

**CRITICAL EVALUATION OF SMALL BUSINESS IN RELATION TO TAX COMPLIANCE
AND AVAILABLE INCENTIVES: A SOUTH AFRICAN PERSPECTIVE**

by

NOMFUYO GALENI

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Supervisor: Mrs H du Preez

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LIST OF ABBREVIATIONS

ATO	Australian Tax Office
CGT	Capital Gains Tax
GDP	Gross Domestic Product
GST	General Sales Tax
PAYE	Pay-As-You-Earn system
SA	South Africa
SARS	South African Revenue Service
SBC	Small Business Corporation
SMEs	Small and Medium Enterprises
SMMEs	Small, Medium and Micro Enterprises
VAT	Value-Added Tax
UK	United Kingdom

ABSTRACT
CRITICAL EVALUATION OF SMALL BUSINESS IN RELATION TO TAX COMPLIANCE
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Nomfuyo Galeni

STUDY LEADER: MRS H DU PREEZ

DEPARTMENT: TAXATION

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Small businesses in South Africa have been overburdened with taxation regulations leading to some pockets of non-compliance. Studies reveal that in some instances these taxpayers lack knowledge and skill to deal with ever-changing tax requirements.

It has also been observed that the South African Revenue Service (SARS) and tax authorities worldwide have taken the issues prevalent in this sector and made an effort to alleviate the pressure from small businesses. This alleviation is in the form of amnesties, which are tax relief measures in respect of each tax category. It was also found that despite all these incentives there are still instances of tax evasion, however, some small businesses acknowledge the benefits associated with complying with the law of the land.

There are certain requirements which need to be met from a taxation perspective, before a small business can be called as such. A decision has to be made by the small businesses themselves regarding which type of business entity they intend using. It is at this point that one needs to apply one's mind as there are tax considerations that influence the route one wants to take.

This study did not look into other considerations such as an accounting or legal point of view, however, the emphasis was more on tax consequences. This study looked at tax consequences and did not consider other consequences, such as an accounting or legal viewpoint

Although SARS issued a guide on taxation particularly regarding small businesses, the objective of this study was to investigate the relationship that exists between the tax relief measures available to small businesses and the influence of these measures on tax compliance. The study also compared available literature internationally with what is currently taking place in South Africa. The study also looked at the available body of knowledge on this topic and made recommendations for further improvements.

OPSOMMING
'N KRITIESE EVALUERING VAN KLEIN EN MEDIUM ONDERNEMINGS (KMO'S) MET
BETREKKING TOT BELASTINGVERPLIGTING (OF: BELASTINGBETALING OF
BELASTINGVOLDOENING?) EN BESKIKBARE AANSPORINGS: 'N SUID-
AFRIKAANSE PERSPEKTIEF

deur

Nomfuyo Galeni

STUDIELEIER: MEV H DU PREEZ

DEPARTEMENT: BELASTING

GRAAD: MAGISTER COMMERCII IN BELASTING

Klein en medium ondernemings in Suid-Afrika is blootgestel aan hewige belastingregulasies, wat in sommige gevalle kan lei tot nie-voldoening aan vereistes. Navorsing toon dat sekere belastingbetalers nie oor die nodige ervaring of kundigheid beskik ten einde die steeds veranderende belastingvereistes te hanteer nie.

Daar is opgemerk dat die Suid-Afrikaanse Inkomstediens en belastingowerhede wêreldwyd die oorwegende kwessies in hierdie sektor as 'n probleemgeval erken en probeer om die druk van klein en medium ondernemings te verlig. Hierdie verligting is in die vorm van amnestie en belastingverligtingsmaatreëls vir elke belastingkategorie. Ondersoeke het getoon dat afgesien van hierdie aansporings daar steeds belastingontduiking plaasvind. Hierteenoor besef sommige klein en medium ondernemings die voordele verbonde aan die nakoming van die landswet.

Uit 'n belastingoogpunt gesien, is daar verskeie vereistes wat nagekom moet word voordat 'n onderneming as 'n klein sakeonderneming beskou kan word. Die eienaars van die onderneming moet self die besluit neem oor die soort besigheidsentiteit wat hulle beoog om te gebruik. Daar moet dan ook in ag geneem word dat daar belastingimplikasies is vir die roete waarop besluit word.

Dié studie het na belastinggevolge gekyk en nie rekenkundige of regsaspekte in ag geneem nie.

Alhoewel die Suid-Afrikaanse Inkomstediens belastingriglyne uitgereik het met spesifieke verwysing na klein en medium ondernemings, was die doel van hierdie studie om die verhouding tussen belastingverligtingsmaatreëls wat aan klein en medium ondernemings beskikbaar is en die invloed van hierdie maatreëls op belastingvoldoening of belastingbetaling te ondersoek. Dié studie het ook internasionale literatuur vergelyk met wat tans in Suid- Afrika gebeur. Verder het dié studie ook beskikbare kundigheid oor dié onderwerp ondersoek en aanbevelings vir verdere verbeterings gemaak.

CHAPTER 1

INTRODUCTION

1.1 BACKGROUND

Small businesses are regarded as important drivers of economic growth and success, according to the majority of studies on this topic in South Africa and internationally (Smulders, 2006). Many countries have realised that most jobs are created by this sector in the economy. Latin American small businesses reached an important level of development agenda as effective jobs and wealth creators, according to Malherbe (2005).

The role of small business in South Africa cannot be underestimated as businesses falling in this category exceed corporate business by a large margin, according to studies performed by Business Partners on promoting and supporting small businesses development: The case of Madagascar and Kenya Malherbe (2005:4). To date, South Africa has in excess of 700 000 small businesses, while micro businesses exceed small- and medium-sized enterprises. To date, the numbers reported for micro businesses are in the region of 2.35 million. In South Africa, large companies are known for shedding jobs while small businesses create job opportunities. This trend is similar to the one cited in the United Kingdom (UK) studies whereby it is reported that out of 3.7 million businesses, 2.3 million are self-employed. Businesses with fewer than 250 employees make up about 56% of the UK non-government jobs and 52% of turnover. In South Africa, small businesses contribute in excess of 20% to GDP while employment contribution is in excess of 40% of GDP (Think Small First, Small Business Service, October 2000)

For small businesses to qualify in terms of **12E** of the Income Tax Act (58/1962) for the relief measures, their turnover should not exceed R14 million. The definition of small businesses might differ from country to country, however, what drives compliance and non-compliance and the challenges faced by the small businesses could be compared with other developing countries.

According to Section **12E** of the Income Tax Act (58/1962), a *small business corporation* means any company or a close corporation whose shareholding is held by natural persons or members during the year of assessment. Before a company can qualify as a *small business corporation* as defined for tax purposes in terms of section **12E** of the Income Tax Act (58/1962) the turnover should not exceed R14 million per annum. According to the 2006 budget speech by the Minister of Finance the tax-free income was increased from R35 000 to the first R40 000 for the small businesses, and the preferential tax rate remained at 10%.

Most research studies focus mainly on the burdens suffered by small businesses which result in non-compliance with tax, and what motivates them to do so. Najeeb (2010:1-24), Smulders (2006), Abrie et,al (2006), Very few researchers look at or consider how compliant taxpayers get affected and seldom look at their understanding of the benefits of complying with tax authorities.

The purpose of this study is to understand more about the benefits of complying with tax laws by small businesses, including and not limited to the reasons why others still choose not to comply. Among others, tax regime has been identified as one of the factors that impede small business growth (Malerbe, 2005:5)

1.2 PROBLEM STATEMENT

The study investigates the factors influencing the decision of small businesses to comply or to not comply with tax legislation. Further, the study explains the impact of the available incentives to the small businesses on the behaviour of these taxpayers

from a compliance perspective and evaluates the reasons behind non-compliance issues.

1.3 SPECIFIC RESEARCH OBJECTIVES

The specific research objectives are:

- to critically analyse the incentives applicable to small businesses in relation to compliance with tax legislation;
- to identify the factors influencing the compliance of small businesses.

1.4 IMPORTANCE AND BENEFITS OF THE STUDY

A body of knowledge already exists in the area of compliance costs and the tax compliance burdens in general. Studies have already been conducted in terms of the relief measures available to small businesses, and these include Abrie & Doussy (2006), Arendse.J et al (2006) and Stern E et al (2005) . This study takes a step further in that it looks at the relationship between the relief measures and the level of compliance or non-compliance specifically regarding these incentives.

Further, the study looks at what needs to be done taking into account the gaps that still exist in relation to the compliance issues in this sector.

This could also assist the South African Revenue Service (SARS) in looking at strategies that will make the compliance issues shift from confrontation to co-operation by all small businesses in the longer term.

The researcher considered it important to understand what causes the dissatisfaction among small businesses in spite of the interventions employed. The question is: What made the rest of the small businesses graduate from non-compliance to where they are ready to leverage on those successes and replicate to the rest of the Small businesses. Finally, the following aspects could provide more insights towards resolving the prevalent challenges:

- the reasons behind continuous non-compliance;
- SARS could work and monitor progress made and stay close to the residual problems and proactively deal with them;
- tax collections could be maximised once the gaps are closed and more understanding of the weaknesses in the system are identified; and
- more Small businesses who still chose to operate informally could change their outlook to tax and register and become compliant citizens like the rest of the peers.

Essentially, some Small businesses do have an idea of what it means to comply with tax due to previous experiences or interaction with tax practitioners or other professionals, yet they are still tempted to not comply. Some are not even aware that they have an obligation to comply. The latter group has a faint idea of what needs to be done; they simply need handholding or further clarity of some relevant matters pertaining to tax. Once having understood the motive, it should be easy to interpret their needs with regard to compliance issues, their perceptions on tax evasion and what motivates them to do so. This is informed by the fact that the level of understanding is not the same in the small business sector McGee, Ho & Li, (2008:156).

The study will, among others also cover aspects relating to tax compliance in South Africa and compare the tendencies with practices abroad. According to Hazelhurst E (2010:1). Some of these tendencies include but not limited to:-

- whether the small owner understands why he or she has to pay tax;
- the expectations of the small business owner from the tax practitioner assisting him/her (or: him or her) when completing a tax return;
- possible areas of non-compliance and the reasons behind these, whether it is out of ignorance or deliberately;
- why others are not having a challenge with registering and complying with the law;
- their level of understanding into what happens to the tax collected from them and what the South African Government does with these collections. For an example in South Africa the trend might be seen to be improving especially with regards to tax evasion and avoidance post 1994 government. Before, some people who were opposing the apartheid government saw no reason to fund the “so called” corrupt homelands. After many campaigns and amnesties provided for past tax sins SARS did come up with a rate of 8 % to 12 % a year. The result was that more people came closer and closer to the tax net E. Hazelhurst, (2010:2)

1.5 DELIMITATIONS

The study is not intended to cover the whole of South Africa as this process would be impractical. The study also does not intend to cover the other employee taxes/levies, such as unemployment insurance fund contributions and workmen’s compensation, nor does it include taxes, such as custom duties and stamp duties, nor double taxation agreements. The study will only cover the major taxes such as the pay-as-you-earn (PAYE) system; capital gains tax (CGT), provisional tax and value-added tax (VAT). Furthermore, tax compliance issues in other developing

countries will not be covered in detail, but might be compared with the South African issues in the discussion.

