

IS TURNOVER TAX A BENEFIT OR A BURDEN: AN EXPLORATORY STUDY OF MICRO BUSINESS OWNERS

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ABSTRACT

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SARS introduced a presumptive tax system namely turnover tax for micro business owners in March 2009. The aim of turnover tax is to reduce the tax burden, thereby encouraging entrepreneurship and creating an environment where small businesses can survive and grow (SARS, 2009:2).

The advantages of the turnover tax system includes relieve of the administrative tax compliance burden on micro business owners. Micro businesses earning high profit margins will also be liable for less tax than would have been payable on the standard income system.

There are several drawbacks to the turnover tax system. Firstly, this system does not favour businesses running at a loss or earning lower profits. Secondly, a micro business that is registered for turnover tax will not be permitted to be registered for VAT as well (SARS, 2009:3). The micro business owner would be liable for VAT deregistration costs. Another negative consequence of deregistering for VAT is that the business will no longer be able to produce VAT invoices. The business may lose valuable clients as a result thereof.

The micro business owner has to carefully consider the influence that turnover tax can have on the bottom line of the business before registering for it.

OPSOMMING

IS OMSETBELASTING 'N VOORDEEL OF 'N LAS: 'N ONDERSOEK VAN EIENAARS VAN MIKROBESIGHEIDE

deur

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STUDIELEIER: PROF M CRONJE

DEPARTEMENT: BELASTING

GRAAD: MAGISTER COMMERCII

SARS het in Maart 2009 'n waarskynlikheidsbelasting naamlik omsetbelasting bekend gestel. Die doelwit van omsetbelasting is om die belastinglas te verminder om daardeur entrepreneurskap aan te moedig en 'n omgewing te skep waarin klein besighede kan oorleef en groei (SARS, 2009:2)

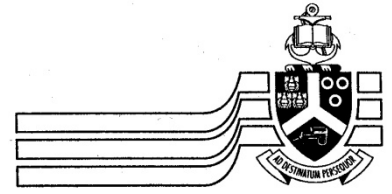
Die vermindering van die administratiewe las van belasting op die eienaars van mikrobesighede is een van die voordele wat omsetbelasting inhou. Mikrobesighede wat hoë winsmarge het, sal voordeel uit die omsetbelastingstelsel trek deur minder belasting te betaal as wat betaalbaar sou wees onder die standaardinkomstebelastingstelsel.

Die omsetbelasting stelsel hou vele nadele in. Eerstens, is die stelsel nie voordelig vir 'n onderneming wat 'n verlies maak of laer winsmarge het nie. Tweedens, word 'n mikrobesigheid wat vir omsetbelasting geregistreer is nie toegelaat om ook vir BTW geregistreer te wees nie (SARS, 2009:3). Die mikro- ondernemer sal as gevolg hiervan verantwoordelik wees vir die deregistrasiekoste van BTW. 'n Ander nadeel van die deregistrasie vir BTW is dat die onderneming nie meer in staat sal wees om BTW fakture uit te reik nie. Die besigheid kan waardevolle kliënte as gevolg hiervan verloor.

Die mikroondernemer moet die gevolge van omsetbelasting op die netto wins van die besigheid deeglik oorweeg voordat hy daarvoor registreer.



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CHAPTER 1

BACKGROUND AND PROBLEM STATEMENT

1.1 BACKGROUND

Regulations and red tape can put constraints on the growth of businesses (FIAS, 2007:1). SARS introduced turnover tax for micro business owners in March 2009 in terms of the Sixth Schedule of the Income Tax Act, 58 of 1962. The aim of turnover tax is to reduce the tax burden, thereby encouraging entrepreneurship and creating an environment where small businesses can survive and grow (SARS, 2009:2). However, the amount of tax payable under this system can be substantially more than that payable under the income tax system. According to Du Preez (2009), the decision to remain in the current tax system or to select turnover tax needs to be weighed carefully.

A further reason why a micro business owner should carefully consider turnover tax is the current economic conditions in South Africa. During difficult economic periods, very low profit margins can be expected. One of the disadvantages of turnover tax is that a business operating at a loss will still have to pay turnover tax (Visser, 2009). Under the income tax system, no tax is payable when businesses are operating at a loss. The assessed loss can then also be utilised against the first profits of the business.

Turnover tax will not only influence income tax, but it will substitute CGT, STC as well as VAT (SARS, 2009:2). Micro businesses already registered for VAT have to deregister for VAT in order to qualify for registration of turnover tax (SARS, 2009:3). The cost to deregister and the implication of not being able to provide customers with VAT invoices might have a serious impact on the micro business owner.

This study is of practical importance to micro business owners and tax practitioners. The aim of the study is to investigate the impact of turnover tax on different types of micro businesses. The amount of taxation payable as well as the costs of being tax compliant will be demonstrated. The application of the turnover tax provisions is optional (SARS, 2009:2). It is therefore essential to be aware of the pitfalls in the system. A better

understanding of the turnover tax system is essential from both an academic and micro business owner's perspective.

1.2 PROBLEM STATEMENT

The aim of turnover tax is to reduce the tax compliance burden of micro business owners (SARS, 2009:2). Registering for turnover tax can, however, have a negative financial impact on the micro business owner.

1.3 PURPOSE STATEMENT

The purpose of the study is:

- to investigate the influence of registering for turnover tax on different types of micro businesses; and
- to investigate the applicability of turnover tax for micro business owners in their various circumstances.

1.4 RESEARCH OBJECTIVES

The following specific objectives guide the study:

- to compare the taxation payable between the turnover tax system to that payable under the income tax system with reference to specific profit margins;
- to compare the taxation payable between the turnover tax system to that in the income tax system with reference to the specific type of business;
- to explore the benefit of a simplified tax system on the South African economy;
- to investigate the influence that the introduction of turnover tax would have on the tax compliance burden of the micro business owner who registers for turnover tax;
- to investigate the impact of VAT deregistration on the micro business owner; and
- to explore the success of introducing turnover tax to the micro business owner.

1.5 IMPORTANCE AND BENEFITS OF THE PROPOSED STUDY

From a theoretical perspective, the study makes a valuable contribution. The turnover tax system has only been introduced recently and only a few academic studies have been executed on the topic.

Registering for turnover tax is optional (SARS, 2009:2). From a practical perspective, the findings should assist micro business in their choice of a tax system. The study investigates the circumstances under which the turnover tax system will benefit the micro business owner as well as the negative impact it could have on the bottom line of the business.

1.6 DELIMITATIONS AND ASSUMPTIONS

1.6.1 Delimitations

The proposed study has several delimitations related to context and literature streams. Firstly, the proposed study was limited to micro business owners in South Africa. Businesses with a turnover of more than one million rand per year were not studied. Furthermore, the study did not include any foreign micro businesses or businesses not qualified to register for turnover tax.

Secondly, the literature review was primarily limited to literature from the discipline of South African taxation. Literature from the international taxation sphere was only consulted in passing.

1.6.2 Assumptions

Several basic assumptions underlie the research study. As such, it is assumed that:

- the micro business owner is tax compliant;
- the micro business owner incurs time and costs in order to be tax compliant; and

- the micro business owner is able to identify the turnover of the business without incurring excessive costs.

1.7 DEFINITION OF KEY TERMS

This study involves a number of key concepts, namely Micro business owner, turnover tax system as well as other taxation terms. The manner in which these key terms are defined for the purpose of this study is considered below.

Bottom line: Referring to the net income of a person, thus the profits that the person has to show after deducting all expenses, the final total of an account or balance sheet is the bottom line (AskOxford.com, 2009).

Compliance costs: Compliance costs tend to include (FIAS, 2007:7):

- the value of time spent on understanding the tax rules and applying them;
- the costs of compiling records in respect of the preparation of tax returns;
- payments made to professional advisors for their expertise; and
- postage, telephone and travelling costs made in order to communicate with advisors and tax authorities.

UK literature defines compliance costs as “the costs incurred by taxpayers..., in meeting the requirements of the tax system, over and above the tax liability itself...” (Sandford, 1995:1).

Dividends tax: It was announced in the 2007/8 Budget Tax Proposal that STC will be phased out and replaced with a dividends tax. This entails conversion to a dividend tax on shareholders, with administrative enforcement through a withholding tax at company level. (Department of Treasury, 2007:3.) Dividends tax will therefore be levied on the shareholder who receives a dividend; and will be withheld by the company declaring the dividend.

Employee's tax: A tax which employers deduct from employees' earnings to pay over to SARS on their behalf. This consists of PAYE (Pay as you earn) and SITE (Standard Income Tax on Employees) (SARS, 2009:1).

Income tax: A tax that is based on taxable income which is receipts and accruals of individuals, companies and other taxpayers, after the deduction of qualifying expenditure and allowances (SARS, 2009:1).

Micro business: A micro business can be a person or a company whose qualifying turnover does not exceed an amount of R1 million (Paragraph 2 of the Sixth schedule of the Income Tax Act 58 of 1962)).

Professional services: "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, research, secretarial services, sport, surveying, translation, valuation or veterinary science" (Paragraph 1 of the Sixth Schedule of the Income Tax Act).

Provisional tax: An amount payable during the year of assessment that is offset against the total income tax liability of a taxpayer in the year of assessment (SARS, 2009:1).

Qualifying turnover: Total receipts received from business activities excluding capital receipts and exempted income in terms of section 10(1)(y), 10(1)(zA), 10(1)(zG), and 10(1)(zH) (Paragraph 1 of the Sixth Schedule of the Income Tax Act).

