the administrative and tax compliance concerns of SMEs. As a result, they held various workshops and consulted with numerous stakeholders, including government and industry. They compiled a list of issues from the inputs received from the various stakeholders (National Treasury, 2005:87), ranging from those relating directly to tax administration and policy to those arising from the regulatory practices of other government departments (National Treasury, 2005:87).

The small retailers VAT package was announced in the 2004 Budget review. It was a means of simplifying the compliance and administration requirements for small businesses that sell both zero- and standard-rated goods (National Treasury, 2005:94).

Also in this year, SARS launched its e-filing service, which allowed taxpayers to submit tax returns and make payments electronically (SARS, 2009h).

### **3.1.3 2005**

The year 2005 saw the process of structural change that was intended to:

- build a positive tax compliance climate in South Africa;
- assist small businesses in the start-up phase;
- reduce costs and red tape; and
- provide tax education and assistance (Smulders & Oberholzer, 2006:8).

The five key focus areas proposed in 2005 to empower small businesses were:

- streamlining taxes;
- streamlining entry;
- streamlining filing;
- advice and assistance;
- tax relief for small businesses (Smulders & Oberholzer, 2006:8).

In 2005, SARS planned the following proposals to demonstrate government's commitment to assisting small businesses:

- To deploy staff to visit small businesses to help and educate them about registration, return completion and business tax obligations;
- To make available dedicated facilities for small businesses in the SARS call-centre and offices;
- To make accounting and payroll packages available to small businesses;
- To have the small retailers VAT package (which was announced in the 2004 budget) ready for implementation in April 2005;
- To specifically initiate VAT education to assist small businesses that have difficulty in understanding the VAT process, and rules were introduced (National Treasury, 2005:87).

It was also proposed to give small businesses with an annual turnover of less than R1 million the option of filing VAT returns every four months instead of two (National Treasury, 2005:88).

In the 2005 Budget review, it was noted that government planned to introduce a simple, modern and fair tax system for small business. Government therefore planned to implement a wide-ranging programme of administrative measures to support small businesses over the coming three years (i.e. 2006 - 2008) (National Treasury, 2005:87).

#### **3.1.4 2006**

Government continued its effort to reduce the compliance burden on small businesses with a series of proposals in 2006 that included tax relief and tax amnesty for small businesses (National Treasury, 2006:63).

Government proposed a tax amnesty allowing SARS to waive taxes due by small businesses for years of assessment ending on or before 31 March 2004, in cases where the turnover for the 2005 year of assessment did not exceed R5 million. This decision was based on the fact that many small businesses were historically marginalised and so were operating informally and remaining outside the tax system. Many were willing to enter the tax system, but the fear of consequences of past non-compliance (which included possible liability for additional tax, interest and prosecution) was a major obstacle preventing many of them from doing so (National Treasury, 2006:74-75)). This amnesty would therefore remove that obstacle.

A dedicated tax practitioners' call-centre was established in 2006 (SARS, 2007: 45).

#### **3.1.5 2007**

In 2007, the National Treasury and SARS commissioned a small business tax compliance cost study (FIAS, 2007). The result of this study would help in the development of a simplified tax regime for small businesses that was planned for introduction in 2008 (National Treasury, 2007:77).

In May 2007, SARS announced significant changes to the income tax return submission process. The income tax returns were redesigned, simplifying the form and reducing the number of pages. Additionally, supporting documents were no longer required and calculations no longer had to be performed (SARS, 2007a).

The Practitioners Unit was established during the financial year ending 31 March 2007 (SARS, 2007:48). The aim of this unit was to establish a better way of engaging with tax practitioners. It would be responsible for managing the registration of practitioners,

exploring and implementing enhanced service offerings and keeping practitioners informed of any developments at SARS. It would also be a means for practitioners to provide feedback to SARS (SARS, 2007:48).

SARS also launched its Modernisation Programme in this year, the aim of which was to make the tax process more automated and electronic (SARS, 2010b:2).

### **3.1.6 2008**

In the 2008 budget speech, further simplification that would reduce paperwork relating to income tax and VAT for small businesses was proposed (Deloitte, 2008:10).

It was proposed that the compulsory VAT threshold be increased from R300 000 to R1 000 000 per year (Deloitte, 2008:10), becoming effective from 1 March 2009 (SARS, 2009g).

