A COMPARATIVE STUDY OF TAX RELIEF MEASURES FOR SMALL AND MEDIUM ENTERPRISES IN SOUTH AFRICA AND NEW ZEALAND

by

Anika van der Merwe

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Study leader: Mr TL Steyn

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TABLE OF CONTENTS

LIST OF TABLES

LIST OF ABBREVIATIONS

FTE	full-time equivalent
GST	goods and service tax
PAYE	pay-as-you-earn (employees tax)
RIT	residual income tax
SARS	South African Revenue Service
SBC	small business corporation
SDL	skills development levies
SME	small and medium enterprises
STC	secondary tax on companies
UIF	unemployment insurance fund
VAT	value-added tax

ABSTRACT

A COMPARATIVE STUDY OF TAX RELIEF MEASURES FOR SMALL AND MEDIUM ENTERPRISES IN SOUTH AFRICA AND NEW ZEALAND

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Anika van der Merwe

STUDY LEADER : MR TL STEYN
DEPARTMENT : TAXATION
DEGREE : MAGISTER COMMERCII

The Government of South Africa recognised the vital role that small businesses play in stimulating economic activity, creating jobs, alleviating poverty and improving the living standards of all South Africans. Therefore, the South African Revenue Service (SARS) and the National Treasury introduced a number of initiatives to empower small businesses by simplifying tax and creating certain tax relief measures specifically relating to small businesses. The first of these was introduced by the previous Minister of Finance, Trevor Manual, in his 2000 budget speech and related to small business corporations.

In this study, the tax relief measures available to small businesses in South Africa were evaluated followed by the evaluation of the tax relief measures available to small business in New Zealand. Thereafter, the tax relief measures were compared and analysed in order to determine whether the tax relief measures in South Africa are on par with the tax relief measures available in New Zealand.

By analysing the comparative study of the tax relief measures available to small business in South Africa and the tax relief measures available to small business in New Zealand, it was found that the South African Government has come a long way to assist and empower small business in South Africa. Furthermore, it was found that the tax relief

measures available to small business in South Africa are on par and in most instances exceed the tax relief measures available to small business in New Zealand.

The following recommendations were made based on the tax relief measures available in New Zealand:

- small businesses, which have not elected the turnover tax system, should be allowed to account for VAT on the payment basis and
- the R1,5 million threshold for Category F vendors should be increased to allow small businesses to only file VAT returns every four months as opposed to every two months.

As small business will continue to play an important role in creating jobs and wealth in the economy, the South African Government should consider implementing the above-mentioned tax relief measures as this could provide further aid to small businesses, furthermore, the government should assess the tax relief measures on a continuous basis to ensure that these measures stay on par with other countries similar to South Africa.

OPSOMMING

’N VERGELYKENDE STUDIE VAN BELASTINGVERLIGTINGSMAATREËLS VIR KLEIN EN MEDIUM ONDERNEMINGS IN SUID-AFRIKA EN NIEU-SEELAND

deur

Anika van der Merwe

STUDIELEIER	:	MNR TL STEYN
DEPARTEMENT	:	BELASTING
GRAAD	:	MAGISTER COMMERCII

Die Suid-Afrikaanse regering erken die belangrike rol wat klein ondermings in die stimulering van die ekonomie, skepping van werksgeleenthede, verligting van armoede en verbetering van lewenstandaarde van alle Suid-Afrikaners speel. Daarom het die Suid-Afrikaanse Inkomste Diens (SAID) en die Nasional Tesourie ’n aantal maatreëls, wat belastingverligting aan klein ondernemings verleen, geïmplementeer. Die eerste van hierdie maatreëls is deur die vorige Minister van Finansies, Trevor Manual, in sy 2000-begrotingsrede bekend gemaak en was gemik op klein sake-ondernemings.