Tax practitioner: A professional person who provides advice on tax matters or completes or assists in completing tax assessments to be submitted to SARS (Section 67A (1) of the Income Tax Act).

Taxable turnover: "The total of amounts, not of a capital nature, received during a year of assessment from carrying on business activities in South Africa, with certain specific inclusions and exclusions" (SARS, 2009:1).

Turnover tax: The annual presumptive tax that is payable by a registered micro business by applying the relevant tax rate to its “taxable turnover” (SARS, 2009:1).

Value-added tax (VAT): A tax which is imposed on the supply and importation of goods and services. The prescribed rate of VAT is 14%. (Section 7 of the VAT Act,89 of1991)

VAT registration threshold: A person is liable to register for VAT if the total actual or expected taxable supplies exceeds R1 million (section 23(1) of the VAT Act).

1.8 ABBREVIATIONS

The abbreviations used throughout the document are listed in Table 1:

Table 1: Abbreviations used in this document

| Abbreviation | Meaning |
|---------------------|---|
| ADR | Advanced Dispute Resolution |
| CGT | Capital gains tax |
| FIAS | Foreign Investment Advisory Service of the World Bank Group |
| GDP | Gross domestic profit |
| SAICA | The South African Institute of Chartered Accountants |
| SARS | The South African Revenue Service |
| SBP | Small Business Project |
| SDL | Skills Development Levy |
| SMME | Small, Micro and Medium Enterprises |
| STC | Secondary Tax on Companies |
| Tax | Taxation |
| UIF | Unemployment Insurance Fund |
| VAT | Value-added taxation |

1.9 LITERATURE REVIEW

Relevant literature on the topics of micro businesses, tax compliance and international comparatives were critically evaluated in order to support conclusions and recommendations. The literature included:

- South African taxation legislation, regulations and annual reports issued by SARS;
- studies conducted on micro businesses and tax compliance; and
- available documentation and information relating to turnover tax.

Chapter 2 explores the introduction of turnover tax to the South African tax system. This includes an overview of turnover tax and the influence of turnover tax on tax compliance and the costs thereof. The effectiveness of the SARS campaign to introduce turnover tax to the micro business owner was also considered.

In Chapter 3 the effect of turnover tax on tax administration is investigated. The consequences of the introduction of similar presumptive tax systems in other countries are also explored.

Chapter 4 studies the influence of turnover tax on the South African economy. This includes the investigation of the current tax compliance burden on the economy. The measure to which turnover tax will contribute to minimising this compliance burden and support growth is also studied.

Chapter 5 is dedicated to the comparison of turnover tax to the current income tax system.

Chapters 6 and 7 document the results and conclusions of the in-depth interviews held with micro business owners.

1.10 RESEARCH DESIGN AND METHODS

The research consists of two elements. The first element involves in-depth interviews with micro business owners. The second element entails the collection of financial data and tax history from the interviewees.

1.11 EXPLORATORY RESEARCH

1.11.1 Description of the inquiry strategy

In-depth interviewing:

The use of non-standardised research interviews as a method of data collection is advantageous to this study for the following reasons:

- The purpose of the research: It is necessary to understand the reasons for the decisions the research participants have taken, as well as the reasons for their attitudes and opinions (Saunders *et al.*, 2007:315).
- The significance of establishing personal contact: It has been found that participants prefer to be interviewed rather than to fill in a questionnaire (Saunders *et al.*, 2007:315). The subject is tax related, this is a sensitive subject and respondents might have concerns to respond on paper. Personal contact is key to explaining the nature and aim of the research as well as ensuring confidentiality and anonymity.
- The nature of the data collection questions: The questions are open-ended questions; the flow of the questions will also depend on the answers given to the previous questions.

Collection of financial data:

The second part of the interview will involve the collection of financial data. This will include turnover figures and profit margins. If actual information is not available, management's estimates will be obtained. Questions relating to operating and capital expenditure will also be included as part of the interview. This will enable the researcher to be in a better position to estimate the tax deductions and allowances that would have been available to the business registered for normal tax.

1.12 ASSESSING AND DEMONSTRATING THE QUALITY AND RIGOUR OF THE PROPOSED RESEARCH DESIGN

1.12.1 Sources of bias or error that can influence the study

Interviewer and interviewee bias: Interviewer bias is when the comments, tone or non-verbal behaviour of the interviewer creates bias in the interviewee's response (Saunders *et al.*, 2007:315). This will be kept in mind by the interviewer and the interview and questions will be structured to minimise bias. The use of open ended questions can be a tool in avoiding bias (Easterby-Smith *et al.* in Saunders 2007:324). Interviewee bias will be reduced by defining concepts clearly and avoiding long questions.

Deliberate distortion: This study is especially subject to possible deliberate distortion due to the nature thereof. Tax is involved; this opens a door for interviewees to distort data in fear of being reported to tax authorities for non-compliance and/ or tax evasion. The possibility hereof will be reduced to the minimum by ensuring that the respondents are aware of the confidentiality and anonymity clause in the informed consent form – refer Appendix B.

1.12.2 Criteria and techniques used to provide evidence for the quality, credibility and rigour of the study

Data obtained during semi structured interviews for the purpose of obtaining an understanding of the mindset of the micro business owner will be tested through respondent validation. Respondent valuation is a process whereby the researcher seeks corroboration from the respondents for the account of their interviews (Bryman & Bell, 2007:411).

The dependability of data will be supported by good recordkeeping measures. Records of every stage of the research will be kept.

Confirmability will be established. Confirmability is ensuring that, while recognising that complete objectivity is impossible in business research, the researcher can be shown to

have acted in good faith, not allowing personal values or theoretical inclinations influencing the conduct of the research and conclusions derived from it (Bryman & Bell, 2007:411).

1.13 RESEARCH ETHICS

The proposed study involves human subjects and is therefore subject to ethical issues highlighted below:

- Participation to the study is voluntary and subjects will have the right to withdraw from the study at any point without negative consequences;
- no financial or non-financial incentives will be used to encourage participation to the study;
- all information received will be held in confidentiality and anonymity will be ensured;
- all of the above is highlighted in the informed consent form (refer Appendix B);
- No special permission will be needed. All respondents will be older than 18 years. Employees within the organisations will not be interviewed; business owners will be approached directly;
- data will be archived along with the thesis/dissertation on CD ROM or in the University of Pretoria digital repository – UP Space – where it can be maintained for long periods of time; and
- the researcher will be objective, honest and act with integrity.

CHAPTER 2

THE INTRODUCTION OF TURNOVER TAX TO THE SOUTH AFRICAN TAX SYSTEM

2.1 INTRODUCTION

Turnover tax was introduced to the South African tax system in March 2009. The driver beyond this new tax was to simplify tax for the micro business owner (SARS 2009:2). By registering for turnover tax, the tax compliance burden of the micro business owner would be reduced substantially.

The expectation is that the introduction of turnover tax will encourage more micro businesses in the informal sector to be formalised and registered for tax purposes. This would in turn narrow the taxation gap.

This simplified tax is in essence a package which substitutes income tax, STC and CGT. This also involves an increase in the VAT compulsory registration threshold to R1 million (SARS, 2009:2). Refer to chapter 5 where the impact on the different taxes is discussed in more detail.

2.2 OVERVIEW OF TURNOVER TAX

It has been a recognised fact that small businesses play a vital role in the economy and social development of a country. (Refer to Chapter 4, where the economic effects of turnover tax are discussed in more detail). However, small businesses constantly report that tax compliance hinder their growth due to the time involved and the costs they have to pay to become and remain tax compliant (FIAS, 2007:6). For this reason, as part of the South African Government's broader mandate to encourage the development of entrepreneurial businesses and improve growth, SARS announced initiatives to reduce this tax compliance burden specifically for micro businesses with a turnover of up to R1 million (SARS, 2009:2). It is important to note that the grounds of turnover tax are founded on pragmatism rather than it being any form of incentive (BDO Spencer Steward, 2009).

Badenhorst, tax director of Edward Nathan Sonnenberg, agrees that the advantage of turnover tax is the relief of the administrative burden of tax compliance (Visser, 2009).

2.3 THE INFLUENCE OF TURNOVER TAX ON TAX COMPLIANCE COSTS

The findings of the FIAS (2007:6) survey revealed that the average fee that tax practitioners charge their small business clients to comply with income tax, provisional tax, VAT and employees' tax amounts to R7 030 per year. The study further revealed that the possible costs of completing and maintaining proper accounting records amounts to a further R12 185. The total costs in 2007 to enable a micro business owner to be tax compliant would therefore amount to about R19 215.

Small businesses usually require the services of accountants and tax practitioners due to the fact that they do not have the expertise or time to perform the taxation function (FIAS, 2007:9). A study conducted by Venter and De Clerq (2007:115) found that most small enterprises outsource their tax functions due to a lack of time available to manage these responsibilities. It is impossible to isolate the costs of tax compliance from business or accounting costs. There is always some overlapping between these costs (FIAS, 2007:8).

Proper bookkeeping is necessary especially where the micro business owner is registered for VAT. Being VAT compliant would require the business owner to report on figures such as turnover and purchases on a regular interval. This would be difficult for the micro vendor who does not have any accounting knowledge or background. The very small informal vendor would generally not even have access to a computerised accounting system. A vendor, who is registered for turnover tax, would not be permitted to register for VAT (SARS, 2009:3). The requirement to have a detailed bookkeeping system is eliminated when a business is no longer registered for VAT.