Additionally, a simplified turnover-based tax system was proposed in the 2008 budget speech for businesses with a turnover of up to R1 million per year. The maximum tax payable according to this system would be R44 500 on a turnover of R1 million. However, a qualifying business would have to remain in the system for a minimum of three years after electing it (Deloitte, 2008:10).

Support is also provided for small and medium enterprises in the high-tech sector and junior mining exploration companies in the form of a tax incentive amounting to a 30% up-front deduction for venture capital investments in non-mining companies and a 50% deduction for investments in junior mining exploration companies (Deloitte, 2008:10).

When it came to tax administration, the following initiatives were proposed for enhancing this:

- Simplification of the classes of income tax returns applicable to individual taxpayers;
- Rationalisation of the returns to be submitted by employers with employee information, while simultaneously improving the quality and timeliness of these returns;

- Removal of legal provisions relating to the submission of documents with provisional and final tax returns. This was to accommodate the administrative drive of promoting e-filing. Supporting documentation would in future have to be kept by the taxpayer and not submitted to SARS (Deloitte, 2008:11);
- Quicker assessment/ electronic payment into a taxpayer's bank account (Smulders & Stiglingh, 2008, 623);
- The introduction of customised and pre-populated income tax return forms (SARS, 2009: 80).

In February 2008, SARS announced a simplified VAT registration process (SARS, 2008c). The new application document was reduced from seven to four pages. Further, only two key documents were required to accompany the registration form, down from a previous maximum of 12. VAT registration numbers could now be issued instantly (SARS, 2008c). In July 2008, SARS introduced its e@syfile PAYE computer software to assist employers in completing and electronically submitting their PAYE reconciliations to SARS (SARS, 2008a).

Taxpayers earning below R120 000 were not required to submit tax returns. However, this income had to be earned from a single employer and the taxpayer should not have any other income or deductions than that reflected on their tax certificate (SARS, 2009: 44).

### **3.1.7 2009**

SARS issued the updated *Tax Guide for Small Businesses*. This guide was created to assist small business entrepreneurs with their tax affairs. It contains general information on many tax-related matters, such as the different types of business entities, registration, aspects of record-keeping, relief measures for small business corporations, and how net profit/ loss and taxable income/ assessed loss are determined (SARS, 2009e:7) Although this is not a detailed guide, it does give entrepreneurs useful guidance, but most of all makes them aware of the necessity for compliance and other administrative issues. In certain instances where the information provided is not detailed enough, it does provide details of where to obtain further information on that particular issue (SARS, 2009e:2).

The simplified turnover-based tax system proposed in 2008 came into effect from 1 March 2009 (SARS, 2009d:2). Additionally, in response to feedback from employers, SARS made changes for the improving the 2009 version of the e@syfile software (SARS 2009c:6).

In 2008, paragraph 20 of the Fourth Schedule to the Income Tax Act dealing with provisional tax was amended to the effect that, if the second payment was based on an amount less than 80% of a taxpayer's actual taxable income, then that person could be liable for a 20% penalty (SAICA, 2009). However, the requirement was amended in 2009. Businesses with a taxable income of up to R1 million would return to the old 'basic amount' system, which meant that the 20% penalty would be levied only if the estimate was below the lesser of the basic amount and 90% of actual taxable income. However, the basic amount would then include an automatic annual 8% increase (SAICA, 2009; RSA, 2009).

### **3.1.8 2010**

It was announced in the 2010 budget that Standard Income Tax on Individuals ('SITE') would be abolished from 1 March 2011 (SARS, 2010a:2). A voluntary non-disclosure programme would be implemented to allow taxpayers to disclose their defaults (non-compliance) and to sort out their tax affairs. This programme will be effective from 1 November 2010 to 31 October 2012. The full amount of tax will still be due. Relief will apply only with respect to interest and penalties (SARS, 2010a:2).

With effect from the 2010 year of assessment, the requirements for the submission of tax certificates and employers' reconciliations have changed (SARS, 2009b:7), and employers have now been given greater responsibility (SARS, 2010b:8). Significant changes include:

- Changes to the IRP5/IT3a which will require employees to update their payroll systems and their employees' demographic details;
- Employers can now register those of their employees who do not have tax reference numbers using e@syfile;
- Enhancing the Employee Reconciliation Declaration (EMP501), by adding employees' demographic details; and
- Rationalising the existing PAYE, SDL and UIF codes to simplify the reconciliation process (SARS, 2010b:8).