The study does not cover other sector segments as long as they fall outside the ambit of the SME definition, for instance, large corporations, publicly listed companies, state-owned entities and other similar organisations. The tax avoidance and evasion practices pertaining to the big companies will not be covered, except to state that comparisons might be made.

The study does not look into ignorance, or deliberate effort to avoid tax or simply not understanding the consequences, but focuses only on the major types of taxations as they apply to the small businesses, depending on the applicable thresholds.

1.6 DEFINITION OF TERMS

The study focuses on a variety of key constructs, namely compliance, taxable income, small business corporation, VAT, PAYE, CGT, tax evasion, SARS small business.

Compliance: According to the Oxford Dictionary, the word *compliance* means “do what someone wants or tells you to do or meet specified standards”.

In tax language, this relates to the level at which the taxpayer is willing to co-operate and abide by the tax laws as prescribed by the authorities from time to time. This includes, but is not limited to, registration with SARS to become a taxpayer, submission of tax returns, disclosing the income from various sources and consequently paying taxes due.

Taxable income: *Taxable income* refers to the amount which forms the basis of tax due or refundable by or to the taxpayer. It is the total amount of all the income

received by the taxpayer during that year of assessment less all the deductions and allowances and assessed losses set off against that income.

The taxpayer in this case could be an individual or a juristic person, yet the Section 12 (E) of the Income Tax Act (58/1962) prescribes certain rules, which must be followed in determining the taxable income of a taxpayer. The taxable income constitutes the amount on which normal tax at the rate determined by the Commissioner is calculated. Taxable income is also arrived at after deducting the assessed tax losses brought forward from the previous years. The following depicts an example of the calculation of how the taxable income is arrived at.

Gross income	xxxxxxxxx
Less exempt income	(xxxxxxxxx)
INCOME	xxxxxxxxx
Less deductions and allowances	(xxxxxxxxx)
Taxable portion of capital gains	xxxxxxxxx
Less assessed loss brought forward (if any)	(xxxxxxxxx)
TAXABLE INCOME	<u>xxxxxxxxx</u>

According to the *Tax Guide for Small Businesses, 2010/2011* (SARS, 2010), there is a link between *net profit* and *taxable income*. *Net Profit* is an accounting term, which refers to the difference between income and expenditure; this is only from an accounting point of view.

Taxable income is the term used to describe the amount which is used as a basis to calculate the tax owed by the business. The amount will always be different as the deductions which apply for accounting purposes will not be the same as the deductions taken into account when calculating income tax. The example cited by the *Tax Guide for Small Business, 2007/2008* (SARS, 2007) is when a business has

an income of a capital nature. This income may be included for accounting purposes while a portion of this amount would be included for income tax purposes. When it comes to deductible expenditure, there are timing differences in respect of the depreciation of the capital assets or special allowances and deductions for purposes of calculating income tax. This on its own, would cause differences in the deductions between accounting and income tax.

Small business corporations (SBCs): According to Section **12E (4)** of the Income Tax Act (58/1962) (58/1968), a *small business corporation* should satisfy the following requirements before it could qualify as such:

1. a close co-operative or a private company in terms of the Companies Act 61 of 1973
2. the shareholders must be natural persons for the rest of the year of assessment;
3. the gross income for the year should not exceed R14 million;
4. the shareholders of the small business should not hold shares or any interest in the equity of any other company during the year of assessment other than certain 'permitted' shareholdings. The permitted shareholdings refer to the following:
 - a listed company;
 - any portfolio in a collective investment scheme;
 - any company referred to in Section 10(1)(e)(i)(aa);
 - less than 5% in a social or consumer co-operative or a co-operative burial society or any other similar co-operative if all of its income is solely derived from its members;
 - less than 5% in a primary savings co-operative bank or primary savings and loan co-operative bank;
 - a venture capital company as defined in Section 12J;

- any friendly society;
- any company, close corporation (CC), or co-operative of the company, CC, or co-op, which has not during the year of assessment carried on any trade and has not owned assets of more than R5 000 in value;
- any company or close corporation if the company or close corporation has taken the steps contemplated in Section 41(4) to liquidate, wind up or deregister;
- investment income and income from a 'personal service' do not make up more than 20% x (revenue receipts & accruals + capital gains): *investment income* refers to dividends, royalties, and rental from immovable property, annuities and similar income;
- *personal service* is defined in the Income Tax Act 58 of 1962 as a service rendered personally to clients by a person holding an interest in the company or close corporation, examples are any service in the field of accounting, actuarial science or architecture.

Value-added tax (VAT): *Value-added tax* is tax levied on the supply of goods and services supplied by a registered vendor. To qualify as a vendor for tax purposes, the person should carry on an enterprise in the Republic of South Africa or partly in the Republic. In terms of Section 1 of the Value Added Tax Act 89 of 1991 an enterprise can only register as a vendor if the value of the taxable supplies made during any 12-month period meets certain requirements. VAT is also levied on goods and services imported into the Republic of South Africa by a vendor. (Deleted: "for VAT purposes" as goods and services are surely not imported only for VAT purposes, but to sell them.) In accordance with Section 7(1)(b) and (c), VAT will be payable on the cost of goods or services imported. Depending on whether or not the taxpayer is a vendor for VAT purposes, the input tax will be claimed in accordance with Section 16(3) of the Value Added Tax Act 89 of 1991 and can be deducted from the output tax to arrive at the VAT amount payable to SARS.

VAT is levied at an applicable rate, which is currently 14%. VAT needs to be accounted for in the correct period. It is thus of great importance to determine the time of supply in accordance with Section 9 of the Value-Added Tax Act 89 of 1991. There are two accounting bases which can be used to account for VAT, either invoice basis or the cash basis in terms of Section 15 of the Value Added Tax Act 89 of 1991.

The following table depicts an example of a typical return, which is expected by SARS from the vendor in each tax period.

Output tax of goods sold during the period	xxxxxxx
At the 14% rate	xxxxxxx
At the 0% rate	0
Less input tax on the goods bought by the vendor	(xxxxxxx)
VAT payable to or receivable by SARS for the period under review	<u>xxxxxxx</u>

The other consideration is the tax periods, which fall into different categories, namely categories A to F. Category A and B are classified together as vendors in these two categories have periods of two months, ending on alternative months., meaning category A periods end on the last day of January, March, May, July, September and November. Whereas Category B VAT periods end on the last day of February, April, June, August, October and December. Category C vendors have a period of a calendar month and are required to make 12 VAT returns a year. Category D vendors have a six-monthly VAT period which need to be submitted half yearly, and are due at the end of February and August each year. Furthermore Category vendor applies to farmers with a turnover not exceeding R1,5 million. Category E vendors have a tax period of 12 months, ending on the last day of their year of assessment.

Vendors falling into category E have to be a company or a trust which receives either rental income and administration fees from a connected person who is also a vendor. Category F vendors have 3 tax periods per annum, they all end on the last day of June, October, and February each year. The category which the vendor falls into is determined by the nature of the vendor or the value of the supplies. These tax periods vary from one, two, four, six to 12 months.

Employees' Tax: *Employees' tax* refers to the amounts which are withheld from the amount paid to an employee in the form of a salary by an employer on a monthly basis. These amounts are paid to the SARS by the employer himself/herself (or: himself or herself) on behalf of the employee. Tables issued by SARS must be used to calculate the applicable taxation to be deducted by the employer from the employee's salary. If the employer pays salaries which fall within the thresholds and attract the pay-as-you-earn system, he or she must register as an employer for employees' tax purposes. Having deducted the employee's tax, the employer should then pay the tax over to SARS within seven days subsequent to the month-end. Paragraph 5 of the Fourth Schedule of the Income Tax Act 58 of 1962 regulates an environment where the taxpayer fails to deduct, and withholds the amount due to SARS from an employee as determined by the tax tables. The following are examples of the consequences of non-compliance by the employer:

- The employer will become personally liable to pay SARS the amount due and payable by the employee. This is in accordance with Section 5(1) of the Fourth Schedule of the Income Tax Act 58 of 1962.
- The employer can only be absolved of the wrongdoing if the Commissioner is satisfied that there was no intent to evade the employer's obligations, provided there are good prospects for recovery from the employee. This is in accordance with Section 5(2) of the Fourth Schedule of the Income Tax Act 58 of 1962.
- In terms of Section 5(3) of the Fourth Schedule of the Income Tax Act 58 of 1962 the employer who was not absolved can recover the tax due from the employee, and until such time that the tax is paid to the employer. He or she will not receive

a tax certificate from the employer, this is in accordance with Section 5(4) of the Fourth Schedule of the Income Tax Act 58 of 1962 which also does not allow a deduction of a penalty.

If the employer in the end pays tax due by the employee, it is deemed to be a penalty, which implies that the employer cannot claim a deduction because of Section 23 (d) of the Income Tax Act 58 of 1962.

The Department of Trade and Industry (DTI) provided small businesses with information on rebates, incentives, etc. and information on how to start a business. The Department of Trade and Industry (DTI) further clarifies requirements and guidelines when one opens a business. This guide falls short of advising small businesses about the type of entity it should embark upon. Such guidelines would have resulted in better understanding and optimisation of tax compliance (SARS, 2011). It is clear that small business will always have to comply with tax laws, although to some extent, relief measures are provided by SARS in accordance with Section 12(E) of the Income Tax Act (58/1962).

Capital gains tax (CGT): *Capital gains tax*, which was introduced into the Income Tax Act (58/1962) on 1 October 2001, applies to the sale of capital assets on or after 1 October 2001. The general principle that is applied is that if an item is of a capital nature and is sold during the year of assessment at a profit, it will be subject to capital gains tax, and if sold at a loss, then that loss can be set off against other profits resulting from the sale of capital assets. Should there be no capital profits during the current year of assessment, then the loss can be carried forward to the following year and set off against the profits made in that year.

South African Revenue Service (SARS): The Income Tax Act (58/1962) in South Africa is administered by the Commissioner for SARS. This is a state organ, which is kept outside the public service. It employs its own staff and operates outside and

independently from the rest of the public service. The Commissioner is appointed by the Minister of Finance and the appointment is then approved by the Cabinet and the advisory board. The Commissioner then delegates his or her powers to SARS.