It can be expected that under turnover tax, micro business owners will not have to rely on accountants and tax practitioners to the extent that they had to in the past. Business owners may find it easier to comply under the turnover tax system due to the fact that recordkeeping is reduced to keeping only a record of the turnover (Du Preez, 2009).

It is a great challenge for authorities to reduce the tax burden. It was found that despite the fact that deregulations and simplified initiatives have been introduced in countries such as Australia and New Zealand, there is no evidence that the burden to small businesses has been reduced (Chittenden *et al.*, 2003:93).

The turnover tax will be calculated by simply applying a tax rate to a “taxable turnover” which will basically consist of the turnover of the business with a few specific inclusions and exclusions. These rules set out the requirement to maintain proof of expenditure and to have knowledge of the comprehensive inclusions and deduction processes of the income tax system. (SARS, 2009:2.)

It is however still likely that a micro business owner would need the assistance of a tax practitioner when it comes to objecting to an assessment and following the alternative dispute resolution process. The turnover tax is, however, designed to assist the truly micro, start-up type of business and therefore the business is not expected to run into complicated problems with the law when using the system (SARS, 2009:4). The chances of a dispute, and incurring the costs associated with it, is therefore slim.

In short, turnover tax will require a simple calculation that a layman will be able to perform, assuming that full accounting records of turnover are kept. It is the view of Hassan (SAICA, 2009), project director of tax at SAICA, that a micro business will no longer have to spend countless hours trying to interpret complicated tax systems.

2.4 THE INFLUENCE OF THE INTRODUCTION OF TURNOVER TAX ON TAX COMPLIANCE

In 2007 a survey of South African tax practitioners was carried out by the Foreign Investment Advisory Service of the World Bank Group (FIAS). This study found that more than 60% of businesses with a turnover of R300 000 and less decide to stay informal rather than to formalise their business operations (FIAS: 2007). An economy would prefer all businesses to be formalised. Yet there are several factors influencing a business owner’s decision to stay informal.

One of these factors is the influence of the tax system on a formalised business. According to Abrie and Doussy, (2006:5) “[t]he complexity of a tax system can be an obstacle for micro enterprises that wish to comply with tax regulations.” However, other factors that influences non-compliance includes the possibility of detection, penalties for non-compliance, stigma, reputation and social norms (Abrie & Doussy, 2006:5). A micro business owner would, for instance, not have the knowledge on how to formalise a business. A typical micro business owner like a street vendor would not see the need in formalising a business. Simplifying the tax system through the introduction of turnover tax will therefore not guarantee tax compliance as all the other factors have to be taken into account as well.

In other developing countries, the introduction of a simplified tax system for micro businesses has proved to have increased the tax registrations. In Russia, 2.8 times more legal entities applied for taxation under the simplified system in 2002 and the number of individual SME operators who applied to be taxed under the simplified system rose 3.2 times in the same period. In Albania 18 000 taxpayers were registered for small business tax according to the tax administration. This increased to 35 000 registered taxpayers in 2002. (Engelschalk, 2005:25.)

SARS has introduced many support mechanisms and incentives to assist small businesses in complying with the taxation requirements in the past. Abrie and Doussy (2006:6) conducted a study to determine the effectiveness of these programmes. The result of the study was that more than half of the respondents were not aware of the tax incentives available to them. The study of Venter and De Clerq (2007:132) revealed that small businesses do not use the support mechanisms available to them. The main reason for this was identified as the fact that business owners are not aware of the incentives available. Another limiting factor could be the strict requirements and process to apply for incentives. According to Abrie and Doussy (2006:5) this is an indication that the tax system is too intricate, that small business enterprises are lacking, and that SARS campaigns are unsuccessful. This raises questions as to whether the introduction of turnover tax will indeed make a difference to the level of tax compliance.

The cost versus benefit aspect of new tax registrations would also have to be considered. A significant number of new tax registrations would increase the administrative burden on the tax administrator without necessarily bringing in enough revenue to cover the administrative costs involved. Refer to Chapter 3 where the tax administration aspect is discussed in more detail.

2.5 THE INTRODUCTION OF TURNOVER TAX TO SOUTH AFRICAN MICRO BUSINESS OWNERS

According to a communication by Sharma (2009), manager of strategic marketing at SARS, SARS embarked on an extensive forty million Rand marketing campaign to promote turnover tax. Advertisements were placed in newspapers and leaflets were distributed. Promotions using other media included television and radio advertisements. According to Sharma research was conducted prior to launching the campaign to establish the specific target market. Advertising were therefore directed specifically at micro business owners. The advertising was, however, more focused on formalised micro businesses, encouraging them to convert to turnover tax. Not much was done in terms of advertising to the informal sector to bring new businesses into the tax net. Due to the low uptake on turnover tax, SARS has obtained the services of media strategists to establish what the flaws in the advertising campaign could have been. Sharma is, however, convinced that the low uptake is not due to flaws in the promotion thereof but rather due to negative sentiment and publicity around the type of tax itself.

Another small business incentive that was launched by SARS was the small business tax amnesty (SARS 2009:4). This was, however, out of synchronisation with the introduction of turnover tax. The registration for turnover tax with the option to get amnesty would have had an impact on the introduction of informal businesses into the tax net.

In an interview with Pillay (2009), SME subject matter expert at SARS, he agreed that the promotion of turnover tax was misplaced by focusing on conversion rather than on first time tax registrations.

2.6 CONCLUSION

Due to the complicated nature of tax in the past, the average business owner had no choice but to outsource accounting and tax matters to costly bookkeepers and tax practitioners (FIAS, 2007:9). When a micro business owner registers for turnover tax, the owner will probably be able to cut out the excessive accounting and tax compliance costs.

The tax system of South Africa has been unsympathetic towards micro business owners. This is one of the reasons that prevented micro business owners from formalising their businesses in the past. With the introduction of the simplified turnover tax, the tax environment becomes more approachable to the micro business owner (Du Preez, 2009). This would probably encourage businesses to register for tax.

According to BDO Spencer Steward (2009), a positive aspect of the turnover tax system is that the gap will be bridged for taxpayers who have previously been outside the tax net, though it is doubted whether this will result in bringing a significant number of taxpayers into the tax system.

CHAPTER 3

THE ADMINISTRATION OF TURNOVER TAX

3.1 INTRODUCTION

Engelschalk (2005:28) warns that a simplified tax system has to be combined with a strong tax administration to detect non-compliant businesses in order to really become an effective tool in reducing underground economy activity.

In this chapter it is questioned whether SARS would be able to provide the necessary system needed to administer a presumptive tax such as turnover tax.

3.2 THE EFFECT OF A SIMPLIFIED TAX SYSTEM ON TAX ADMINISTRATION

Simplified tax systems often entail changes to the tax structure such as exemptions and presumptive rates or amounts. These simplified tax systems are, however, regarded as practicable administration methods. (Terkper, 2003:214.)

Tax agencies are usually preoccupied with small and medium size taxpayers. Simplified tax systems can reduce compliance and administration costs of the tax administration offices. (Terkper, 2003:211.) However, the introduction of a simplified tax might encourage small businesses to register for tax, bringing new taxpayers into the tax net. More taxpayers would in turn increase the administration burden.

Enforcement programs must be put in place to improve the success of the simplified tax system. Presumptive programs can be more successful when it involves the whole tax process including auditing, collection and enforcement (Terkper, 2003:216). The effectiveness of a simplified system lies in the design, implementation, monitoring and review of the scheme; this should not be weakened by poor planning, research and coordination (Terkper, 2003:215).

3.3 ADMINISTRATION OF SIMILAR TAX SYSTEMS IN OTHER COUNTRIES

Engelschalk (2005:1) found that although Georgia, Russia, Ukraine and Albania offered generous tax reductions to small enterprises, this has not changed their tax behaviour significantly. It is the opinion of Terkper (2003:211) that although various presumptive tax or official assessment programs are available to improve compliance, these are not properly managed in many countries. Many simplified tax schemes are not linked to audit and enforcement programs, as the focus remains mainly on assessment (Terkper, 2003:215). Tracing taxpayers remains a high administrative burden no matter how simplified the tax system (Engelschalk, 2005:4).

It was found that if a tax administration is not in a position to at least estimate the real turnover of a small business, a turnover-based tax will not reduce the evasion possibilities and the degree of tax evasion (Engelschalk, 2005:22).

3.4 ADMINISTRATION OF TURNOVER TAX IN A SOUTH AFRICAN ENVIRONMENT

During the interview with Pillay (2009), he confirmed that there are certain audit measures that are built into turnover tax. The record keeping requirements include keeping records of assets and liabilities with a value of more than R10 000 at the end of each period (SARS, 2009:11). According to Pillay, this would enable SARS to compare the turnover declared to the movement in assets and liabilities, identifying gross misstatements.

Pillay (2009) highlighted that the turnover tax was introduced to encourage growth and not necessarily to enforce tax compliance. SARS is currently using the “carrot approach” whereby businesses are encouraged to register for tax. He is of the opinion that with the evolving of turnover tax, this approach will be changed to a “stick approach” where stronger enforcement measures will be put into place to ensure that micro businesses in the formal and informal sector are tax compliant.

3.5 CONCLUSION

The purpose of turnover tax in South Africa is not solely to avoid tax evasion but also to encourage growth. According to Pillay (2009), the current administration systems that SARS has in place would provide the sufficient control needed.