### **3.1.9 SIGNIFICANT INITIATIVES UNDERTAKEN BY GOVERNMENT**

From the above review it is clear that government has made a significant effort to reduce the compliance burden for small businesses. In this section some of the more significant actions taken by government will be considered.

#### **3.1.9.1. eFiling**

SARS eFiling was introduced in 2004 as an online replacement process for the manual tax return submission. This service allows taxpayers, tax practitioners and businesses to register and submit tax returns, make payments and perform a number of other interactions with SARS in a secure online environment (SARS, 2009h). This has made the process of submitting tax returns considerably easier. In addition, SARS will issue electronic assessments.

#### **3.1.9.2. Turnover tax for small businesses**

In 2008, as part of government's broader mandate to encourage entrepreneurship and create an enabling environment for small businesses to survive and grow, the National Treasury and SARS announced initiatives to reduce the tax compliance burden on businesses with an annual turnover of up to R1 million (SARS, 2009d:2).

This system was essentially a package comprised of a turnover tax as a substitute for income tax, CGT, STC and an increase in the VAT compulsory threshold from R300 000 to R1 million. The turnover tax would be both optional and available to sole proprietors (individuals), partnerships, close corporations, co-operatives and companies, with effect from 1 March 2009 (SARS, 2009d:2).

The turnover tax is a stand-alone tax and does not form part of the usual calculations for determining income tax payable by a taxpayer on his or her taxable income. Receipts for a business forming part of the turnover tax system is therefore exempt for the purposes of calculating a taxpayer's income tax liability in terms of the Income Tax Act (SARS,

2009d:5). This tax is calculated by applying a tax rate to a 'taxable turnover', which basically consists of the cash receipts of the business with a few specific inclusions and exclusions (SARS, 2009d:2).

A business is disqualified from the turnover tax if that business or any shareholder in that business holds shares or has any interest in certain companies or close corporations. Certain investments are, however, permitted, because they are of a more public or social nature and present fewer opportunities for tax arbitrage. The following are such interests:

- in listed South African companies;
- in collective investment schemes;
- in bodies corporate and share-block companies;
- in venture capital companies;
- of less than 5% in social or consumer co-operative;
- of less than 5% in co-operative burial societies or primary saving co-operative banks;
- in friendly societies (SARS, 2009d:6);
- Interests in a company that did not trade during any year of assessment and which did not own assets with a total market value that exceeds R5 000 during any year of assessment (RSA, 2010).

A business is disqualified if more than 10% of the total income of the business consists of investment income. A person who is a 'personal service provider' or a 'labour broker' who has not been issued with a tax exemption certificate by SARS is also disqualified (SARS, 2009d:2).

A business that renders 'professional services' as defined is also disqualified (SARS, 2009d: 7). According to SARS, this system is aimed at the truly micro, start-up type of business (SARS, 2009d:4).

### **3.1.9..3. Small retail VAT package**

Audits carried out by SARS revealed that many small businesses were not maintaining adequate records to substantiate their output tax liability. In order to simplify the

administration, the small retailers VAT package was introduced in April 2005 (National Treasury, 2005:87). This package was essentially a method for determining the total output VAT liability. The small retailers VAT package uses the following method to determine VAT liability:

- Step 1: Calculate your daily gross takings inclusive of VAT over a period of two months;
- Step 2: Calculate the value of your zero-rated sales by adding the value of the Industry Mark-up Percentage to total zero-rated purchases that you used to make zero-rated supplies;
- Step 3: Calculate your standard-rated sales by deducting the zero-rated sales (from step 2) from your daily gross takings;
- Step 4: Apply the 14% tax fraction to the total standard-rated sales determined in Step 3;
- Step 5: Account for the output tax in your VAT 201 return (SARS, 2009f:1-4).

#### **3.1.9..4. Tax amnesty**

As pointed out above, it was announced in the 2006 budget speech that SARS would offer a tax amnesty to small businesses with a turnover of less than R5 million that had remained outside the tax system. In terms of this amnesty, SARS would waive taxes and penalties for years of assessment ending on or before 31 March 2004. This was subject to a non-disclosure penalty of 10% based on the 2005 taxable income. However, after certain consultations, the following changes were made to the original proposals:

- The business turnover limit was increased to 10 million;
- The penalty was decreased from 10% to a graduated levy not exceeding 5% on taxable income for 2006 (SARS, 2009a).