Small Businesses: This term, (for the purposes of this research) refers to SME's SMME's and SBC's. w

1.7 RESEARCH DESIGN AND METHOD

The topic of tax compliance in any other sector is always avoided and the participants are not expected to provide honest responses about how this topic affects them. The research is qualitative and non-empirical, the extended literature review will be used, this will include both South Africa and other countries.

Targeted literature will be journals, articles, books, publications and other papers, which have already covered the topic of Small businesses and tax evasion. The first review will be of South African literature and this review will then be extended for comparison purposes.

1.8 FORMS OF DATA TO BE COLLECTED

As indicated above, the information will be collected from different sources including but not limited to:

- *the Tax Guide for Small Businesses, 2007/2008 (SARS, 2007);*
- the website of the South African Revenue Service (SARS, 2007; 2010); (www.sars.gov.za)
- books on tax ethics and small businesses available at the library of the University of Pretoria;

- the website EBSCOHost: Academic Search Elite;
- the website (if it is a website) Proquest;
- the website Google Scholar;
- the website of the small Business Development Corporation (SBDC);
- the website Google for keywords used, such as small businesses, tax evasion, tax avoidance and tax compliance;
- various press releases and statements made by individuals on the topic;
- dissertations and theses ;
- the Income Tax Act (58/1962);
- notes on South African income tax by Huxhum and Haupt (2010); and
- relevant newspaper articles.

1.9 DATA ANALYSIS

Once the data has been extracted, the next step will be to convert it into evidence and achieve the goal (Leedy & Ormrod, 2005:2).

Extracted data will be reviewed collectively with a view to arriving at a conclusion. There is also a need to ascertain what further study is necessary in this area to ensure that the National Treasury and SARS become more aware of peculiarities affecting small businesses, and enhance the level of assistance required to close the existing gaps in terms of the following key aspects:

- whether small businesses understand why they have to pay tax;

- the expectations of small businesses from the tax practitioner assisting them when completing or advising them on tax returns;
- possible areas of non-compliance and the reasons behind these, whether in ignorance or deliberately;
- the reasons why others do not necessarily experience challenges with registering and complying with tax law;
- the level of understanding by small businesses as to what happens to the tax collected from them and what the Government does with the collections.

1.10 CONCLUSION

The guiding principles for this study stem from the fact that small businesses are different from the rest of the other taxpayers due to their economic importance in the country coupled with the unique challenges they tend to face from a tax compliance perspective.

Chapter 2 will deal with the analysis of the level of understanding of the reasons for non-compliance by SARS, which is underpinned by the interventions available in South Africa compared with other countries.

Chapter 3 will focus on the available relief measures applicable to small businesses and possibilities of further interventions in the event that these are proving to be inadequate.

Chapter 4 provides a conclusion and recommendations for further research.

CHAPTER 2

TAX IMPLICATIONS FOR SMALL AND MEDIUM ENTERPRISES

2.1 OVERVIEW OF SMALL BUSINESSES AND COMPLIANCE WITH TAX LAW

It is a fact of life that small and medium enterprises (small businesses) represent a lower end of the commercial market in terms of revenue when it comes to business. However, these businesses have now been recognised as a sector that plays a pivotal role in the social development of a country both locally and internationally.

From their very nature, taxation to small businesses is being perceived as rather a burden and a constraint on the sustainability of their businesses. These business owners have to incur large sums of money in ensuring that they are kept up to date with tax

Most of the studies reviewed thus far refer to the fact that there is a correlation between tax compliance and how these taxes are being spent on services provided by the Government by mounting up massive campaigns and through the introduction of tax amnesties, the South African Government has increased the tax base from 8% to 12%. Tax evasion is still a big problem in the United States and Europe, while in South Africa, all the efforts are put into place to maximise collections. There are no statistics available to prove this point among the small businesses. It is simply a fact

that there are a number of interventions available to small businesses to enhance and improve the level of collections. Coolidge & Ilic (2009:19)

It is one thing to avoid paying tax or comply with tax legislation; the other one is the reason behind this avoidance and evasion, and finally, the remedial actions to circumvent this unbecoming behaviour.

Eriksen and Fallan (1996:3) point out that “knowledge about tax law is assumed to be of importance for preferences and attitudes towards taxation”. For instance, in the case of VAT, some taxpayers may feel prejudiced because most of the time they find themselves having to pay over a sum equalling to the difference between output tax and the input tax. On the other hand, some taxpayers consistently claim more VAT because their level of purchases versus the level of sales is skewed. Furthermore, one area which has been cited as leading to non-compliance by taxpayers is dissatisfaction with tax authorities (Adams et al 2001:10). The other area which has not been dealt with by previous authors on the topic of tax is that the challenges of small businesses in the tax arena are not the same as those experienced by large businesses. Some of these challenges are:

- small businesses do not have adequate infrastructure to enable them to accurately report on the accounting records on a regular basis;
- small businesses are not always able to afford the services of the tax practitioners who would assist them with completion of VAT returns or tax returns as such; and
- the time lag between when these small businesses provide the services to the customers/clients and when they collect cash is somewhat long, and they often do not have enough cash resources to pay over the VAT amount due at month-end.

The threshold for compulsory registration for VAT is that the total value of taxable supplies made in the preceding period of 12 months must exceed R1 million, which has changed as prior to 1 March 2009 it was R300 000. Also if a taxpayer believes that tax supplies in the next 12 months will exceed R1 million, he or she should register voluntarily if taxable supply exceeds R50 000 or is likely to exceed R50 000 (Huxham & Haupt, 2010:879).

Furthermore, the inconsistently imposed VAT rates indirectly encourage corruption and tax evasion.

The lack of education for a small business owner regardless of his or her qualification, possibly not being tax literate, could be a punishment for having exceeded a turnover of R1 million per annum.

There are benefits in registering for VAT, however, due to lack of knowledge, the only thing that may come to mind in the above circumstances is that the Government takes away all that one has and leaves one with nothing. Often this is the kind of attitude adopted by the majority of taxpayers. One can observe that this way of thinking is based on misperception. Eriksen and Fallan (1996:11) state: "When myths and misperceptions are replaced by knowledge, we expect a change in attitudes towards taxation even if the subjects' basic ideology and values remain unchanged and the tax law is unchanged." In reality, if taxable supplies exceed R1 million, it becomes necessary to either have a fulltime employee, who is knowledgeable, looking after the Small businesses' VAT and tax affairs or have a tax professional assisting in this area.

Unfortunately, perceived unfairness leads to an inclination to avoid tax, but this is not necessarily true, understanding of one's rights and obligations is not considered as one of the factors that can lead to unintentional defaulters.

According to the *Australian Tax Guide* (Kwok, 2006-07) *small businesses* are defined to be businesses with an annual turnover below \$2 million. In Australia, the small businesses account for 96% of all businesses registered for tax. Some of them do prepare their own returns; however, most of them use 'tax agents' to prepare their income tax returns.

Some do comply with tax obligations but there are still areas which need attention in terms of the registration process, record-keeping, lodging on time, reporting information, claiming refunds and paying tax on time.

In order to maximise compliance, the Australian Tax Office (ATO) does the following: identify high-risk taxpayers and areas proactively and more accurately; Kwock,(2006-07:54)

- expand the capability to enforce tax return submission issues;
- better integrate management issues to ensure that whatever issues raised by small business, these are resolved timely;
- attend to issues relating to compliance with entrepreneurs' tax offsets;
- target taxpayers who intentionally fail to report their income or business to consumer transactions. Already inroads have been made in that the ATO contacted in excess of 55 000 taxpayers last year and conducted audits and unannounced visits. By so doing, the tax office realised an additional \$123 million in revenue;
- offer practical and meaningful and non-financial advice to small business;

- provide valuable information to help trustees understand the expectations and compliance issues;
- review record-keeping trends and issues by small businesses. In this regard, the tax office would make contact with about 13 000 small businesses to help them understand the obligations from a tax perspective and reporting of correct information;
- aid small businesses and the advisors involved to comply with the tax-related obligations and work on reducing the compliance costs;
- monitor business owners' use of business assets and cash especially shareholders loans, payments and debts written off by private companies; also pay attention to aggressive tax planning including limited partnerships and unpaid refunds;
- identify the culprits that claim false input tax credits.

In conclusion, it appears that South Africa can learn a lot from the other countries especially in the area of enforcing collections and optimisation of tax collection issues as it is the case in Australia and other countries. In this regard, industries that the ATO targets are building and construction, fishing, licensed hotels and registered clubs.

2.2 TAX AWARENESS ISSUES

There is a correlation between tax knowledge and tax compliance. If one knows less about one's rights and obligations, one will be more inclined to fall in the non-compliant category of taxpayers. Some believe that if one finds an opportunity to evade tax, one will definitely use it (Kirchler et al., 2003:549).

According to Govender (2008:34), research conducted on the United States agency for International Development (USAID) compliance indicates that if the taxpayer is frequently audited by SARS or written queries are sent to him/her (or: him or her), the taxpayer becomes more aware of the consequences of non-compliance and makes every effort to comply. However, a study revealed that only a small percentage of Small businesses have been audited or inspected by SARS. Although SARS aggressively intensifies the area of audits, Small businesses have not as yet been a target as SARS focuses on large businesses.

For the minority of small businesses that have been audited, there is an observation that this exercise costs the Small businesses severely in terms of time and also the frustration of knowing that SARS will be targeting them. Furthermore, there is the fact that now suddenly they have to seek assistance from tax practitioners.

Much as there are tax relief measures pronounced by the tax authorities, the question is how many Small businesses get to know about these, including the amnesties. Some taxpayers in this sector often claim that they are not even aware of these interventions. The other related factor is access to SARS, which is being identified as a critical issue. There is a need for these taxpayers' lives to be made easier by making SARS offices more accessible to them, in terms of travel and time taken to visit SARS offices or even a satellite office that would be accessible to remote areas Govender (2008:34).

The difficulties experienced in South Africa pertaining to tax compliance issues by Small businesses are similar to the difficulties experienced by other developing countries. According to Abrie and Doussy (2006:6), most small businesses do not know about tax implications, although tax incentives are available to them. Or: Although tax incentives are available to small businesses, most of them do not even know about the tax incentives, according to Abrie and Doussy (2006:7) According to

Abrie and Doussy (2006:6), although tax incentives are available to Small businesses, most of them do not even know about the tax implications. Less than 50% of the taxpayers) are not aware of the incentives available to them. Regarding the new e-filing system introduced by SARS, which helps taxpayers to submit the returns electronically, only 33% of the taxpayers indicated that they used the e-filing system, 23% of the tax population were not even aware of the system, according to Abrie and Doussy (2006:8).