CHAPTER 4

THE INFLUENCE OF TURNOVER TAX ON THE ECONOMY OF SOUTH AFRICA

4.1 INTRODUCTION

In 2007, small businesses contributed 36.1% of South Africa's gross domestic product. The compliance burden is, however, noted as one of the constraints to growth of businesses both in South Africa and internationally. (FIAS, 2007:1.)

In President Thabo Mbeki's 2006 State of the Nation Address, he indicated that the regulatory climate for small businesses would be enhanced to facilitate development of this sector, as it plays an important role in the national strategy for accelerated and shared growth (Mbeki, 2006). Government has increased the focus of attention on the SMME sector, firstly as a means of stimulating economic growth, secondly as a medium for distribution of wealth, and thirdly as a means to address increasing unemployment (DTI, 2005).

This chapter explores the effect that turnover tax can have on the economy of South Africa.

4.2 THE EFFECT OF THE TAX COMPLIANCE BURDEN ON THE ECONOMY

Micro businesses play a vital role in terms of economic development. Regulation imposed by government is one of the biggest hindrances to business success (Chittenden *et al.*, 2003:94). Abrie and Doussy (2006:1) agree that the tax compliance requirements in South Africa are a stumbling block to small and medium enterprises. It is therefore of the utmost importance to stimulate growth in this sector by instituting such measures as a suitable taxation approach that will create an environment that is favourable to the prosperity and viability of the sector (Venter, 2007:115).

A study which the Small Business Project (SBP, 2005:4) conducted found that red tape cost the South African businesses R79 billion in 2004, this amount is equal to 6.5 percent of GDP. Compliance with all taxes made up 26 percent of the overall compliance burden, contributing R20.5 billion to aggregate compliance costs. A study by Abrie and Doussy (2006:10) has shown that compliance costs devour resources that could have been used to run the business more effectively.

Small businesses bear a higher compliance cost burden than larger businesses. It was found that businesses with less than twenty employees bear up to 35 percent more tax burden than larger businesses (Chittenden *et al.*, 2003:108). Small businesses are more severely affected by red tape than large businesses due to the fact that small firms are less capable of dealing with the complexities of regulation and are unable to spread the costs of compliance across large-scale operations (Chittenden *et al.*, 2003:94). It is for this reason that a simplified tax system for small businesses is being introduced in countries worldwide.

Despite the introduction of simplified tax schemes for small businesses, studies in Russia and surrounding countries found that taxation remains one of the key obstacles to business development (Engelschalk, 2005:28).

4.3 THE EFFECT OF TURNOVER TAX ON GROWTH

Traditionally presumptive tax regimes have been criticised for not encouraging small businesses and individuals to convert or graduate to the normal tax regimes (Terkper, 2003:215). In South Africa, turnover tax intentionally increases the tax burden on micro businesses on the higher end of the turnover range to “encourage them, as they grow, to maintain sufficient accounting records to migrate to the normal income tax system” (SARS, 2009:5). Turnover tax will for this reason not benefit the bottom line of businesses with a higher turnover. The bottom line of businesses on the higher end of the turnover range will in actual fact be negatively impacted through the turnover tax.

According to Pillay (2009), an important function of turnover tax is to get formerly informal micro businesses such as street vendors and spaza shops on the tax register. It is

estimated that there is two to three million informal businesses in South Africa. By legitimising these businesses, growth is encouraged. Having data on these businesses will also prove to be of immense value in gaining an understanding of this part of the economy. Pillay (2009) stated that SARS has a responsibility towards government and towards society to ensure that every member of the population pays their fair share of taxes. Turnover tax gives informal micro business owners the opportunity to register for tax.

Another benefit of turnover tax highlighted by Pillay (2009) is the fact that it is a ring-fenced tax. A person can have a full-time job and a business on the side. Only the business side will be subject to turnover tax. This will result in the first R100 000 of turnover being tax free. This will encourage entrepreneurship. In times of recession where there is a higher unemployment rate, Pillay (2009) hopes that turnover tax will simplify the process of starting up an own business.

4.4 THE ALIGNMENT OF TURNOVER TAX WITH THE STANDARD TAX SYSTEM

According to Engelschalk (2005:24), the revenue potential from small businesses can be increased dramatically if the tax system for small businesses is in line with the standard system. This would however require a restructuring of the tax, creating closer links between the tax rates and business activities to avoid the over taxation of certain businesses. This would in turn increase the complexity of the tax and the resulting compliance costs.

Terkper (2003:213) is of the opinion that a simplified tax system need not only focus on increasing revenue. It can be used to make the tax system more fair, optimise wealth and increase tax compliance. There is often a situation of unfairness between similar taxpayers due to tax defaults (Terkper, 2003:214). The one business will be paying taxes while a similar taxpayer evades taxes. Introducing a simplified tax would seek to reduce tax evasion resulting in less inequity between taxpayers.

The simplified tax system is designed to assist the truly micro, start-up type of business (SARS, 2009:4). However, in the start-up phase of a business, most businesses are running at a very low profit margin, which would make the turnover tax option a very

expensive one. Du Preez (2009) agrees that it is better for start-up businesses, which are likely to have a low profit margin, not to register for turnover tax. BDO Spencer Steward (2009) also agrees that a small vendor with a low mark-up on their goods can potentially pay more tax.

4.5 CONCLUSION

Small businesses are recognised as important drivers of economic success (FIAS, 2007:1). The regulatory burden linked to taxation systems of small businesses has been highlighted as a concern in many economies (Chittenden *et al.*, 2003:109). SARS has therefore introduced the turnover tax.

It has however been highlighted that the simplified tax system needs to be aligned to the normal tax system in order to be truly efficient (Engelschalk, 2005:24). According to SARS (2009:5), the tax liability imposed through turnover tax is broadly aligned with the tax liability under the current income tax system, but it is simplified and reduces the compliance requirements. This statement will be investigated in the following chapters.

CHAPTER 5

TURNOVER TAX VERSUS INCOME TAX

5.1 INTRODUCTION

The tax liability imposed through turnover tax is broadly aligned with the tax liability under the current income tax system, but it is simplified and reduces the compliance requirements (SARS, 2009:5).

Even the smallest businesses have to deal with VAT, Income Tax, Provisional Tax, CGT and STC, submitting about nine returns per tax year. If registered for turnover tax, a business will only submit three tax returns during the tax year – two interim and one final return (Stokes, 2009). This simplified tax is in essence a package which substitutes Income Tax, STC and CGT. The introduction of turnover tax also involved an increase in the VAT compulsory registration threshold to R1 million (SARS, 2009:2).

This chapter will explore the influence of turnover tax on the tax liability of a micro business.

5.2 INFLUENCE OF TURNOVER TAX ON INCOME TAX PAYABLE BY DIFFERENT KINDS OF ORGANISATIONS

Badenhorst (in Visser, 2009) advises that the tax rate associated with turnover tax is lower, but one must keep in mind that no deductions are allowed. This results in turnover tax favouring businesses with a higher profit margin. Businesses with a low overhead structure have a higher profit margin - this will include businesses in the service industry. Broad spectrums of professional services are however disqualified (BDO Spencer Steward, 2009). Labour brokers, personal service providers and professional services are specifically excluded from turnover tax (SARS, 2009:5). It is the opinion of BDO Spencer Steward (2009) that the aim was to exclude more sophisticated services. Tomasek (in Du Preez, 2009), the general manager for legislation at SARS, says it was a compromise not to include professionals in order to have a single simplified tax rate. If professional

services with high profit margins were allowed, a second tax rate structure would have had to be introduced. Turnover tax will favour wealthier non-professional taxpayers with a high profit margin which is not excluded from turnover tax, such as a plumber, garden service provider or repair man (BDO Spencer Steward, 2009).

A micro business that is registered for turnover tax will not be able to deregister voluntarily for the following three years, unless it closes down (SARS, 2009:9). Before a company closes down, it is usually in a period of running at a loss. Stokes (2009) points out that one of the disadvantages of turnover tax is that a micro business operating at a loss will still have to pay tax on its turnover (the tables however excludes the first R100 000 of turnover from turnover tax.) The result of this is that when a business in the turnover tax system goes through a difficult period, it will not be able to deregister for this type of tax immediately. This can put even more financial strain on the suffering business.

Businesses should thoroughly consider whether the turnover tax will really work in their favour (Stokes, 2009). The cost of the administrative burden must be weighed up against the convenience of paying an annual simplified tax, even if the result is that more tax will be payable. Du Preez (2009) agrees with this, and emphasises that this calculation is especially important because the new system may not improve the bottom line of businesses with a low profit margin. She also emphasises that the difference that turnover tax makes at a high or a low profit margin and the requirement that you stick with one or the other tax system for three years highlights the importance of choosing the correct tax system. The new system may not improve the bottom line of businesses with a low profit margin. Hassan (SAICA, 2009) welcomed the turnover tax. He is of the meaning that the decrease of the administrative tax burden would free businesses up to create profits.

5.3 IMPACT OF TURNOVER TAX ON THE TAX COMPLIANCE BURDEN OF INCOME TAX (INCLUDING PROVISIONAL TAX)

Because of the simplicity of the turnover tax, SARS (2009:4) does not expect the micro-business owner to run into complicated legal problems when using the system. This would reduce the compliance costs of the complicated objection, appeal and ADR procedures.