#### **3.1.10 Conclusion on government initiatives**

It is clear from the above review that government is committed to reducing the compliance burden faced by small and medium enterprises. It is also evident that government has made a significant effort in this regard, but it is equally important for the effort to actually address the concerns identified. This will be shown in the following chapter, in which a

comparison will be made between the compliance costs identified in Chapter Two and the initiatives undertaken by government identified in this chapter.

## **CHAPTER FOUR**

# **COMPARISON BETWEEN TAX COMPLIANCE BURDEN AND SARS' RESPONSE**

## **4 INTRODUCTION**

In Chapter Two, the tax compliance burdens faced by small businesses were reviewed. This was followed, in Chapter Three, by a review of government initiatives to assist SMEs in reducing this burden. In this section the tax compliance burdens identified above, as well as the recommendations made in the various studies, will be compared with the initiatives undertaken by SARS. This will explain the extent to which government is responding to the tax compliance burdens identified and the recommendations made, and will establish what burdens/ recommendations, if any, have not been addressed.

### **4.1 COMPARISON OF TAX COMPLIANCE BURDEN AND SARS' RESPONSE**

Table 3 below summarises the compliance burdens identified in the studies that have been reviewed and matches (where possible) the initiative/s undertaken by SARS to address (either in total or to some extent) the burdens identified. The table also includes the year in which the study was published (not necessarily performed) and the year in which SARS responded. This indicates how long SARS took to respond to the burdens identified. It is acknowledged that this provides only a very approximate indication of the timeliness of SARS' addressing the compliance burdens identified and does not in any way suggest an accurate measurement. There are various reasons for this, one being, inter alia, the fact that certain of the studies were published some time after the research had been carried out (FIAS, 2007), which means that the burden could have existed for a longer period than is indicated by the publication date of the study. SARS could also have already been aware (by means of their own surveys, for instance) of the compliance burdens long before the research study identified them. Furthermore, SARS could already have started planning its compliance initiative many months or even years before implementing it.

All of these reasons, along with many others not mentioned here, are factors that should be borne in mind when considering the timeliness of SARS' responses to the small business tax compliance burden.

This table will be followed by Table 4, which compares the recommendations made in those studies to SARS' responses.

**Table 3: A comparison of the significant tax compliance burdens per study identified and SARS' responses**

Compliance burden identified	SARS' response
<p><b>Smulders Study</b></p> <p><i>I. Clover &amp; Darroch, 2005- June 2005</i></p> <ul style="list-style-type: none"> <li>• Complex VAT registration process.</li> </ul> <p><i>II. SARS, 2004- September 2004</i></p> <ul style="list-style-type: none"> <li>• One of the most burdensome taxes for SMMEs is VAT.</li> </ul>	<ul style="list-style-type: none"> <li>• The VAT registration process was simplified in February 2008 (SARS, 2008b).</li> <li>• SARS increased the compulsory VAT threshold to R1m in 2009 (SARS, 2009g).</li> <li>• Small retailers' VAT package was introduced in April 2005 (National Treasury, 2005).</li> <li>• A specific initiative to educate SMEs on VAT was undertaken in 2005 (National Treasury, 2005).</li> <li>• SARS introduced a simplified turnover-based tax system from 1 March 2009 (SARS, 2009d: 2) Registration for VAT no longer required or, in fact, permitted if this system is adopted.</li> <li>• SARS increased the compulsory VAT threshold to R1m in 2009 (SARS, 2009g).</li> <li>•</li> </ul>