According to Thanh Hai Nguyen et al. (2009:63), who conducted a study in Vietnam, there is a shortage of information about tax incentive policies including all the challenges that taxpayers experience and the hidden costs in so far as the application process is concerned. Officers working for the Vietnamese revenue service appear to have power to enforce the tax rates and this process is creating tax return and tax incentive application difficulties for small business. Other contributing factors cited in this study are delays that are experienced due to bureaucracy of tax assessments and tax incentives. Applications have at times led to unfair conduct in provision of tax incentives and hidden costs.

Application processing for tax incentives and tax-free arrangements cause difficulties not only for tax collectors but also for the taxpayers. According to Thanh Hai Nguyen et al. (2009p: 67), Small businesses in Vietnam are said to be having difficulties in accessing information and global networks. Most of the information can only be obtained from informal sources. This refers to information about markets and opportunities available to Small businesses. Most of the time, the information is obtained through the media and personal contacts of firms and not through formal sources. In Vietnam, only the dynamic Small businesses get the information from formal organisations like the Small businesses club and various other associations. Apparently, Small businesses do face a problem of missing out on business opportunities and co-operation due to lack of credible information, which includes tax-related matters.

2.3 REGISTRATION PROCESS

Small businesses in African countries rather operate in the informal economy. This in itself results in a smaller coverage ratio when it comes to compliant citizens. There are also concerns that even larger businesses with higher turnover levels will in the end hide in the informal economy as well. If compliance administration works effectively, it should then result in a level of voluntary tax compliance. Some Small businesses do not deliberately evade or avoid taxation regime, they rather face difficulties and need assistance in order for them to comply with tax obligations (ITD Africa Conference on Taxing Micro and Small Business: April 2009). Some small business owners do not understand that non-registration constitutes tax evasion.

South African tax law does take tax evasion seriously, with consequences. Tax evasion is a criminal offence which, if practised, could lead to serious penalties including fines and imprisonment. According to Section 75 of the Income Tax Act (58/1962) there is also a possibility of a fine or imprisonment of up to 24 months. The Income Tax Act (58/1962) does not specifically preclude Small businesses. Tax avoidance does not lend itself to breaching the Act. The Income Tax Act (58/1962), however, covers the sections that regulate anti-avoidance. The general anti-avoidance is covered under Sections 80A to 80L of the Income Tax Act (58/1962), which would cover those that are not necessarily covered under specific provisions. According to Huxham and Haupt (2010:467), According to the USAID compliance survey report “Tax gatherers dislike people who get the better of them. They see themselves as the custodians of the fiscal morals of the nation. Tax avoiders, they say, are bad citizens who dodge the column and put part of their burden onto theirs. While the small fry get up to minor tricks, the big boys employ specialists to launch tax-avoidance rackets on a scale which makes bank robbers envious.” This statement is so true when it comes to Small businesses, they can barely afford the professionals who would assist them with minimising tax exposures.

The understanding of the state of registration and non-registration and non-compliance is still prevalent among the small business sector. The report further states that the reasons for this non-registration appear to be attitudes and beliefs that are widely held by small businesses with respect to taxation rules in general. While most taxation rules are reported to be perceptual, it has a direct impact on tax behaviour. Therefore, there remains a need to resolve this problem if SARS is to reap benefits from increased collections from this sector (USAID, Govender, 2008:41).

Some tax evasion mechanisms involve understating the income; on the other hand, there is the inclination to overstate the deductible expenses. Some taxpayers simply do not submit tax returns, according to Abrie and Doussy,(2006:2).

According to the *Tax Guide for Small Businesses, 2010/11*, issued by SARS (SARS, 2010), the issue of registration is a must in that the Commissioner expects the SME as soon as the business commences to register with the local SARS office in order to obtain a tax reference number. The process is the same regardless of the nature of the legal entity, whether it is a sole proprietor, a partnership or a company. The requirement is that the registration process should take place within 60 days after the commencement of the business by completing the IT77 form, and the form is available at any SARS office or on the website.

When the close corporation or private company is registered with the Registrar of Companies and Corporations, the business owner obtains a business reference number. The business will then be registered automatically as a taxpayer. There is a requirement that if a business owner does not get any correspondence from SARS after registering, he or she has to contact the SARS office.

There is also an option to register as an e-filer or one can submit the annual returns manually to SARS by a specific date each year. All types of taxes can be submitted electronically on the e-filing system (SARS, 2010).

According to a study conducted by Govender on USAID in an informal SMME Tax Compliance Survey Report (2008:53), all of the small businesses affected by the study were found not to be registered for tax, consequently, the taxes due to SARS were not paid. The survey revealed that there were certain perceptions and attitudes that often led to the failure to register as a taxpayer. The starting point was to assess the importance of formalisation of the informal businesses. It became clear that the taxation was a stumbling block to increased formalisation of the informal small businesses. Many of these small businesses believed that once they register, they would be exposed to taxation, so the best route was to stay away from registration.

The study further revealed that the concerns were not that much on the part of registration but what happens after registration. Overall, the concerns were about compliance, these taxpayers were neutral or even positive about the registration process but compliance seemed to be a concern. The main concern was about capacity and expertise shortfalls with regard to meeting tax compliance requirements and the costs involved in covering the shortfalls. The registration process was seen as a once-off activity and the cost and effort resulting from this process were seen to be lower than the cost and effort of tax compliance Govender, (2006:41).

In the African context, small businesses choose to remain in the informal sector, because they perceive benefits to be less than the costs of registering for tax purposes and becoming a formal business. Most of the developing countries do not see their tax payments being used in a meaningful manner in rendering government services. The small business entrepreneurs in Africa see both finance and time as they relate to the cost of paying taxes as too much and driving them away from complying with the tax regime. By the same token, the cost of collecting taxes from small business by the government is also cumbersome, time-consuming, costly

and aggravated by the scarcity of resources to perform the task Stern, et al (2005:6).

Regardless of the above statements, there are still compelling reasons for small business and the Government to make the tax regime work, on the side of the taxpayer, to comply and on the side of the government, to enforce compliance. The process does not only help the economy in terms of tax compliance but also brings the firms into the formal sector, which includes bringing them in touch with credit markets and the government procurement process. By doing this, the government also encourages firms to enter the formal sector and the government promotes a culture of compliance. In this way, small business is encouraged to grow and comply with all other regulations and obligations rather than remain in the informal sector forever.

According to a study regarding lessons from Africa conducted by Stern et al., (2005:8) in three countries, namely South Africa, Zambia and Rwanda, Zambia was named the most business-unfriendly regime among these countries. The survey revealed that the Zambian government estimated that 80% of the economic activity takes place in the informal sector. There is so much inflexibility in this situation that many firms under the high turnover threshold are not allowed to enter the general tax net. The turnover tax for small businesses in Zambia suggests that new firms will have to pay part of their tax even before the sales take place. There are no deductions in place, which makes the tax burden even worse, aggravated by the flat tax rate with differentiation. The small firms participating in the small business tax regime are not considered registered for tax purposes unless they possess a VAT number, this denies them access to benefits such as government tenders and secured financial assistance by financial institutions. Zambian authorities do not engage in education and outreach initiatives in order to reduce the number of informal businesses and increase the level of compliance.

The study revealed that in South Africa, attempts are made to lessen the burden on the standard regime in terms of instruments and rates. However, there are still gaps in meeting the needs of small businesses as the reporting requirements were found to be the same as those for the other taxpayers. Tax avoidance was found to be more prevalent in this sector because of a lack of literacy, lack of information, education and skills to comply. Some small firms confirmed that the small tax regime did help to instil a culture of compliance and good accounting practices.

The other point to note is that the South African system is designed to make it easy for businesses to enter the tax net, with an option also for VAT registration. However, it was found that the system is still unreachable for many small businesses. The thresholds for registration are still a challenge, leading to issues of non-compliance as well. The study also revealed that the SARS authorities were effective and responsive in responding to the needs of the large and medium taxpayers, yet not that effective in meeting the needs of the small businesses. Training and education came up as a sore point in the small business sector and the authorities were found to be aware of this shortcoming, and planning to resolve it at the time this survey was conducted.

According to the survey report conducted by the World Bank in August 2007, it was found that the time taken to register a small business for tax purposes in South Africa for either income tax or employees' tax was on average 12.65 hours. It was also found that VAT took the longest period of about 5.9 hours, income tax took 2.8 hours. Although this also is determined by the turnover bands of the businesses, the higher the turnover bands, the higher the time taken to register. This report cited the fact that time taken for income tax is different as SARS tends to request the same information to register for income tax resulting in the same amount of time being spent by every business to register.

The report further revealed that the reason for the longer time taken to register for VAT was due to the complexity of the VAT registration form (VAT 101). The onerous requirements and information which need to be produced at the time of registration, such as the number of attachments and proof of turnover, make it difficult for small businesses to register for VAT.

2.4 COMPLIANCE COSTS

Compliance costs are one area which the other studies have touched on. There are a number of categories that the previous studies have covered, like value of time spent by owners on understanding rules, record-keeping costs, payments made to professionals and incidental costs. These also have the potential of affecting the morale of the SME owner pertaining to tax compliance Stern *et.al* (2005:4)

Hasseldine (1999:96) conducted a study with regard to the correlation between compliance costs and how this will have an impact on the behaviour of Small businesses pertaining to tax compliance. According to Hasseldine (1999:96), tax compliance costs are large and consume many resources. These costs generate some resentment adversely affecting compliance; this is true for self-employed persons. Compliance costs, fall disproportionately on small business and more heavily on self-employed persons than on employees. According to Smulders (2006:89), in South Africa, tax compliance costs are one type of regulatory cost that is viewed to have a large impact on small businesses. The costs pertaining to registration coupled with the costs payable to the tax practitioners appear to be burdensome.

Other studies revealed that businesses in developing countries do not see evidence of their tax contributions at work in the form of government services. The costs do not only consist of money but time as well, and these are both added to firms' cost-benefit analysis of paying taxes, the result is that the disincentive to comply becomes

even stronger. By the same token, the cost of monitoring and collecting tax from Small businesses usually outweighs the revenues generated by them (Stern et al.,2005:11)

According to a study conducted in Pakistan on the regulatory burden of small business in 2010 Najeeb (2010:1); income tax tends to impose high costs on small business especially in developing countries. The report also revealed that small business owners were inclined to run their businesses informally in fear of being caught. Consequently, contribution by these small businesses to the economic growth in these developing countries tends to be non-existent. Small businesses in developing countries tend to run their businesses on a smaller scale than in the case of developed countries thereby making tax implementation difficult. No matter how much the regular income tax regime is simplified, this might not help because there is still the requirement for maintenance of accounts. Therefore, the compliance costs are still prevalent and are high.