The FIAS study (2007:7) revealed that, from the tax practitioner's view, provisional tax is considered to be the most burdensome tax, with the most burdensome aspect of this tax being the penalties and interests that are often incorrectly raised by SARS. Under turnover tax micro businesses will still be required to make interim payments (SARS, 2007:10). The rules set out for these interim payments are very similar to the provisional tax regulations under the current tax system. Interest at the prescribed rate will also be charged on all late payments and underpayments (SARS, 2007:2). Despite the findings of the survey, no real relief is given in terms of provisional tax. However, the calculation of the basic amount for provisional tax purposes will be much simpler on turnover tax as the taxable income does not need to be determined as is the case with normal income tax.

5.4 VAT CONSEQUENCES OF TURNOVER TAX

With the introduction of turnover tax, the VAT registration threshold was increased from R300 000 to R1 million (Manual, 2008). The simplified tax system was introduced to reduce record keeping, therefore a micro business that is registered for turnover tax will not be permitted to register for VAT (SARS, 2009:3). If a micro business owner is currently registered for VAT, he will thus be required to deregister for VAT before he can register for turnover tax.

A problem that this creates is that the VAT threshold will always have to be linked to the turnover tax threshold.

5.4.1 Impact of deregistering for VAT

According to VAT legislation, when a vendor deregisters from the VAT system, the vendor is required to pay exit VAT on the lesser of the cost or market value of the assets held before deregistering (SARS, 2009:3). It must be considered that input VAT was initially claimed when the micro business owner became a VAT vendor or when he acquired the assets. Although it makes sense that the VAT vendor should repay what he has claimed in the past – this could have a serious impact on cash flows. SARS (2009:3) has put in place certain relief measures. Firstly the exit VAT can be paid over a period of 6 months and

secondly R100 000 will be granted by way of a deduction from the value of the assets held by that vendor prior to deregistration.

5.4.2 Impact of not being a VAT vendor

The clients of micro businesses may prefer to do business with VAT registered dealers; this includes government which requires its suppliers to be registered for VAT. If the business is subject to the risk that contracts or clients might be lost, the owner should seriously consider his bottom line before registering for turnover tax.

The typical micro business will not provide goods and services to clients who require VAT invoices. This statement will be explored in the in-depth interviews (refer to Chapters 6 to 9). It is expected that the more sophisticated VAT vendor will have compliance measures in place, reducing the need to register for a simplified tax system.

5.4.3 Impact of turnover tax on the tax compliance burden of VAT

According to SARS (2009:11), surveys amongst micro businesses identified VAT as the most burdensome tax product to comply with. This is due to the fact that it is transaction based and requires diligent record keeping. The FIAS (2007) survey results were that the most expensive and time consuming tax is VAT. The SBP survey also resulted in VAT being the most time-consuming, troublesome and costly regulation to comply with (SBP, 2005:87).

When a registered micro business no longer qualifies for turnover tax, for instance where the qualifying turnover exceeds the R1 million ceiling, and it cannot demonstrate that this will be a small and temporary event, it is compulsory to deregister for turnover tax. When a business grows beyond the R1 million threshold, a business also has to register for VAT. Makwakwa from SARS (in Visser, 2009) admits that confusion could arise about the registration and deregistration of VAT. According to the survey performed by FIAS (2007:8), the period taken to register as a VAT vendor is the most burdensome aspect of VAT.

Stokes (2009) argues that a business earning less than R1 million in turnover per annum might be better off deregistering for VAT and continuing on the existing tax system rather than registering for turnover tax.

5.5 STC CONSEQUENCES OF TURNOVER TAX

Micro businesses that register for turnover tax will be exempt from STC to the extent that the dividend distributions do not exceed R200 000 a year. Any excess distributions will be subject to STC (SARS, 2009:3). The R200 000 limit has been set to prevent businesses from suddenly distributing large amounts of capital profits.

5.5.1 Impact of the introduction of dividends tax

STC will be replaced with a tax on dividends. The same exemption will apply to this tax (SARS, 2009:5). Currently dividends received are not included in turnover for the purpose of turnover tax. When tax on dividends is introduced, SARS (2009:5) expects that dividends might be included as part of turnover. The reason for this will be to reduce revenue leakage. This will then increase turnover tax payable.

5.6 CAPITAL GAINS TAX (CGT) CONSEQUENCES OF TURNOVER TAX

Micro businesses that register for turnover tax will not be liable for CGT. Taxable turnover will however include 50% of the amounts received from the disposal of business assets (SARS, 2009:2). Tax on capital sales will thus still have to be paid; the calculation has just been simplified.

5.6.1 Impact of turnover tax on the tax compliance burden of CGT

CGT is a very difficult tax to compute and the fact that this difficult calculation no longer needs to be made, definitely reduces the taxation compliance burden.

SARS has put in specific measures to avoid abuse. A person is disqualified from being a micro business if the receipts of the disposal of capital business assets exceed R1,5 million over a three year period (SARS, 2009:9). This has the result that a micro business owner which owns his own land and buildings has to carefully consider registering for turnover tax, for if he ever has to dispose of that property and the value exceeds the R1,5 million, he will be forced to deregister for turnover tax.

5.7 IMPACT OF TURNOVER TAX ON EMPLOYEES' TAX

One has to consider the fact that employees' tax is not influenced by the turnover tax and that the compliance costs related to it will still have to be incurred. PAYE, UIF and SDL forms still need to be submitted on a monthly basis. According to SARS (2007:3) no specific relief is granted in terms of payroll taxes as under existing law. Businesses whose employees are not liable for employee's tax will not be required to register for employees' tax and businesses with a payroll of less than R500 000 are exempt from SDL. As turnover tax is not aimed at service intensive businesses, the payroll of non-service intensive businesses is likely to be less than R500 000. Turnover tax also excludes professionals and it is therefore possible that the majority of employees of micro businesses earn below the tax threshold.

Micro business owners might feel more comfortable in outsourcing the payroll function as well as the administration of the taxes thereon. In the study of Abrie and Doussy (2006:7), it was however established that 84% of small and medium enterprises choose to deal with employees' tax internally. One would therefore not expect that the registration for turnover tax would influence the compliance burden and related costs of employees' tax.

5.8 CONCLUSION

While there is consensus that turnover tax will reduce the compliance burden, in some instances the turnover tax will increase the tax liability. The increase in tax liability can possibly replace the costs of compliance which results in a minimal impact on the bottom line of a business. Careful consideration has to be given as to whether the business lends itself to the benefits of turnover tax.

CHAPTER 6

DISCUSSION OF IN-DEPTH INTERVIEWS WITH MICRO BUSINESS OWNERS

6.1 INTRODUCTION

The research consists of two elements. The first element will involve in-depth interviews with micro business owners. The second element will involve the collection of financial data and tax history from the interviewees. This chapter seeks to discuss the sampling method and the collection of data. Questions outlined for the interview, and the relevance thereof to the study are considered. Results of the interview are discussed.

6.2 SAMPLING

The target population of the study is micro business owners in South Africa. The sample does not include micro business owners that are disqualified to register for turnover tax in terms of the Sixth Schedule of the Income Tax Act.

The non-probability sampling technique was used. Due to the nature of the target population it is not possible to specify a sampling frame. Many micro business owners are in the informal sector and are not legitimised. Using the companies register or tax registration register could not be used as a selection platform as this would exclude the informal micro businesses.

Judgement was used to select cases that would best enable the researcher to answer the questions and to meet the research objectives. Purposive or judgemental sampling is useful when working with small samples when one wishes to select cases that are particularly informative (Neumann in Saunders *et al.*, 2007:230). Judgemental samples cannot be considered to be statistically representative of the total population (Saunders *et al.*, 2007:230). Cases were selected on a convenience sampling base. This method involves selecting haphazardly those cases that are the easiest to obtain for the sample

(Saunders *et al.*, 2007:234). This sampling technique is prone to bias. However, the research does not seek to make generalisations about the whole population but rather seek to investigate the effect that turnover tax can have on a taxpayer.

The sample is heterogeneous. The population is micro business owners, but the study will seek to interview micro business owners in as much diverse sectors of the economy as possible. Any patterns that do emerge from such a study are likely to be of a particular interest and value and will represent the key themes; the data collected will also enable the researcher to document uniqueness (Patton in Saunders *et al.*, 2007:232).

The units of analysis of the study are micro business owners. The sample was drawn from different sectors of the economy, focusing on:

- services;
- retail; and
- manufacturing.

The sample size was limited to twelve cases. This number is deemed to be sufficient in light of the nature and intensiveness of the study.

The following table lays out the sample of twelve respondents and their respective area of business:

Table 2: Types of businesses interviewed

| Respondent | Type of business |
|-------------------|--------------------------------------|
| Respondent 1 | Street vendor selling hats and belts |
| Respondent 2 | Laundromat |
| Respondent 3 | Retail – pool cleaning accessories |
| Respondent 4 | Retail – frozen foods |
| Respondent 5 | Fast food outlet |
| Respondent 6 | Recruitment agency |
| Respondent 7 | Farm stall |
| Respondent 8 | Building renovator |
| Respondent 9 | Baking cakes from home |

| | |
|---------------|------------------------------|
| Respondent 10 | Hair salon |
| Respondent 11 | Appliance repairs and spares |
| Respondent 12 | Retail – fashion and shoes |

6.3 DATA COLLECTION

There are some potential problems relating to access to the required sources of data. The biggest problem relates to the nature of the topic and its potential sensitivity. Business owners might refrain from answering questions about tax practice in fear of being reported to authorities especially in cases where tax is being evaded or where the business owner is uncertain if the correct tax practice is being followed. This problem was overcome by explaining the purpose of the interview to the potential interviewee and providing assurance that anonymity will be in place.