<p>for larger ones</p> <p>IV. <i>Upstart Business Strategies, 2004-</i></p> <ul style="list-style-type: none"> <li>• It was much more expensive to outsource record-keeping and completion of tax returns than to do this in-house.</li> <li>• Tax software for record-keeping and VAT could reduce the burden significantly.</li> <li>• The greatest contributors to the total compliance cost of VAT were recurring rather than once-off burdens.</li> </ul> <p>V. <i>UNISA, 2005- October 2005</i></p> <ul style="list-style-type: none"> <li>• SMEs believed that the burden had increased over the previous three years.</li> <li>• SMEs prefer tax consultancy and tax update courses.</li> </ul> <p>VI. <i>UNISA, 2006a</i></p> <ul style="list-style-type: none"> <li>• SARS takes, on average, seven minutes to answer incoming calls and takes approximately three</li> </ul>	<p>This system is aimed specifically at the smaller businesses (SARS, 2009d: 2).</p> <ul style="list-style-type: none"> <li>• The simplified turnover-based tax system for micro-businesses was introduced from 1 March 2009, its main aim being to reduce their tax compliance burden, which could now be done by reducing the need for a tax practitioner to assist a small business with its tax affairs (SARS, 2009d:2).</li> <li>• Small retailers VAT package was introduced in April 2005 (National Treasury, 2005).</li> <li>• Introduction of e-filing in 2004 (SARS, 2009h).</li> <li>• N/a- does not relate to a specific burden.</li> <li>• N/a- does not relate to a specific burden.</li> <li>• Tax practitioner call-centre centralised, additional staff during filing season (Smulders &amp; Stiglingh,</li> </ul>
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<p>telephone calls, on average, to effectively address tax enquires.</p> <ul style="list-style-type: none"><li>• It takes SARS approximately ten weeks (54 working days) to return refunds on VAT, while it takes approximately 15 weeks to return refunds on tax returns.</li></ul> <p><i>VII. UNISA, 2006b</i></p> <ul style="list-style-type: none"><li>• SARS was found to take approximately eight minutes to answer an incoming call, while an average of five telephone calls are required to address tax enquires effectively.</li><li>• It takes SARS just more than a month to respond to written correspondence and eight weeks to process tax returns.</li><li>• It takes SARS approximately ten weeks to return refunds on VAT and 13 weeks to return refunds on tax returns.</li><li>• Less than half the business services SMEs handle deal with income tax functions internally while most outsource this function.</li></ul> <p><i>VIII. Chamberlain &amp; Smith, 2006</i></p> <ul style="list-style-type: none"><li>• This study confirmed that the tax compliance burden on small businesses is significant.</li><li>• We could further improve our</li></ul>	<p>2008, 623).</p> <ul style="list-style-type: none"><li>• Quicker assessment/ payment made into taxpayer's bank account electronically (Smulders &amp; Stiglingh, 2008, 623)</li></ul> <ul style="list-style-type: none"><li>• Tax practitioner call-centre centralised, additional staff during filing season (Smulders &amp; Stiglingh, 2008, 623)</li><li>• Introduction of e-filing in 2004 (SARS, 2009h). Dedicated tax practitioner email (Smulders &amp; Stiglingh, 2008, 623).</li><li>• Quicker assessment/payment made into taxpayer's bank account electronically (Smulders &amp; Stiglingh, 2008, 623).</li><li>• N/a- does not relate to a specific burden.</li></ul> <ul style="list-style-type: none"><li>• N/a- does not relate to a specific burden.</li><li>• SARS commissioned a small</li></ul>
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<p>knowledge of the burden.</p> <p>IX. <i>World Bank and International Finance Corporation, 2006</i></p> <ul style="list-style-type: none"><li>• South Africa is placed in the 74<sup>th</sup> position in terms of ease of paying taxes.</li></ul>	<p>business tax compliance costs study in 2007 (FIAS, 2007).</p> <ul style="list-style-type: none"><li>• N/a- does not relate to a specific burden.</li></ul>
<p><b><i>Venter &amp; de Clerq, 2007</i></b></p> <ul style="list-style-type: none"><li>• The main reasons for outsourcing were lack of time and skilled staff.</li></ul>	<ul style="list-style-type: none"><li>• N/a- does not relate to a specific issue.</li></ul>
<p><b><i>Abrie &amp; Doussy, 2006</i></b></p> <ul style="list-style-type: none"><li>• SMEs could be liable for up to 11 different taxes.</li><li>• SMEs performs the routine functions internally and outsources the more complicated ones.</li></ul>	<ul style="list-style-type: none"><li>• SARS introduced a simplified turnover-based tax system from 1 March 2009 (SARS, 2009d: 2).</li><li>• SARS simplified the format for tax returns. The process began in 2002, but significant simplification came about only in 2007 (SARS, 2007a).</li><li>• SARS has made available the e@syfile software application to assist employers in 2008. This software simplifies the PAYE reconciliation process (SARS, 2008a).</li></ul>
<p><b><i>FIAS, 2008</i></b></p> <ul style="list-style-type: none"><li>• The tax registration process is complex and cumbersome.</li><li>• VAT takes the longest to register for and is the most costly.</li></ul>	<ul style="list-style-type: none"><li>• SARS introduced a simplified turnover-based tax system, with effect from 1 March 2009, which would essentially replace CGT, STC and normal tax, and the entity would</li></ul>