According to Najeeb (2010:8), in the report on Pakistan, tax authorities and small business are in conflicting positions, which need to be reconciled on a logical basis.

The following points support this statement Najeeb (2010:3-8):

1. Tax forms part of the major barriers to small business operations in many countries as it is the only mechanism by which small business interfaces with the government. This study also revealed that income tax tends to be blamed for the difficulties faced by small businesses as many small businesses are not within the thresholds of indirect taxes. In Pakistan, 84% of enterprises have annual turnover below PKR 0.5 million. For small businesses, it is believed that the compliance tax burden does lead to a strong demotivation to comply with tax requirements. In Bulgaria, small businesses refer to the tax compliance burden as a “major impediment in their expansion”. It is reported by this survey that in New Zealand, 41% of total compliance costs are linked to tax compliance , while

in Pakistan, 67% of small businesses perceive tax as the “most problematic in carrying out business activity”.

2. *Administrative compliance costs* are costs that arise from complying with administrative rules and include reporting compliance such as bookkeeping . A complex tax system has the potential of increasing the costs to comply with tax regime requirements and obligations and is regarded as one of the reasons for non-compliance and for operating in the informal sector, as well as for the business getting motivated to remain informal and avoid formal processes.
3. A lack of accounting skill by small business also leads to complaints about costs as these businesses now need to hire a qualified finance specialist to prepare their books leading to proper accounting for what is due to the authorities.
4. A study in Malaysia revealed that bookkeeping was also one of the major compliance costs especially when it comes to personal income tax, as far as it affects both time and money. In India, audits, bookkeeping and filing of returns were identified as the highest of the compliance costs. Another study refers to record-keeping and advisors’ fees forming the bulk of costs for individuals who are non-salaried earners. The same study revealed that compliance costs made up 6,8% of gross income of taxpayers who were non-salaried taxpayers. Najeeb (2010:2)
5. The compliance burden emanating from administrative requirements is higher for small businesses in most developing countries compared with the burden in developed countries. In Australia, for instance, the free record-keeping software given to taxpayers by the tax agency is very expensive for small businesses. The reason for this is that the software needs computer systems and operators.
6. Technical compliance costs are a type of cost which primarily arises from payment of taxes calculated in accordance with the provisions of the tax code. Consequently, the burden arising from high tax rates has a direct bearing on the well-being of small business.

Finally there is a universal truth that small business is a positive force for a country's economy, and that regulatory compliance costs of small businesses as well as operating costs are higher in this sector than in the large firms. The reasons are:

- economies of scale, and
- the fixed cost nature of the costs.

According to Arendse *et.al* (2006:3), small businesses are at a competitive disadvantage compared with large businesses. They further state that the costs of complying with the tax regime, whether in terms of time or money, are generally high for small business. The other factor they allude to is time to learn about new laws as well as external costs of obtaining professional advice or assistance.

2.5 TAX ADMINISTRATION

One of the contributing factors towards lethargy on tax compliance issues by Small businesses is the unacceptable service levels experienced when dealing with SARS officials. There seems to be evidence of capturing and processing errors and time taken to correct these. FIAS (2007:41) The other burden cited in this survey is the length of time it takes to receive registration particulars for most of the tax types. It was reported the time taken was longer than the time which is promised in the SARS Service Charter. It transpired that for SARS to turn the situation around SARS would have to reduce the time taken to perform registration process by more than half in the case of Income Tax, VAT and Employees' tax. By so doing SARS would then achieve the objectives set in the Service Charter.

The other area revolves around the technical knowledge by SARS officials, often some keep on transferring a client from one administrator to the next. These factors are irritating to the large corporates and individuals alike. The small businesses

operate in another space where time is of critical importance and they need help immediately otherwise the query is likely to be left unattended for a long time. McGee *et.al.* (2007:2) hold the view that one must begin with the premise that the state has an obligation to provide services in exchange for tax revenue. By so doing, one is more likely to obtain reliable answers, which will indicate whether the interviewee is knowledgeable, disgruntled or simply does not have cash to pay his or her taxes as they fall due. It is not fair to assume that all taxpayers in the SME bracket simply evade taxes, without understanding their challenges.

The other critical factor mentioned in the FIAS report that influences a decision to comply or not to comply pertains to the responses to objections lodged at SARS by small businesses. According to section 81 and section 107A of the Income Tax Act and section 32 of the VAT act, SARS is having approximately 90 days within which to respond to an objection. Although SARS was said to be within the time limits as per the Service charter, the following issues were also mentioned as being burdensome by the small businesses:

1. Lack of Knowledge by SARS personnel especially with regards to dealing with specific objections
2. Unavailability of the person responsible for the issuing of the assessment itself.
3. Human errors by SARS officials in capturing and processing the returns resulting in objections raised by small business.
4. Difficulties experienced in following up on the status of the objection
5. Some documentation being requested for the second time by SARS despite having been submitted in the first place. FIAS (2007:46)

All the above factors have a direct impact on the small business' decision to comply with tax requirements.

In 2006, in his State of the Nation address, President Thabo Mbeki (Mbeki, 2006) confirmed the need to expand the small business sector. A commitment was made to generate the necessary resources for the development of the small business sector. He further suggested ways and means that could be employed by the Government to speed up, among others, consultations that determine the measures geared towards improving the regulatory climate, resulting in expansion of the sector. Structural changes proposed in the 2005 year in an effort to empower small businesses were streamlining of taxes, entry and filing. This also included advice, assistance and tax relief for small business Deloitte 2005

Furthermore, a simplified basis for calculating VAT on sales in terms of the small retailers' VAT package was made available for tax periods commencing on or after 1 April 2006. Some studies revealed that despite all the initiatives introduced by the Government to encourage taxpayers to comply, there would still be pockets of evaders. In contrast, other studies revealed that small firms might find it easier to escape the tax collector's regime, since enforcement costs could be more than the potential tax revenue collected Gauthier & Reinikka, (2005:374).

The World Bank (2004) points out that the high level of informality in developing countries such as South Africa, coupled with poor tax administration, tends to place a disproportionate tax burden on firms that comply with the tax code. While one agrees with this contention, it is believed that some taxpayers tend to lose faith and confidence in the South African tax authorities including the officials employed by SARS.

The other irony with the cited studies is that tax evasion was more common among small businesses. Although this study does not concentrate on the large businesses in South Africa, the extent of tax evasion cannot be said to be affecting only the small businesses. In South Africa, much intervention has been introduced to ensure that small businesses do not feel the tax burden, which is currently felt in other countries.

In South Africa the most favoured type of legal entity is a Private Company. This type is treated by law as a separate legal entity which must be registered as a taxpayer. The companies or small businesses which are registered companies in terms of the Companies Act 61 of 1973, would invariably have audited financial statements. It would therefore be surprising if these companies would fall foul of tax evasion, as defined. Close corporations can easily escape the tax net because they are not legally obliged to issue audited financial statements. According to Bruce and Mohsin (2006:1), "tax policy influences not only the choice of whether or not to create a new business, but also how the new firm should be organised, and how profitable it can be" in other developing countries such as Brazil, India and China. Although the results of these studies would not necessarily be common in respect to South Africa, the most common aspect is that the small business sector is targeted by these countries for economic growth. It has been proved that small firms always accounted for the gross domestic product growth creating employment opportunities.

These small businesses are often seen as engines of economic growth, yet they cannot keep up with the complexities of the tax systems and administration involved. Shome (2004:6) suggests that the small taxpayer would benefit from tax simplification to maximise tax collection from them. The first thing that would need to be done in this regard is to segregate the taxpayers according to size, and create different systems for each group. The challenge that these developing countries would face is to decide the cut-off point, namely who is small, who is medium and

who is large. In South Africa, as mentioned above, small businesses are given some preferential treatment over larger businesses.

The other concern pertains to government services. If people believe that the government provides good services in return for the amount of taxes paid, then they will definitely comply, but they will not see any reason for complying if they do not see services provided Coolidge *et.al* (2009:16-17)

However, small business owners are still expected to complete the VAT returns, the income tax returns and the PAYE for employees on a regular basis just like their large business counterparts.

In order to ensure that there is proper control and monitoring of the different groups and that they do register for tax, the following must be done:

- The demarcation point should be determined to define the entry point or threshold.
- As one graduates to a higher level annually, there should be a record of all these.
- The demarcation points should be revisited to ensure that there are meaningful contribution and more efficient generation of tax revenues. This method would result in credible results when establishing the level of compliance for different groups, unlike the viewpoints derived from the authors referred to above. The weakness of this method is that it would be difficult to find out whether cultural, legal and other differences may account for differing perceptions of tax evasion (McGee et al., 2007:2).

In a research working paper issued by Coolidge *et.al*, (2009:19-20), there were general attitudes about government services in South Africa, which affected the

perception by Small businesses of tax compliance. The authors further note that if businesses feel that the government provides good service for taxes paid and collected, and also see the benefits of registration, they will more likely register for tax. Likewise, if they do not see any value in paying tax or they perceive the government not to be providing the necessary or expected services, in all likelihood they will not comply.

Furthermore, this research working paper issued by Coolidge et al, (2009:2) revealed that taxpayers in South Africa reporting major problems with infrastructure and government services had a lower attitude about the 'returns' that businesses get from the government for taxes paid. Such taxpayers were less likely to report that they were considering registering for tax in the near future. When the taxpayers were asked about the possible advantages and disadvantages of registering for tax, the responses were that it was good for business growth and others cited "being legal".

The perceived advantages lead to a high likelihood for registering for tax, as the strongest effects reported by the said study were the "better access to government services", "being legal", "access to and price of financing" and "better opportunities for business growth". Taxpayers who do not see advantages are less likely to consider registering for tax.

According to the research working paper issued by Coolidge *et.al*, (2009:22-25), the taxpayers cited disadvantages of registering for tax as the financial burden. The taxpayers who saw a lot of disadvantages in registering for tax were more than likely not to comply. Some mentioned that the government did not provide enough services to the nation and therefore they did not see any reason to comply. Some of these taxpayers cited fear of prosecution and the fact that registering for tax leads to a worse business situation and less opportunities.

Training aspects were also raised by small business owners as a requirement for them to be able to fully comply with tax regime. According to the Coolidge *et.al* (2009:29) these taxpayers were receptive to the idea of training being offered by SARS or an independent agency with SARS involvement, and that the format of the training should be designed as a workshop.

Access to SARS was also cited as one of the critical issues indicating a strong preference for locating SARS offices in close proximity to where the businesses are located. The driving factor here was the costs and time involved with respect to having access to community-based resources, which could serve as tax ombudsperson and will aid taxpayers' confidentiality in tax matters.