Data was collected through semi-structured interviews. Verbal primary data as well as financial data was collected.

Due to the small sample size and nature of the interviews, all interviews were conducted by the researcher.

The structure to the interviews in this study is included as Appendix A and is further discussed in the following sections.

6.4 DATA ANALYSIS

Data was recorded by taking short hand notes of interviews. This ensured that the data was recorded accurately.

The data was analysed by following the data analysis spiral (Creswell in Leedy & Ormrod, 2005:151):

- organization - data was organised into a computer database. Large bodies of texts were broken down into smaller units;
- perusal - data was perused to get a sense of what the data contained as a whole;

- classification - general categories was identified and subcategorised. classification was done in accordance with the interview structure described in Chapter 6; and
- synthesis - data was integrated and the results are summarised in the following sections.

6.5 DISCUSSION OF INTERVIEW QUESTIONS

Due to the nature of the research, the interviews were semi-structured. The flow of questions depended on the answers obtained on the previous questions. The interview was conducted in five sections.

6.5.1 Part 1 - Registration for turnover tax

Questions were asked to establish whether the respondents were already registered for turnover tax.

In cases where the respondent was not already registered for turnover tax, the interview tried to ascertain whether the respondent was planning on registering for turnover tax. This established the interest of the micro business owner in registration for turnover tax.

The reasons for the respondent's choice to register or not for turnover tax were also explored. Knowing the factors that influenced such a choice assisted in determining the perception of the micro business owner towards turnover tax.

6.5.2 Part 2 - Awareness of turnover tax

It was expected that some of the respondents might not be aware of the turnover tax initiative. Questions regarding the respondent's awareness of the turnover tax initiative verified this anticipation.

Where the respondents were in fact aware of turnover tax, the interview tried to establish how awareness was created. This in turn gave an indication of the success of the SARS advertising campaign.

6.5.3 Part 3 - Influence of VAT on the micro business owner

This question established whether the business is currently registered for VAT. If the business is in fact registered for VAT, the reasons why the business is registered for VAT were explored.

Possible reasons for being a VAT vendor would include:

- the taxable supplies were above the VAT registration threshold in the past; and
- pressure from clients to supply VAT invoices.

Being aware of the incentive of VAT registration assisted in establishing what effects deregistration for VAT would have on the business.

The influence that VAT has on the business owner's choice in registering for turnover tax was also determined.

6.5.4 Part 4 - Compliance burden on the micro business owner

This part established the view of the micro business owner towards tax compliance. It also established whether the business is tax compliant.

The way by which the business deals with tax compliance, whether the owner is self compliant or uses the services of a third party to be compliant was explored. The extent of the tax compliance burden in time and money value was established and compared between the different respondents.

This part of the interview investigated the benefit of the turnover tax system, measured against the average tax compliance costs before the implementation of the turnover tax system.

6.6 RESULTS OF IN-DEPTH INTERVIEWS

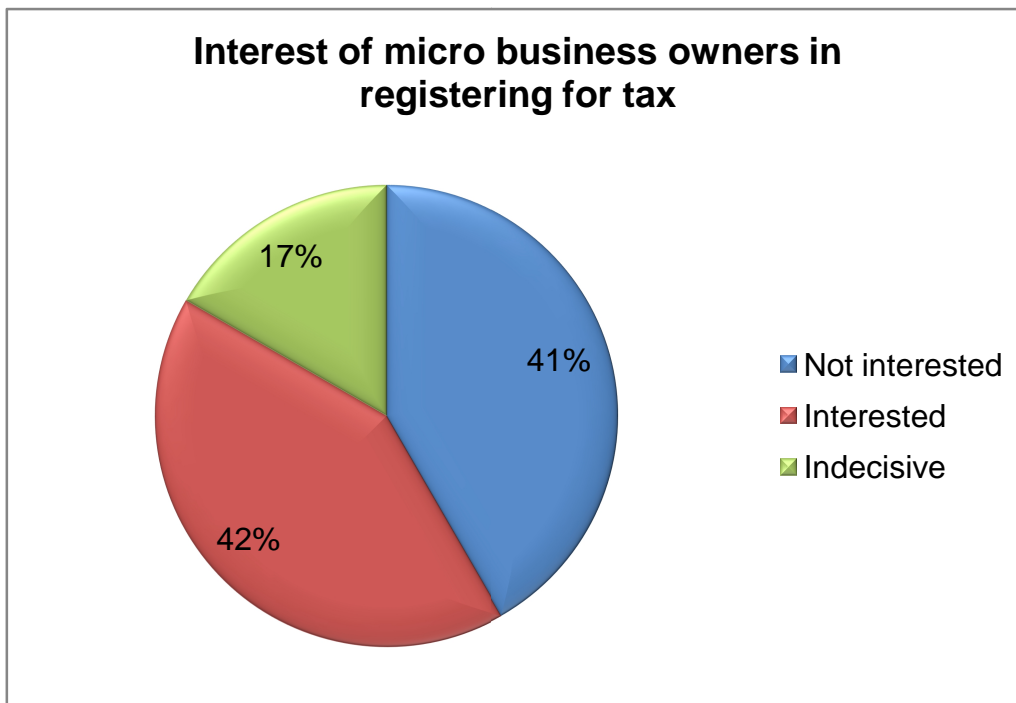
6.6.1 Part 1 - Registration for turnover tax

None of the respondents were registered for turnover tax. The general perception of the respondents who were in actual fact aware of turnover tax was not negative. The following were presented as reasons why the respondents were not registered for turnover tax:

- the respondent was not aware of turnover tax (further discussed in part 2);
- the system does not lend itself to tax planning (further discussed in Chapter 7.7);
- the tax liability of the respondent would increase when registered for turnover tax compared to the current income tax system (discussed in Chapter 7) ; and
- the respondents need to be registered for VAT (discussed further in part 3).

Some of the respondents indicated that they would like to find out more about turnover tax. The following graph illustrates the interest of the respondents in registering for turnover tax in future:

Figure 1: Interest of micro business owners in registering for turnover tax



The significant percentage of interest illustrates that raising the awareness of turnover tax would probably increase the registrations for turnover tax.

6.6.2 Part 2 - Awareness of turnover tax

Only twenty five percent of the twelve interviewees were aware of turnover tax. The awareness was created by the SARS television advertisement, accountants, auditors and family members.

One cause of the unawareness might be that the SARS advertising campaign as described in Chapter 2.5 has not been successful.

The blame can however not be placed entirely on a failed SARS campaign. Most of the respondents make use of tax practitioners to take care of their tax compliance (refer to Chapter 7.5). When a tax practitioner is contracted by a micro business owner, the owner would expect that the tax practitioner would keep up to date with new developments in tax. It is also expected that the tax practitioner would act in the best interest of the client. Micro business owners will therefore not always notice tax campaigns because the responsibility has been deferred to the tax practitioner.

The aim of turnover tax is to reduce the tax burden of micro business owners (SARS, 2009:2). The expectation is that turnover tax will simplify tax compliance to such an extent that the services of tax practitioners will no longer be required. The possibility therefore exists that tax practitioners might intentionally withhold information about turnover tax from their clients. The clients will as a result of the lack of knowledge not register for turnover tax and consequently still require the services of the tax practitioner.

6.6.3 Part 3 - Influence of VAT on the micro business owner

Only two of the respondents are currently registered for VAT. Only one of these respondents indicated that it is a business requirement to be registered for VAT. The respondent would not want to deregister out of a fear of losing clients if VAT invoices can no longer be presented.

The other respondent would prefer to deregister for VAT. This respondent was originally complied to register for VAT due to the fact that taxable supplies were above the VAT registration threshold at that time. The VAT registration threshold was previously set at R300 000. The reason for deregistration of VAT would mainly be to reduce the compliance burden thereof.

It appears that the requirement to deregister for VAT would not be a major factor in the decision to register for turnover tax.

6.6.4 Part 4 - Compliance burden on the micro business owner

The following table sets out the compliance and method of compliance of the respondents:

Table 3: Summary of compliance method

| Respondent | Method of compliance |
|------------|---------------------------|
| 1 | Self |
| 2 | Tax practitioner |
| 3 | Tax practitioner |
| 4 | Tax practitioner |
| 5 | Tax practitioner - friend |
| 6 | Tax practitioner |
| 7 | Tax practitioner - friend |
| 8 | Tax practitioner - family |
| 9 | None |
| 10 | Tax practitioner |
| 11 | Tax practitioner |
| 12 | Tax practitioner |

One of the respondents is not registered for tax. Further investigation revealed that the income of this respondent from the business is minimal and would fall under the tax threshold. The respondent is in the process of formalising the business into a closed corporation. The respondent was planning on acquiring the services of a tax practitioner to handle the tax registration and related matters. The respondent was under the impression that tax compliance is an intricate matter which can only be dealt with by a tax practitioner. The respondent admitted that had he been aware of turnover tax, he might

have registered for it without the assistance of a tax practitioner. Although no concise conclusion can be made from only one such a response, the response does prove that the introduction of turnover tax can bring in taxpayers into the taxation net.

As can be seen from the table above, the majority of micro business owners choose to make use of the services of a tax practitioner. The majority of respondents using the services of a tax practitioner indicated that should they want to register for turnover tax, they would still make use of the services of a tax practitioner. Making use of a tax practitioner's services gives a business owner the comfort of knowing that he is tax compliant. According to FIAS (2007:7), compliance costs tend to include the value of time spent on understanding the tax rules and applying them. The business owner would believe that the onus of keeping up to date with taxation laws and amendments is on the tax practitioner and not on the business owner himself.