<ul style="list-style-type: none"><li>• Tax practitioners regard provisional tax as the most burdensome.</li></ul>	<p>not have to register for VAT (SARS, 2009d: 2).</p> <ul style="list-style-type: none"><li>• The VAT registration process was simplified in 2008 (SARS, 2008b).</li><li>• Small businesses with a taxable income of R1 million or less can rely on the previous year's assessment to calculate the 2<sup>nd</sup> provisional tax payment (RSA, 2009a) instead of making an estimate which has to be 90% correct to avoid penalties.</li><li>• Small businesses with taxable income above R1 million, however, have to make an estimate which must be 80% correct to avoid facing potential penalties.</li></ul>
<p><b>Citizen Surveys &amp; Govender, 2008</b></p> <ul style="list-style-type: none"><li>• One third of SMEs were entirely dependent on tax consultants.</li><li>• Employees' tax places a heavy burden on SMEs.</li></ul> <ul style="list-style-type: none"><li>• VAT was time-consuming.</li></ul>	<ul style="list-style-type: none"><li>• A tax practitioner unit was established in 2007 (SARS, 2007:48).</li><li>• SARS has made available the e@syfile software application to assist employers in July 2008. This software simplifies the PAYE reconciliation process (SARS, 2009d: 2).</li><li>• A specific initiative to educate SMEs on VAT was undertaken in 2006 (National Treasury, 2005).</li><li>• Small retailers VAT package was</li></ul>

<ul style="list-style-type: none"> <li>• SMEs outsource the tax function owing to the complex nature of tax.</li> </ul>	<p>introduced in April 2005 (National Treasury, 2005).</p> <ul style="list-style-type: none"> <li>• The VAT registration process was simplified in February 2008 (SARS, 2008b).</li> <li>• SARS increased the compulsory VAT threshold to R1m (SARS, 2009g).</li> <li>• SARS introduced the simplified turnover-based tax system from 1 March 2009 (SARS, 2009d: 2).</li> <li>• N/a-does not relate to a specific issue.</li> </ul>
<p><b>FIAS, 2008</b></p> <ul style="list-style-type: none"> <li>• Practitioners' costs are higher in urban provinces than in rural areas.</li> </ul>	<ul style="list-style-type: none"> <li>• N/a-does not relate to a specific issue.</li> </ul>

Most of the above reviewed studies concluded with recommendations for both SARS and the small business sector. This study will now consider these recommendations to establish whether any of the measures introduced by SARS actually addressed the recommendations made in the studies. Table 4 below summarises the major recommendations made in these studies and, where possible, links these recommendations to initiatives or administrative aids that SARS has introduced. This table will once again highlight areas that still require SARS' attention and will provide insight into whether or not SARS has addressed the needs of small business within a reasonable period of time, considering the limitations mentioned.

**Table 4: A comparison of the recommendations made in compliance cost studies in South Africa with SARS' responses**

Recommendation	SARS response
A simplified tax regime for SMEs (FIAS, 2008).	<ul style="list-style-type: none"> <li>• Introduction of turnover-based tax system in March 2009 (SARS, 2009d: 2) combining five taxes into one.</li> </ul>
Reduce the number of taxes that SMEs have to administer (Abrie & Doussy, 2006).	<ul style="list-style-type: none"> <li>• Introduction of turnover-based tax system in March 2009 (SARS, 2009d: 2) combining five taxes into one.</li> <li>• Abolition of SITE from 1 March 2011 (SARS, 2010a), which must be calculated and deducted by employers.</li> </ul>
Simplify the tax laws for SMEs (Abrie & Doussy, 2006).	<ul style="list-style-type: none"> <li>• Introduction of turnover-based tax system in March 2009 (SARS, 2009d: 2).</li> </ul>
Assistance to SMEs in the form of software or other tools (Abrie & Doussy, 2006).	<ul style="list-style-type: none"> <li>• Small retailers VAT package was introduced in 2005 (National Treasury, 2005).</li> <li>• E@syfile software introduced in 2008 (SARS, 2009d: 2).</li> <li>• Efiling introduced in 2004 (SARS, 2009h).</li> </ul>
Simplify tax returns (Citizen Surveys & Govender, 2005).	<ul style="list-style-type: none"> <li>• Introduction of efilings in 2004 (SARS, 2009h).</li> <li>• SARS simplified the format of tax returns. The process began in 2002, but significant simplification only came about in 2007 (SARS, 2007a).</li> </ul>