One of the findings in the USAID study was that the small businesses were neutral or even more positive about registering for tax but more apprehensive about compliance issues. The apprehension was based more on the resources shortfall coupled with lack of expertise to deal with complex tax requirements. According to this study registration was seen as a once off activity which was perceived to be less costly and did not require much effort as compared to the compliance costs. The majority of these small businesses expressed concerns about having to employ an extra person to deal with administrative work associated with tax requirements. This was true for businesses with incomplete records. Govendor R. (2008:35)

According to the research conducted on tax compliance burden for small businesses, (FIAS, 2007:54), provisional tax was also regarded as one of the difficult taxes to deal with. In the study conducted by Business Partners and contained in a report, *Counting the Cost of Red Tape*), VAT was seen as the troublesome and time-consuming regulation for the small business. According to this study, income tax was also seen as the most burdensome aspect because of the capturing and processing errors made by tax officials and the time and trouble taken to rectify the errors

Objections were made to a number of assessments due to capturing and processing errors made by SARS officials. These errors led to more time being taken by practitioners and small business to adhere to the objection processes to ensure that the errors were rectified to the satisfaction of both parties. Often this process tends to lead to additional costs incurred because tax practitioners charge the small business for assisting with these errors. It is argued in this study that 35% of errors were either incomplete submission by the small business or the tax advisor or due to the incorrect information being provided.

2.6 ASSISTANCE BY TAX PROFESSIONALS

The majority of the studies consider the assistance given by tax practitioners as taking the interest of the taxpayer at heart, by not engaging in lies and giving satisfactory advice to the taxpayer (leading to minimisation of taxation), be it corporate tax or VAT. One finding which is common across most of the countries surveyed, is that there is increasing complexity of tax law and more taxpayers seek assistance with their tax work (Tan, 1999:433). Though one finds a contradiction, because there are those taxpayers who are still not registered for tax purposes or even if they did, they experience problems with tax clearance certificates. It is true that this sector cannot just be ignored due to its size, because tax non-compliance is of grave concern to the government as it affects the raising of revenue and economic stabilisation (Tan, 1999:434).

Tax practitioners are used both in South Africa and in other parts of the world to serve as a source. Compliance costs are also one area which the other studies have touched on. There are a number of categories that the previous studies have covered, such as:

- value of time spent by owners on understanding rules,
- record-keeping costs,

- payments made to professionals, and
- incidental costs.

The above have a potential of affecting the morale of small businesses negatively when it comes to full tax compliance. The information also touches on the frustrations suffered by Small businesses with regard to tax compliance issues and what makes them evade tax. It is important to note that Small businesses do not only require financial assistance but mentoring or non-financial assistance in other forms and ways, such as advisory duties by professionals.

It is important to note that it is beneficial to small business to understand the tax system so these businesses can take advantage of the available tax relief measures such as deductible expenditure, other tax-saving initiatives and tax credits such as rebates. Therefore, it becomes rather unavoidable to hire a competent tax practitioner although the ultimate responsibility for record-keeping, submission of returns and payment of taxes still rests with the small businesses concerned.

In the study on tax compliance burden for small businesses (FIAS, 2007:120-121), doubts were expressed about the capacity to complete tax requirements in-house and the affordability of employing someone to assist. The other challenge was the adequacy of record-keeping especially with regard to the small businesses.

In the same study, there was a general belief that the taxation would impose a number of demands on the business, and the informal small businesses did not see any benefits in being tax-registered and compliance was the last thing they considered as a priority. There was awareness that there were benefits associated with the registration and compliance, but these were seen to be few and concerns far outweighed the benefits

The concerns raised included the following:

- Some concerns were regular SARS audits and inspections. The respondents believed that the registration process would expose them to inspections and audits by SARS automatically.
- The complicated tax rules and procedures were also seen as another confusion with respect to rules, regulations and procedures, and these rules placed a requirement on the small businesses for learning about the complications which they would much rather avoid (FIAS, 2007).
- Tax practitioners viewed the current tax legislation as complex for a number of taxpayers and as a result, understanding of the detail tends to be a challenge. It is said that small businesses can always engage the service of accountants to calculate and complete tax returns for them. However, some small businesses find it difficult to make a profit thus the hiring of a tax profession will complicate issues even further.
- Of small businesses, 37,6% with a turnover in the category less than R300 000 use tax practitioners, and this figure can increase to 78% with businesses within a threshold of about R6 million and R14 million. In the final analysis, there seems to exist a direct relationship between the high turnover and the likelihood to make use of a tax practitioner to aid with tax affairs. This in itself does not necessarily mean that the small business that does not make use of the tax practitioner does not need his or her services, affordability could be an issue. Consequently, a number of small businesses then remain in the informal sector due to limited resources. If they then remain in the informal sector, there tends to be limited future growth, visibility and security and the country does not need that. FIAS (2007:83)

From this study FIAS(2007) it is clear that tax practitioners play an important role in providing researchers with valuable information on the taxation needs and requirements of small business.

2.7 BENEFITS ASSOCIATED WITH TAX COMPLIANCE

In the South African tax law, there are negative consequences for tax evasion. However, there should also be benefits associated with compliance. Since small businesses are not a significant source of revenue by value but volume for the Government, the system of collecting revenue should be different. It should first be geared towards encouraging small firms to join the tax regime. It should be made clear that there are benefits in becoming part of the compliance league. For example, small firms would receive training on operating the simple accounting systems, which lend themselves to fulfilling compliance requirements while building capacity. Stern et al., (2005:3).

It is not all doom and gloom in the tax world for Small businesses in the sense that by complying, a small business can also enjoy some benefits, which are not necessarily enjoyed by those who chose not to comply. The first benefit is that the business will instil a culture of discipline by maintaining accurate financial records Coolidge & Ilic (2009:4). The brand name of the small business is also enhanced, which could result in more respect and honour being given by customers.

The other benefit is that when called to tender for jobs by government bodies or even the private sector, one of the requirements is that the tenderer should provide a tax clearance certificate. Should a business not have this important document, it will definitely not be competitive and will jeopardise the chances of securing the tender.

The other spill over relates to when an SME requires a loan from a bank or any other financial institution, the requirement has always been there of providing financial statements, income statements, balance sheets and cash flow statements. Regular submissions of tax returns ensure that a small business has this information readily available. The banks therefore do play a part in ensuring that Small businesses are faithful citizens.

In an article titled *SARS dumps PAYE worries on SME's*, SARS is referred to as alluding to the fact that PAYE is often teeming with errors, and the cure for this is to make the employer responsible for the accuracy (insert proper source reference). According to Mr. Barry Hore, the Chief Information Officer at SARS, e-filing was introduced in order to alleviate the exposure of inaccuracies by taxpayers. In this article titled *SARS dumps PAYE worries on SME's*, Hore is quoted as committing SARS to providing all employers with free bespoke software to perform the reconciliations for them.

The other benefits of being compliant are cited in a Ugandan article written by Joloba Daily Monitor, September,(2010:1),

- If one complies with tax law, then one becomes a responsible citizen. Every business is run under a set of laws and one needs to abide by such laws. The state will impose penalties and interests, and also one can in the end close one's business if one is found to have been flouting tax laws. Some businesses have had their accounts frozen, and their businesses locked by the 'taxman' due to non-compliance, which is called tax evasion or fraud, "and you do not want your business to be branded as a fraud just because you did not pay taxes".
- If one remains compliant with tax laws, it gives one an edge over other non-compliant businesses.

The above benefits do not only apply in Uganda, in South Africa as well there are huge benefits associated with being tax compliant. According to an article by

Business Partners, there is a Small Retailers Vat Package which is provided for small retailers which forms part of SARS' drive to aid small businesses. If one qualifies for the package it becomes easy to satisfy the VAT Act without having to keep detailed records. The system keeps track of sales on various product types one sells. Important to note is that this package is available only if you are registered for VAT. SME Toolkit South Africa, (2010:1).

According to FIAS, (2007:83) the other incentive that SARS can introduce is to make the tax compliance process simple, quick and cheap, this should start at the level of registration by small business. The other useful intervention is provision of training and mentorship programmes thereby creating a more supportive than 'watch-dog' environment.

Improved management information (MIS)

In most of the studies reviewed, it became apparent that if one does not maintain a complete set of records and adhere to proper record-keeping, compliance with the tax system, especially VAT, becomes a challenge. With the demands for tax compliance, there has been a major driver to acquire computerised accounting systems by small businesses. The positive result of all this is proper record-keeping, which means that the cost of acquiring the systems is outweighed by the benefits as compliance with tax also becomes less of a challenge than before.

According to Lignier (2009:110), small business owners in Australia were interviewed before GST was introduced in 2000 and they stated that the introduction of GST was the main reason for them to think of acquiring a computer.

The other benefit which small business enjoys is that the Government provided a grant to enable this sector to acquire the information technology they needed. This

was introduced as a result of significant computer costs which were incurred by small businesses whenever a new tax was introduced, or amendments to the existing tax regime were made. This benefited taxpayers as they were now able to perform the same task in less time more accurately with utilisation of fewer resources. Lignier (2009:110)

Savings on other business costs

Tax compliance appears to encourage taxpayers to prepare the financial accounts either on their own or by hiring an accountant. If they then decide to prepare these accounts in-house, there is a potential savings on accounting and audit fees. When the auditors come to audit the accounts, the information relating to their queries and the follow-up on previous year's findings will be obtained without having to rehire the accountant who prepared the books Lignier,(2009:112)

Furthermore, taxpayers will also realise savings where taxpayers obtained additional services for which they would have had to pay for had they not sourced the services of an external accountant for tax compliance purposes. Lignier (2009:113)states the following: "Empirical evidence suggests that many accountants or other tax advisers were providing a variety of business services incidentally to tax related activities."

According to the same study (Lignier, 2009 p 112), in Australia, accountants assist the clients with compliance matters for third parties other than the tax office. Some accountants even offer general business advices, financial planning and business plans and are an important source of support in the selection and installation of computer software and the training of internal staff.

When the practitioners charge the clients for the additional services, it is reasonable to expect that the fees would be higher if the services are provided separately from tax compliance activities. This results in economies of scale, because the accountant will be in a position to perform different activities for the same client with increased productivity. Furthermore, a common base of information is sometimes used to provide different services and because the accountant is familiar with the client's business.(Lignier, 2009, p112).

Other benefits

According to a study conducted by Arendse et al. (2006:6) in the United States, the main non-tax benefit of being classified as a small business in the United States was that one could receive funding from the bank through the Small Business Administration (SBA). Accessibility to certain government contracts was cited as another advantage. Another benefit cited in this study is the immediate expensing of assets such as equipment, vehicles and other computer equipment. Other benefits are the use of the cash method of account, the fact that they are exempt from compliance with onerous and complex tax rules, investment losses being considered an ordinary loss rather than a capital loss, and lower tax rate.