The costs of tax practitioners vary significantly. The costs would also depend on the type of services rendered. Services rendered range from handing in an annual tax return to drawing up a monthly set of management accounts. Some of the respondents indicated that even if the tax compliance burden is minimised, the services of an accountant would still be required to draw up management accounts and financial statements. The financial effect of tax compliance will be discussed in more detail in Chapter 7.

6.7 CONCLUSION

The questions were structured to support the research objectives as described in Chapter 1.

The results of the survey indicated that only a small portion of micro business owners are aware of turnover tax. The indication is that should the awareness level be raised, the registrations for turnover tax would also increase.

The outcome from the interviews indicated that the reduction in the costs of compliance would not be the main driver for registering for turnover tax.

It seems as if the requirement to deregister for VAT would not be a stumbling block for business owners who would like to register for turnover tax.

CHAPTER 7

ANALYSIS OF FINANCIAL DATA OBTAINED FROM RESPONDENTS

7.1 INTRODUCTION

Registering for turnover tax will impact the amount of tax payable by the micro business owner. To be able to investigate this impact, the interview process included the collection of financial data. Management's estimate of turnover and profit margins was obtained.

7.2 DATA ANALYSIS

Where possible, copies of financial data were obtained. Where financial information is kept in an informal way, the same steps as outlined in Chapter 6.4 were followed to contract the data into a usable format.

The aim of analysing the financial data is to establish what the effect of registering for turnover tax will be on the tax payable by the taxpayer. The overall financial impact on the taxpayer was also assessed.

Data was summarised into spreadsheets before performing the actual analysis.

The amount of tax payable was compared between the different systems available to the micro business owner namely standard income tax and turnover tax.

7.3 FINANCIAL DATA

The table below summarises the average or expected turnover and profit margins of the businesses:

Table 4: Summary of financial data

| Respondent | Type of business | Turnover | Profit margin |
|-------------------|--------------------------------------|-----------------|----------------------|
| Respondent 1 | Street vendor selling hats and belts | R 120,000 | 20% |
| Respondent 2 | Laundromat | R 290,000 | 1% |
| Respondent 3 | Retail – pool cleaning accessories | R 750,000 | 20% |
| Respondent 4 | Retail – frozen foods | R 300,000 | 40% |
| Respondent 5 | Fast food outlet | R 100,000 | Loss |
| Respondent 6 | Recruitment agency | R 240,000 | 95% |
| Respondent 7 | Farm stall | R 900,000 | 13% |
| Respondent 8 | Building renovator | R 300,000 | Loss |
| Respondent 9 | Bakery | R 36,000 | 50% |
| Respondent 10 | Hair salon | R 540,000 | 35% |
| Respondent 11 | Appliance repairs and spares | R 850,000 | 30% |
| Respondent 12 | Retail – fashion and shoes | R 240,000 | 25% |

Data relating to other taxable deductions and deemed income which have not been included in the net profit were also obtained. Questions relating to operating and capital expenditure, were also included as part of the interview. This enabled the researcher to better estimate the taxable income of the business registered for normal tax.

The data accumulated as described above was used to calculate the estimated income tax payable and compare it to the estimated turnover tax payable.

7.4 COMPARISON OF TAX PAYABLE

The chart below compares the tax payable under the turnover tax model with tax payable under the normal income tax model:

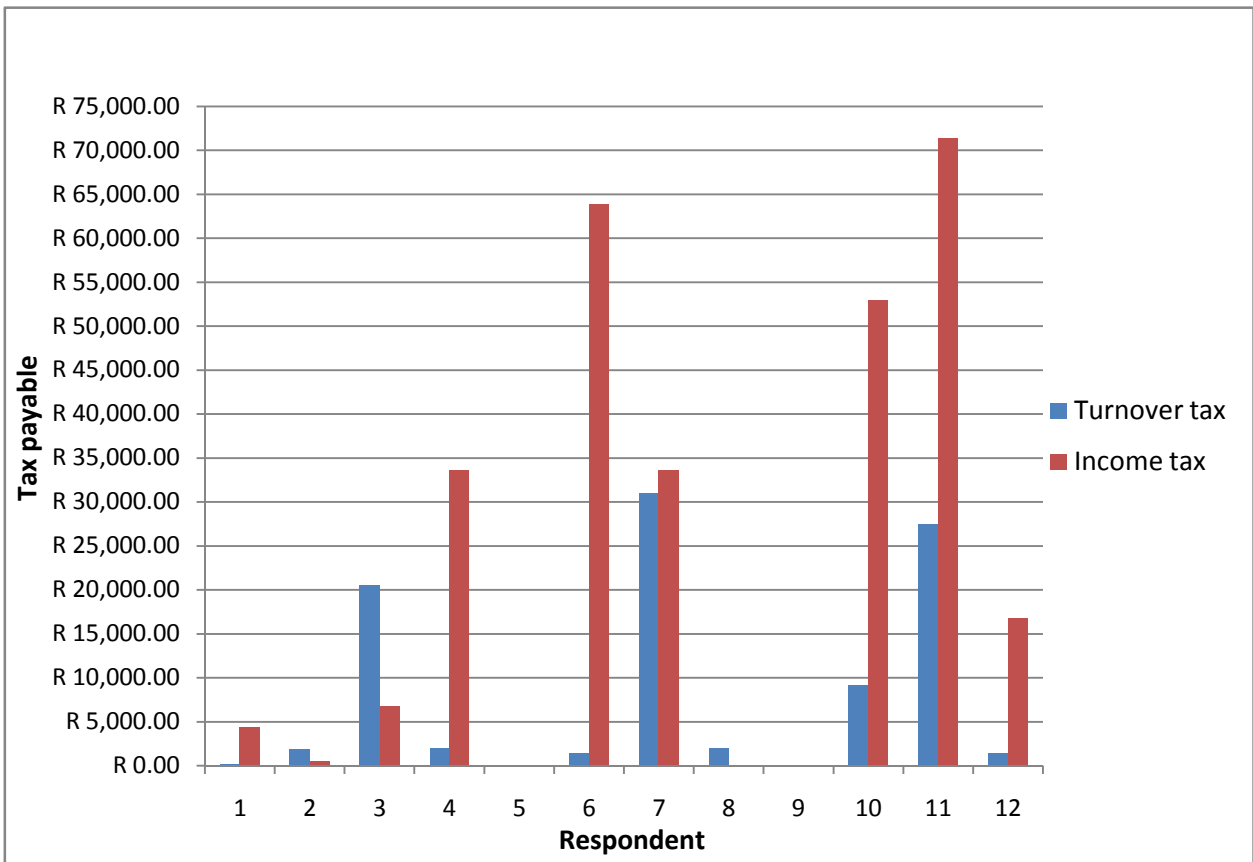


Table 5: Summary of compliance cost

| Respondent | Method of compliance | Compliance cost |
|-------------------|-----------------------------|------------------------|
| 1 | Self | No cost |
| 2 | Tax practitioner | R 8,400 |
| 3 | Tax practitioner | R 8,000 |
| 4 | Tax practitioner | R 750 |
| 5 | Tax practitioner - friend | No cost |
| 6 | Tax practitioner | R 6,000 |
| 7 | Tax practitioner - friend | No cost |
| 8 | Tax practitioner - family | No cost |
| 9 | None | No cost |
| 10 | Tax practitioner | R 2,000 |
| 11 | Tax practitioner | R 14,000 |
| 12 | Tax practitioner | R 2,000 |

More than 40% of the respondents bear no annual compliance costs. The reason for this is that the respondent is either self-compliant or knows a tax practitioner who provides the necessary service without charging any fees. This indicates that the tax compliance requirements are probably not excessively difficult, time consuming or costly. The micro business owner in such a situation would have no other incentive to register for turnover tax other than a saving in the actual tax liability.

A third of the respondents indicated that they pay more than R2 000 in annual compliance costs. In all of these cases, the respondents indicated that these costs include some or all of the following functions:

- completion and submission of income tax returns;
- completion and submission of VAT returns;
- performance of the monthly payroll function;
- employees tax;
- UIF payments and administration; and
- accounting

The only saving that will result from being registered for turnover tax would be the saving in the fee relating to the VAT and income tax functions. This saving would in all probability be minimal.

Turnover tax has been introduced by SARS to reduce the compliance burden on micro businesses (SARS, 2009:2). The results of this section of the interviews lead us to question whether the introduction of turnover tax would really make a significant difference to the tax compliance burden of the micro business owner.

7.6 INFLUENCE OF PROFIT MARGINS ON TAXATION

Turnover tax is very favourable to businesses with high profit margins. Such would include businesses in the service industry. SARS has therefore ruled out professional services to avoid abuse of the turnover tax system (SARS, 2009:5).

One of the downsides to turnover tax is that even where a loss situation exists, tax would still have to be paid on turnover (Stokes, 2009). This is a drawback especially in the case of start-up businesses which are running at a loss. The normal income tax system recognises the loss and allows the carryover of an assessed loss. This would in turn be recognised against the first profits of the business in consequent years. This is a key tax benefit that would be lost if a start-up business registers for turnover tax.

7.7 TAX PLANNING

Tax planning is one of the factors presented by the respondents as a reason for not wanting to register for turnover tax. It is often the practice to give the owner a salary that would result in the least amount of tax paid when taking into account both the company's tax and the individual's tax. The full salary is deducted from the taxable income of the company while the tax benefits of the tax rebate and progressive tables are utilised for the individual's tax. It is not possible to minimise the overall tax like this when using the turnover tax system.