	<ul style="list-style-type: none"><li>• The VAT registration process was simplified in 2008 (SARS, 2008b).</li><li>• Pre-populated returns for salaried individuals were introduced in 2008 (SARS, 2009: 80).</li><li>• Submission of supporting documents with the tax returns no longer required (SARS, 2007a).</li></ul>
Establish a threshold, below which no tax return should be submitted (Citizen Surveys & Govender, 2005).	<ul style="list-style-type: none"><li>• Addressed for salaried employees (earning below R120 000), but not for small businesses. However, this income must be earned from a single employer and the taxpayer should not have any income or deductions other than what is reflected on their tax certificate (SARS, 2009: 44).</li></ul>
Assist SMEs with tax education e.g. <ul style="list-style-type: none"><li>• Workshops (Citizen Surveys &amp; Govender, 2005).</li><li>• Include tax as part of school curriculum.</li></ul>	<ul style="list-style-type: none"><li>• SARS did hold workshops from time to time on important new developments e.g. Small Business Tax Amnesty and the turnover-tax system (SARS, 2009:24).</li><li>• SARS introduced a tax guide for SMEs from 2004 (National Treasury, 2004: 94-95).</li><li>• No action taken.</li></ul>
Improve communication with SMEs (FIAS, 2008).	<ul style="list-style-type: none"><li>• SARS introduced a tax guide for SMEs from 2004 (National Treasury, 2004:94-95).</li></ul>



	<ul style="list-style-type: none"><li>• The National Small Business Office in SARS was established in 2007 (SARS, 2010).</li><li>• SARS established a webpage in 2008 for small businesses, to provide them with information on, inter alia, the tax process, useful guides, links to important information and information on the tax season. This webpage acts as a means of communication for the SMEs (SARS, 2010).</li></ul>
Exempt first-time offenders from penalties and interest and provide them with insight into their mistakes (FIAS, 2005).	<ul style="list-style-type: none"><li>• With respect to the administrative penalties in terms of section 75B of the Income Tax Act (RSA, 2008), the Commissioner may remit a portion or the entire penalty imposed if it is a first-time offence (SARS, 2010c). This was effective from 1 January 2009.</li></ul>
Require first-time offenders to attend courses instead of raising penalties (FIAS, 2005).	<ul style="list-style-type: none"><li>• No action taken.</li></ul>
Reduce rates for penalties and interest (Citizen Surveys & Govender, 2005).	<ul style="list-style-type: none"><li>• No action taken.</li></ul>

## 4.2 TIMELINESS OF CHANGES INTRODUCED BY SARS

The table above includes the year in which the study was undertaken and the year in which SARS responded. It shows how long SARS took to respond to the burdens identified. It appears that SARS takes, on average, from two to five years to respond to the findings of the studies reviewed. Admittedly, this is not an accurate indication of the actual time SARS takes to respond to recommendations in the surveys reviewed, and further detailed research is required to obtain accurate information on this matter. Nevertheless, this serves as a good platform from which to evaluate SARS.

## CONCLUSION

From the above comparison, it would appear that SARS has been responsive in most cases to the compliance cost burdens identified and recommendations made in the studies done on small businesses. Of particular significance were the introduction of the Small Retails' VAT Package and the Turnover Tax system. The introduction of the latter is also an indication of SARS' responsiveness, as SARS and the National Treasury commissioned a small business tax compliance study which led to the introduction of this system. The areas to which SARS has not responded or has not addressed or only partially addressed are the following:

- The lack of software to assist small businesses with their record-keeping (the role of SARS in this function is, however, questionable);
- The calculation of the second provisional tax payment. Although new legislation (RSA, 2009) has been introduced, small businesses with a taxable income of more than R1 million could be subject to discretionary penalties should their second provisional payment not be 80% accurate. This increases the compliance burden for small businesses (BDO, 2009; Lester, 2008; Vanek, 2009) and this initiative by SARS may require further research and amendments to ensure that the compliance burden is adequately addressed;
- Inclusion of tax as part of the school curriculum. Although this has been implemented in South Africa to a limited extent, SARS has not introduced initiatives or given assistance (Oberholzer & Nel, 2006:117);
- Require first-time offenders to attend courses instead of raising penalties;
- Reduce rates for penalties and interest; and

- Establishment of a threshold below which tax returns need not be submitted (this has only been done for individuals).