According to Arendse et al. (2006: 6), in Australia, small businesses are offered a number of tax concessions including optional or simplified income tax depreciation and inventory accounting. A number of exemptions for capital gains tax, simplified VAT accounting and less frequent submissions of income tax, GST (VAT in South African terms), and fringe benefit tax obligations.

In Australia, a business does not require to be a business with annual turnover of less than A\$50 000 to register for GST, but if the business wants to do it voluntarily

so that it gains the benefit of input tax credits for GST on acquisition, it is allowed to do so. Arendse et al. (2006:7)

It is further cited in this study by Arendse (2006:6) that Australian small business depreciation concessions include immediate expensing of assets costing less than A\$1 000 and pooling of other assets. In Australia, capital gains tax concessions are generous and are restricted to certain types of businesses including small businesses. Small businesses are also subject to the tax rates such as other businesses, however, from 2005 small businesses pay reduced tax on the first A\$75 000 of income generated by the business if they choose to use simplified accounting methods. Use of non-business operating vehicles, such as discretionary trusts, can give significant income-splitting advantages for family-controlled small businesses.

In Ireland, small business taxpayers enjoy a corporation tax advantage whereby the preliminary tax paid by them can be calculated as 100% of the prior year's liability. The result of this is saving of an expense of computing the current year's profits and tax liability before the year is ended. Provisions for small companies in Ireland alleviate the tax payment burden by allowing small business to estimate their tax liability for a given accounting period by reference to the liability for that given period. This certainty in the estimate reduces the risk of imposed penalties or any other interests for underpayment as well as reducing compliance costs, which may be payable upfront and which relate to estimating the tax liability in the middle of the tax period (FIAS World Bank Group, December (2005).

2.8 CONCLUSION

It would appear from the studies reviewed that there are many reasons why some small businesses are still reluctant to comply with the tax regime. The reasons range from perceptions about what happens to the taxation collected to the compliance

costs and affordability issues. There are similarities between the studies conducted in South Africa and those conducted in other countries with regard to compliance issues. Some of the reasons for non-compliance are very valid and need resolving by the tax authorities in South Africa. The rules and regulations remain complex for most of the taxpayers in this sector.

The next chapter deals with the benefits associated with compliance with the tax regulations. Although there are still pockets of non-compliance in this sector, it is evident from the studies conducted as indicated in the following chapter, that, for the small businesses who comply, there are benefits associated with this behaviour.

CHAPTER 3

TAX RELIEF MEASURES AVAILABLE TO SMALL BUSINESSES

3.1 BRIEF OVERVIEW

Tax relief measures pertaining to each category of tax have been made available to small businesses by SARS. These relief measures are available owing to the nature of the sector in which Small businesses operate. These measures are considered critical evaluation as they may lead to the change in attitudes of some business owners in this sector, changing their perception about SARS and improving the level of compliance. In 2008, SARS published the *Tax Guide for Small Businesses, 2007/2008* (SARS, 2008). The guide contains information pertaining to tax laws and obligations, which are applicable to Small businesses. The tax responsibilities of each legal entity, as long as it falls within the ambit of Small businesses, are covered in the document.

In a Business Day article of November 2006, small businesses are quoted as struggling with tax compliance. These businesses often tend to face a threat for survival, especially if they ignored the small business amnesty offering. Small businesses are overwhelmed by the changes and new introductions relating to tax compliances. Often, they unintentionally fall behind and then violate tax law (Keyser, 2006:1). The key focus of Small businesses is always the survival of their business. They see other tax-related issues as a nuisance and a threat to their survival. To deal with these complex tax issues, it is clear that they will always need assistance.

Keyser, (2006:1) states the following: “Many small businesses regard unpaid VAT and PAYE as part of working capital.” The problem with this practice is that it is a criminal offence to ignore the payment of dues to SARS in respect of VAT and PAYE. The members of close corporations are personally liable for such liabilities. The starting point with Small businesses is to ensure the proper bookkeeping systems are in place to alleviate the trouble of having to perform all these calculations manually.

3.2 INCOME TAX

Income tax is viewed as SARS’s main source of revenue and it is the type of tax that is based on the income derived after deducting allowable expenditure as defined by the Income Tax Act (58/1962).

It is expected that as soon as small business has commenced business, it has registered with a SARS office to obtain a tax reference number. It is evident that there is no concession for the Small businesses in this regard; they are treated in the same way as the rest of the other legal entities. Should a small business qualify by reason of Section **12E** of the Income Tax Act (58/1962), they will then enjoy the following relief measures:

All shareholders or members of a small business must at all times during the year of assessment be natural persons.

- Shareholders or members of the small business may not hold any shares or interest in the equity of any other company.
- The gross income of the small business for the tax year may not exceed R14 million.

- Not more than 20% of the total of all receipts and accruals (other than those of a capital nature) and all the capital gains of the small business may consist collectively of investment income and income from rendering a personal service.

The first concession is to be taxed on the basis of a progressive rate system at which tax is calculated at the rate of 0% on the first R57 000 of taxable income, 10% on taxable income in excess of R57 000 but not exceeding R300 000 and thereafter at a rate of 29% for every R1 in excess of R300 000. For the 2010/2011 tax year, this has improved as thresholds have been increased and the tax rate is now 28% of taxable income and no longer 29%.

Secondly, there is an immediate write-off of all plant or machinery used in a process of manufacture or similar process in the tax year it is brought into use for the first time. An accelerated write-off allowance for depreciable assets (other than manufacturing assets) acquired on or after 1 April 2005 is available at 50% of the cost of that asset in that tax year during which that asset was brought into use for the first time, 30% during the second year and 20% in the third year.

Small business taxpayers involved in the business of farming also enjoy an allowance in respect of assets brought into use for the first time. This allowance is equal to 50% of the asset cost during the year of assessment in which the asset is used. 30% of the asset cost in the second year and 20% of the cost in the third year.

CGT is dealt with under the income tax as it is accounted for in the calculation. Small businesses are, subject to certain conditions, entitled to a concession, which excludes capital gains of up to R750 000 on the disposal of active business assets when the owners attain the age of 55 years. It will be noted that most of the above relief measures were different in the previous years; they get updated almost every year.

3.3 VALUE-ADDED TAX

According to Section 23 of the Value Added Tax Act 89 of 1991 all persons carrying on business in the Republic of South Africa have to register as vendors if the taxable supplies of this business for a period of 12 months have exceeded R1 million, before 2009 this threshold was R300 000. The minimum threshold was R20 000, which increased to R50 000 in 2010. A person or a company can also register voluntarily if the turnover derived in any 12-month period has exceeded R50 000 or is likely to exceed R50 000. The only advantage here is that the SME can register and take advantage of the input VAT claims although they have to also declare the output tax collected from customers.

There is a special relief measure available for small business from a VAT perspective, with the exception that if the small business is really small, it needs not bother about compliance costs and painful registration processes. However, as the definition of a small business includes a person having turnover in excess of R14 million, it is therefore evident that most Small businesses will be above the threshold. Further than that there are no more relief measures. According to the FIAS report on the tax compliance burden for small businesses (2007), the registration process for VAT takes a good 5.9 hours due to the number of forms and the nature of information that needs to be provided.

The Small Retailers VAT Package is another VAT option for small retailers, which is also part of the attempt by SARS to aid small businesses. The tool helps simplify the record-keeping exercise especially for retailers who sell various types of products. This tool has not only been seen as critical for the success of the business of Small businesses, but to support the growth of the South African economy. SARS came to realise that small retailers battle and take too long a time to keep the details or

records of sales as required by the (full name) Value Added Tax Act 89 of 1991, therefore, this tool assists Small businesses to account for VAT without trouble.

Effective from 1 March 2009, small businesses are given an option to register for the turnover tax in accordance with Sections 48, 48B and 48C, read together with the provisions of the Sixth Schedule of the Income Tax Act instead of normal tax payable by other taxpayers

These small businesses are then taxed on turnover at a low rate of tax. The proceeds from the sale of goods are not necessarily subject to normal tax but to turnover tax. These small businesses are taxed on a receipt basis and are not required to maintain sales records. The same applies to expenses. There is no need to keep the records incurred during that tax year in question. This intervention was introduced by the Government in order to reduce the compliance burden on small businesses. What is crucial is that once the small business opts for registering for turnover tax, it therefore cannot participate in the registration for VAT.

The other condition is that the investment income may not exceed 10% of the receipts of the taxpayer before the business owner qualifies for turnover tax.

The condition to qualify for turnover tax is that a small business has to meet the requirements to register as such and must elect to be registered as a micro business prior to the commencement of the year of assessment.

When a business is registered for turnover tax, it is not allowed to voluntarily deregister with the exception of those that have been registered for at least three years for the tax. Failure to comply with registration requirements for the tax on an

ongoing basis, may lead to the Commissioner deregistering the small business for turnover tax purposes.

The second reason for the introduction of this tool is to reduce VAT fraud. Some vendors resort to dishonest reporting of sales information to reduce the liability for VAT and, in turn, inflate the input VAT paid. SARS is also on a drive to reduce the criminal acts by increasing the audit activities to identify the culprits.

3.4 EMPLOYEES' TAX

Employees' tax is the tax that is collected by the employer on a monthly basis from the employee. As long as the employee's salary is in excess of R43 000, he or she must register with SARS for employees' tax purposes. Once registered, the employer, in this case the small medium enterprises (SME), will receive a monthly return called (EMP) 201, which needs to be completed and submitted together with employees' tax within seven days following the date of deduction. In this regard, no relief measures apply to Small businesses. The risk exposure with regard to PAYE is collection and non-payment to the receiver owing to cash flow challenges.

In an article titled *SARS dumps PAYE worries on SME's* (Hore, 2008), SARS appears to be making an intervention to assist employers in order to comply. It does not appear that this intervention came as a result of the need by Small businesses, rather because of the challenges SARS experiences with regard to accurate reporting by employers.. The intervention is in the form of reconciling software. This reconciling software again benefits only those that already have computers and proper infrastructure. Although this tool is provided free of charge, it still requires a certain level of skill and knowledge to assist the taxpayer with the reconciliations. Again affordability might be an issue with some Small businesses. According to Hore should an employer fail to deduct employees' tax from the employee's salary/wage,

he or she is liable to pay same over to SARS. This is also possible in the light of cash flow challenges that are experienced from time to time by small entrepreneurs. It is not unusual for these small businesses to deduct employees' tax from the salaries of the employees and still not pay it over to SARS.