7.8 CONCLUSION

Turnover tax would result in a reduced amount of tax being paid compared to standard income tax for the majority of micro businesses interviewed. It is clear from the analysis of the financial data, that the profit margin has a direct impact on the tax benefit that could be

obtained from registering for turnover tax. In a loss situation, the turnover tax system is expensive.

The data analysis could not prove that the registration for turnover tax would result in a saving of tax compliance cost.

Other disadvantages of the turnover tax system include that there are less tax planning options available to minimise the overall tax payable by the business owner as well as the business.

CHAPTER 8

SUMMARY OF CONCLUSION

8.1 INTRODUCTION

Regulations and red tape can put a constraint on the growth of businesses (FIAS, 2007:1). SARS introduced turnover tax for micro business owners, with the aim of reducing the tax burden and thereby encouraging entrepreneurship and creating an enabling environment for small businesses to survive and grow (SARS, 2009:2). However, the amount of tax payable under this system can result in more tax payable than would have been payable under the income tax system.

A VAT vendor is not allowed to register for turnover tax. Micro businesses that are already registered for VAT will have to deregister for VAT. The cost of deregistration and the practical implication of not being able to provide customers with VAT invoices can have a serious impact on the micro business owner.

Another disadvantage of turnover tax is that a business operating at a loss will still have to pay turnover tax (Visser, 2009). Under the income tax system, no tax is payable where businesses are operating at a loss.

Registering for turnover tax can have a negative financial impact on the micro business owner.

8.2 THE RESEARCH PURPOSE AND OBJECTIVES

8.2.1 Purpose

The purpose of the study was:

- to investigate the influence of registering for turnover tax on different types of micro businesses. This was discussed in Chapter 5; and

- to investigate the applicability of turnover tax for micro business owners in their various circumstances. This was done in Chapter 5.

8.2.2 Research objectives

This study was guided by specific objectives. The first two objectives of the study were:

- to compare the taxation payable between the turnover tax system to that payable under the income tax system with reference to specific profit margins; and
- to compare the taxation payable between the turnover tax system to that in the income tax system with reference to the specific type of business.

The tax payable under the turnover tax system was compared to tax payable under the income tax system. The study revealed in chapter 5 that businesses with a higher profit margin would benefit from registering for turnover tax. Businesses in the service industry would usually have a high profit margin. SARS has ruled out professional services to avoid abuse of the turnover tax system;

The third objective of the study was to explore the benefit of a simplified tax system on the South African economy. The influence of turnover tax on the South African economy was explored in Chapter 4. Micro businesses play a vital role in the development of the economy of a country. Regulation imposed by government has been proven to be one of the biggest hindrances to business success (Chittenden *et al.*, 2003:94). It is expected that the economy would benefit from the reduction of the compliance burden. Turnover tax gives informal business owners the opportunity to formalise by registering for tax. The expectation is that the introduction of turnover tax will encourage more micro businesses in the informal sector to be formalised and registered for tax purposes. By legitimising businesses, growth is encouraged. Turnover tax will also simplify the process of opening up a new business and would therefore encourage entrepreneurship.

The fourth objective of the study was to investigate the influence that the introduction of turnover tax would have on the tax compliance burden of the micro business owner who registers for turnover tax. The influence of the introduction of turnover tax on the tax compliance burden of the micro business owner was considered in Chapters 2 and 7. The

only saving that will result from being registered for turnover tax, would be the saving in the fee related to the VAT and income tax functions. Tax compliance is not excessively difficult, time-consuming or costly for the average micro business owner who is not a VAT vendor. The in-depth interview process revealed that the reduction of the costs of compliance would not be the main driver for registering for turnover tax.

The fifth objective of the study was to investigate the impact of VAT deregistration on the micro business owner. A micro business owner who is currently registered for VAT would be required to deregister for VAT prior to registering for turnover tax. The impact of VAT deregistration on the micro business owner was investigated in Chapter 5. The study revealed that the typical micro business owner, who is targeted by the introduction of the simplified tax, will not provide goods and services to clients who require VAT invoices. The investigation has further shown that the requirement to deregister for VAT would not be a stumbling block for most business owners who would like to register for turnover tax.

The sixth objective of the study was to explore the success of introducing turnover tax to the micro business owner. The success of the introduction of turnover tax to the micro business owners was explored in Chapter 2. The introduction of turnover tax makes the tax environment more approachable to the micro business owner (Du Preez, 2009). This would probably encourage business to register for tax. The in-depth interviews have revealed that there is a lack of knowledge about turnover tax. One cause of the unawareness might be that the SARS advertising campaign was not successful. Another reason is that the micro business might not know about turnover tax because the owner expects the tax practitioner to be aware of tax initiatives. None of the respondents included in this study is registered for turnover tax. This implies that the introduction of turnover tax was not entirely successful.

8.3 FINAL CONCLUSION

The micro business owner needs to carefully consider whether to register for turnover tax or not. The convenience of a reduction on the tax compliance burden needs to be weighed against the detriments of the turnover tax system. Such detriments would include

that the business will have to deregister for VAT which would imply that the business would no longer be able to provide VAT invoices to clients. In loss situations or where the business are running at low profit margins, more tax would be payable under the turnover tax system than under the standard income tax systems.

The introduction of turnover tax to the micro business owner was not successful. The micro business owner needs to be made aware of the fact that there is an alternative option to the standard income tax system.

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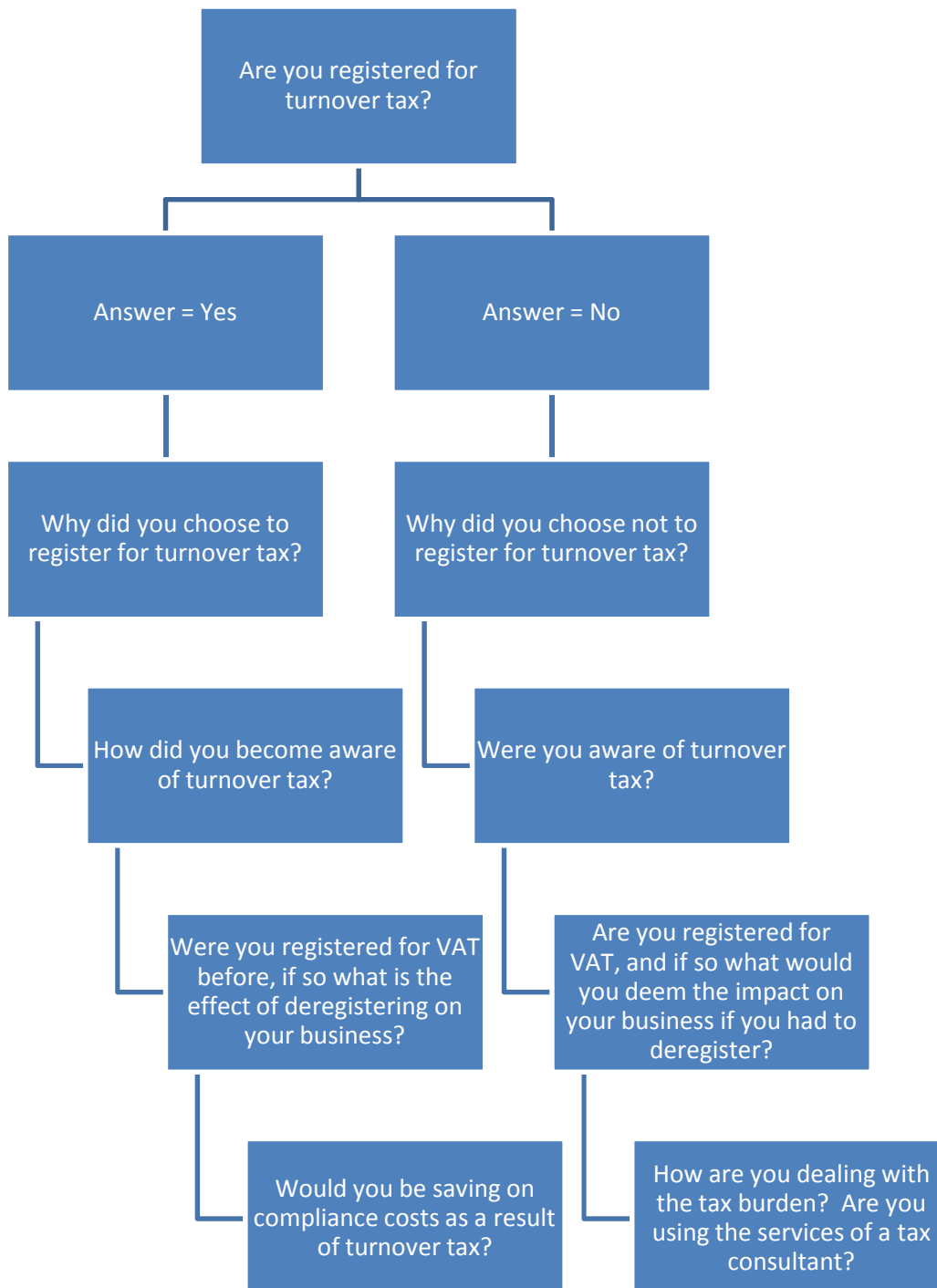
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APPENDIX A

- Data collection instruments -

Semi-structured interview with qualifying micro business owners:





APPENDIX B
- Informed consent form Part A -



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