Further research into the reasons why these have not been implemented is required.

This study has not considered the effectiveness of the responses by SARS. It is therefore suggested that further research be carried out to evaluate how effective SARS' responses have been. This would provide valuable insight into whether the responses are, in fact, alleviating the burden faced by small businesses.

A final conclusion of the findings of the tax compliance burden studies and SARS' response thereto will be dealt with in the next chapter, which will conclude with final remarks and areas for further research and initiatives by SARS.

## **CHAPTER FIVE**

### **CONCLUSION**

#### **5 INTRODUCTION**

The purpose of this study was to establish the existence of the tax compliance burden facing small businesses and then to outline what the National Treasury and SARS have done towards addressing this burden. This would provide some understanding as to whether government is actually responding to the burdens faced by these small businesses, how quickly they are responding and to what extent. This chapter will summarise the findings of this study and will comment on the extent to which the tax compliance burdens faced by SMEs and recommendations made in the various studies reviewed have been addressed and implemented by government.

##### **5.1 SUMMARY OF FINDINGS**

Compliance costs are regressive in nature in that they weigh more heavily on smaller enterprises. Government appears to be gaining a better understanding of the tax compliance burden faced by small businesses and they have, over the past several years, taken steps for reducing it.

Compliance with VAT, the complexity and time-consuming nature of tax returns, too many taxes to comply with and complying with provisional tax requirements were identified as the most significant tax compliance costs faced by small businesses. Measures introduced by government to reduce these costs/burdens include the Small Retailers VAT Package, various training workshops, a simplified VAT registration process, introduction of e-filing and, more recently, a simplified tax regime for small businesses. This simplified turnover tax regime was the result of a small business tax compliance research study commissioned by SARS and the National Treasury in 2006 and conducted in South Africa.

A comparison of the tax compliance burdens identified and recommendations made to the steps taken by government reveal that government is actively trying to reduce the compliance burden faced by small businesses. Government has taken steps to address many of the compliance burdens identified and recommendations made. However, a few remain unaddressed (refer to Chapter Four) and it is important that government make every effort to address them.

The areas to which SARS has not responded, has not addressed at all or has only partially addressed are the following:

- the lack of software to assist small businesses with their record-keeping (the role of SARS in this function is, however, questionable); and
- the calculation of the second provisional tax payment (although new legislation (RSA, 2009) has been introduced, small businesses with a taxable income of more than R1 million could be subject to discretionary penalties should their second provisional payment not be 80% accurate. This increases the compliance burden for small businesses (BDO, 2009; Lester, 2008; Vanek, 2009). This initiative by SARS may require further research and amendments to ensure that the compliance burden is adequately addressed).

. The following recommendations identified have not yet been addressed:

- Require first-time offenders to attend courses instead of raising penalties;
- Reduce rates for penalties and interest;
- Establishment of a threshold below which no submission of a tax return is required.

## **5.2 AREAS FOR FURTHER RESEARCH**

An aspect that was not considered in this review was whether the actions taken by government were effective in addressing the tax compliance costs and the recommendations made. It is recommended that a further study be carried out to evaluate the effectiveness of the steps taken by SARS and the National Treasury. The results of this study should then be analysed to determine whether the steps already implemented are effective, whether they should be amended or whether they should be replaced altogether with different measures, with the overall aim of reducing the compliance burden faced by small businesses.

This study should be repeated every two to four years to ensure that there is no duplication of research and that SARS is addressing the burdensome aspects of taxes faced by small businesses.

### **5.3 OVERALL CONCLUSION**

This study reveals that there are significant tax compliance burdens faced by small businesses. However, it is pleasing to see that government has made a commitment to reducing the tax compliance burden and that they are actively taking steps to reduce it in a timely manner. Equally pleasing is that government's effort is significant. This would include, for example, the introduction of the turnover tax system, e-filing, software that simplifies the PAYE process and simplifications of the income tax returns. Reducing the tax compliance burden on small businesses will help these enterprises grow, which will benefit the economy as a whole. It is therefore important for government to continue its efforts to reduce this burden.

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