In this regard there is no middle ground, the law is straightforward, what the employer deducts, the employer pays over. Non-payment results in penalties and interests, which exacerbates the problems experienced by the small business further. The law does not treat them the same as large businesses, who often do not necessarily experience the same challenges as the small business.

3.5 CAPITAL GAINS TAX

Capital gains tax (CGT) is not independent from the normal income tax. A portion of the gain as a result of disposing of an asset is included in the taxable income, which ends being taxed in the normal way. There are two rates involved; there is a percentage of the net capital gain, which needs to be included in taxable income, followed by the tax on the taxable income attributable to the capital gain.

In the case of a small business corporation or SME, the inclusion rate is no different from the normal company rate at 50%, the statutory rate at which this is taxed ranges from 10-28%, and then the effective tax rate is 5-14%.

3.6 PROVISIONAL TAX

Apart from the fact that no obligation exists to a make a third provisional payment, and that should the income of an SME be less than R20 000, no interest will be charged on the outstanding tax amount payable. Besides the requirements to register for income tax, certain taxpayers are required to register as provisional

taxpayers according to the requirements laid down in the Fourth Schedule of the Income Tax Act (58/1962).

3.7 COMPARISON WITH INTERNATIONAL STANDARDS

Similar to South African, in Australia, subsequent to the amendments contained in the Tax Laws Amendment Bill of 2007, Small businesses are now referred to as *small business entities* (SBEs). In South Africa, these are now called *small business corporations*. In Australian tax terms, to qualify for benefits available to SBEs, one needs to carry on a business and must satisfy the requirement of the \$2 million aggregated turnover test. In South Africa, the threshold referred to above is R14 million.

The tax concessions in relation to South African tax law are summarised in Table 3.1. (demonstrating that South Africa still lags behind when it comes to other forms of taxation).

TABLE 3.1 – COMPARISON OF SME TAX TREATMENT VERSUS OTHER TAXPAYERS

Concession	Available to small business entities in Australia	Available to small business in South Africa
STS accounting method for simplified trading stock	Income derived only when received and deductions allowed when paid This method only available if one: - was in the STS in 2007 - has used the STS accounting	No simplified trading stock rules exist in South Africa

	method continuously since before 1 July 2005 (however, refer SBE rules for changes since 1 July 2007)	
Depreciation	<p>Immediate write-off for depreciating assets < \$1 000 (excl. GST)</p> <p>Assets \geq \$1 000 with an effective life of</p> <p><25 years depreciated at 15% in the First year and 30% thereafter</p> <p>Assets \geq \$1 000 with an effective life of</p> <p>\geq 25 years depreciated at 2.5% in first year and thereafter</p>	<p>100% cost of the plant and machinery deductible on the 1st year.</p> <p>Manufacturing plan on or after 2005 - 50%, 30%, 20%</p>
Prepayments	<p>Immediate deduction available provided that:</p> <p>\leq 12 months; and the prepaid period ends no later than the end of the next financial year</p>	No concessions available in South Africa
Trading stock	If the difference between opening and closing stock values for the income year can be reasonably estimated to be < \$5 000, the movement does not need to be accounted for and no stock take is required	No concession like this in South Africa

Source: Adapted from Seward Dawson Chartered Accountants.

The other area which is worth mentioning is that, in South Africa, it is still evident that there is a lack of consistency in adoption of criteria and thresholds to qualify as small business for tax purposes. This leads to unnecessary administration work when it comes to analysing and reviewing the applicability of each concession.

It is clear that Small businesses have different interpretations and outlook in South Africa, regarding tax compliance. This is not necessarily unique to South Africa, internationally, there are still gaps relating to education to enhance understanding, monitoring of tax compliance by Small businesses, assistance with awareness and benefits that could accrue to the business if it complies with the law.

The following issues need to be taken into account with regard to small business and tax compliance issues:

- Small businesses enjoy preferential tax treatment, this is not happening in South Africa, but also in other developing countries, such as Australia and Pakistan.
- Small businesses make innovative contributions, which need to be tapped into from an economic perspective.
- The Government still needs to reduce the compliance burden over and above the incentives given to small business. By so doing, it will optimise revenue collection.
- There is a need for a win-win solution for both small business and the Government.
- Collection of optimum revenue is still a goal for the Government hence a need for a win-win solution.

The next chapter covers the various incentives available to small business. Having dealt with/discussed the hindrances in complying with legislation, one needs to take a look at what incentives there are for small business, whether these are achieving

the intended objectives or not; further, to see if the Government is making meaningful progress in terms of collections due to incentives made available to the small business taxpayers.

3.8 CONCLUSION

From the findings of this research, the following can be concluded:

- The Government needs to impose taxes to enable it to sustain the provision of services to the country.
- Small businesses are not an exception to the rule, although there are a number of incentives and amnesties available to this sector to encourage compliance.
- Despite the prevailing incentives and amnesties provided, some Small businesses still find it burdensome to comply with tax requirements.
- Authorities and local courts in South Africa and beyond disapprove of tax evasion, including the improvement of audits.
- There are reforms regarding administrative efficiency and client service, and strategies to restrain tax evaders, as well as strategies to encourage all Small businesses to pay their taxes as they fall due.
- Although the then Minister of Finance, Trevor Manuel, and the then Commissioner of SARS, Mr. Pravin Gordhan, both indicated that there is still room for improvement on the record (Abrie & Doussy, 2006:4).

There is also a view that among the small business regime there are attempts to render the system less onerous than the standard regime applicable to other sectors.

However, there are still gaps when it comes to reporting requirements (Stern et al., 2005:12).

From the studies reviewed, it is a prominent fact that there still remains a need to reduce the compliance cost burden from Small businesses to optimise the level of compliance.

Much as a number of strategies exist to encourage Small businesses to comply, SARS remains at a risk of losing out on the majority of the compliant Small businesses if incentives available to Small businesses are not annually reviewed.

CHAPTER 4

CONCLUSION

4.1 INTRODUCTION

The objective of this study was to investigate the reasons for non-compliance by Small businesses relative to the concessions given by the Government in an attempt to encourage compliance with tax laws. The issue of compliance by small businesses, is high on the agenda of the government, both locally and internationally. The aim was not to duplicate what already exists but to identify existing gaps given the consistently high level of non-compliance by this sector. The results of the study will be summarised, findings spelt out and areas of further research highlighted.

4.2 SUMMARY OF FINDINGS

There seems to be more tax concessions in other countries compared with those in South Africa. In South Africa, there seems to be a focus only on changing tax rates applicable to income tax and special depreciation allowances. It is welcomed that SARS also introduced other administration interventions in 2004, following consultations conducted to identify areas of concern by Small businesses. Although this is the case, there does not seem to be follow-ups to track progress on how effective those identified interventions are. On the other hand, it is evident that SARS is putting in more effort in empowering Small businesses, who always had obstacles and challenges related to infrastructure. Now there are toolkits and systems available to Small businesses to ensure that the shortcomings are resolved.

There are Small businesses who see benefits in registering with tax authorities and becoming tax-compliant citizens for the following reasons:

- Small businesses will be compelled to have proper financial records, which can be used for other strategic reasons such as applying for a loan at the bank.
- Small businesses stand a better chance in securing government tenders as the tax certificate is a perquisite before one can be considered for a job.
- Small businesses can take advantage of claims pertaining to input VAT and they can deregister as soon as they no longer are within the defined threshold in terms of the Value Added Tax Act 89 of 1991.
- Small businesses do not want to be seen as fraudsters by SARS, for them, a good name is still crucial for survival.
- Some Small businesses are more privileged than others, either by virtue of their location, e.g. urban areas that have access to technology. They are in the position to access all the publications relating to the PAYE simplified tax processes by SARS.

From all of the above, it is evident that in this sector, further segmentation needs to be done by SARS. It is rather problematic to paint the Small businesses with the same brush as some are more privileged than others.

According to the findings, it is clear that some Small businesses do buy into the campaigns that SARS has embarked upon due to the tax concessions that are made available. However, as noted above, there are still pockets that do not see a reason to change their mind about tax compliance due to several reasons, such as costs involved and how the money is being spent by the SA Government subsequent to the collections. As the South African Government is committed to maintain

economic growth, more effort and resources still need to be invested in the Small businesses sector to change the perception of tax compliance. As long as Small businesses see the tax regime as a deterrent to the growth of their businesses, the experiences of non-compliance will still be the order of the day from a SARS point of view.

It is clear from the results of the study that, subjectivity still exists regarding the definition of a small business. In South Africa, attempts have been made in recent years to refine the definition, as is evident in the new name given to small business for tax purposes, which is small business corporation (SBC). It is also clear that some businesses still prefer to remain in the informal sector and choose not to register with SARS for fear of incurring 'unnecessary costs' or exposing themselves to follow-ups and audits, which might get these businesses into trouble. Similarly, in Australia, refinements of the definition of a small business and revisiting of tax frameworks applicable to this sector regularly receive attention.

SARS refers to refinements as this as simplified tax system regime; in July 2007, this was changed to small business entities regime. Broadly speaking, there is a concerted effort by tax authorities to simplify the tax regime applicable to the small business sector. The question remains: Are these efforts enough in the light of challenges being experienced with non-compliance?

It is also evident that South Africa can still learn from the other countries with regard to priorities or strategies being employed to change the mindset of small businesses and their perceptions about tax. For example, in the United States, priorities will be announced to be introduced in the 2011 tax year pursuant to the global crisis. It is a fact that the small business sector views tax compliance as being counter-productive relative to growing their businesses. Therefore, much needs to be done on a continuous basis to monitor the progress achieved with the interventions already in

place and to identify those still requiring attention. The strategies in the United States referred to above are aimed at restoring prosperity and creation of an economy that works, especially for Small businesses. These are referred to as tax cuts to jumpstart job growth and economic recovery.

4.3 AREAS OF FURTHER RESEARCH

A body of knowledge exists that covers in detail the issues around burdens of taxation endured by Small businesses in South Africa. There is, however, still scope for improvement in the interventions introduced by SARS either to encourage compliance or to raise awareness about taxation.

The following needs to be researched further:

- the effectiveness of the concessions introduced by SARS to assist Small businesses in dealing with burdens associated with taxation;
- the extent to which the technology improvements introduced by SARS benefit or frustrate Small businesses, for example, the e-filing system;
- the effectiveness of campaigns and mentoring programmes introduced by SARS to assist Small businesses;
- costs incurred by SARS to maximise compliance and awareness by Small businesses in comparison with the collections made from the sector – costs vs. benefits analysis;
- the extent to which the packages introduced by SARS get utilised by Small businesses such as the small retailers VAT package, and the PAYE package;
- knowledge by small business owners of how close are services rendered by the Government connected with their paying or non-paying of tax.

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