In hierdie studie word die belastingverligtingsmaatreëls vir klein ondernemings in Suid-Afrika geëvalueer gevolg deur die evaluering van die belastingverligtingsmaatreëls vir klein ondernemings in Nieu-Seeland. Daarna word die belastingverligtingsmaatreëls vergelyk en gronding ontleed om te bepaal of die belastingverligtingsmaatreëls in Suid-Afrika ooreenstem met die belastingverligtingsmaatreëls wat in Nieu-Seeland beskikbaar is.

Deur ontleding van die vergelykende studie van die belastingverligtingsmaatreëls wat in Suid Afrika geld en die belastingverligtingsmaatreëls in Nieu-Seeland is gevind dat die Suid-Afrikaanse regering ver gevorder het om klein ondernemings in Suid-Afrika te ondersteun. Verder is daar gevind dat die belastingverligtingsmaatreëls in Suid-Afrika op

gelyke voet staan met en in die meeste gevalle beter is as die belastingverligtingsmaatreëls wat vir klein ondernemings in Nieu-Seeland geld.

Die volgende aanbevelings, wat gegrond is op die belastingverligtingsmaatreëls wat in Nieu-Seeland geld, word gemaak:

- dat klein ondernemings wat nie vir omsetbelasting geregistreer is nie, vir BTW mag verantwoord volgens die betalingsbasis;
- dat die R1,5 miljoen-drempel vir kategorie F-ondernemers verhoog moet word. Hierdeur sal meer klein ondernemings kwalifiseer om BTW-opgawes slegs elke vier maande in plaas van elke twee maande in te dien.

Aangesien klein ondernemings steeds 'n belangerike rol speel in die skepping van werksgeleenthede en welvaart in die ekonomie kan, behoort die Suid-Afrikaanse regering dit te oorweeg om bogenoemde belastingverligtingsmaatreëls te implementeer sodat dit verdere verligting kan verskaf aan klein ondernemings. Verder behoort die regering die belastingverligtingsmaatreëls op 'n deurlopende grondslag te beoordeel om te verseker dat dit steeds op dieselfde vlak is as die van ander lande soortegelyk aan Suid-Afrika.

CHAPTER 1

INTRODUCTION

1.1 BACKGROUND

"The small business sector can play a major role in creating jobs and wealth in any economy" (Ntsika in Herbst, 2001:104).

Kroon and Moolman (in Herbst, 2001:106) confirm this by giving the following reasons for the importance of small organisations in any country:

- small organisations are multitudinous, suppliers of employment and creators of work opportunities, innovators and initiators, subcontractors for large organisations, responsible for the manifestation of the free market system, in many instances the entry point into the business world, playing an important socio-economic role;
- small organisations can have a multiplying effect on the economy; and
- small organisations provide economic stability and a better distribution of economic activities.

Boone and Kurtz (in Herbst, 2001:108) furthermore, state the following unique advantages of small organisations:

- innovation: small organisations are often the first to offer new products to the market;
- better consumer service: a small organisation can be more flexible than a large organisation, allowing it to tailor its products and services to the exact needs of potential and current customers;
- lower cost: small organisations can often provide products and services at a cheaper price than large organisations. Small organisations usually have lower cost and can earn profits on lower prices; and
- filling of isolated niches: the size of the large organisation can exclude it from some markets. This situation provides substantial opportunities for small organisations with lower overhead costs.

Due to the above-mentioned factors, it is imperative that small and medium enterprises (SMEs) be able to sustain their business in the future. One of the main ways of aiding the sustainability of SMEs is by utilising the available tax relief measures.

This study aims to discuss the tax relief measures available for SMEs. It furthermore draws a comparison between the provisions of the South African Income Tax Act (58/1962) and the provisions of the taxation laws of the New Zealand Income Tax Act (97/2007).

1.2 PROBLEM STATEMENT

The tax compliance burden for SMEs in South Africa has been researched extensively but little research has been conducted on the tax relief measures available to SMEs which may level the playing field with regards to the high tax compliance cost.

These tax relief measures will play an important role to determine the sustainability of a small business, but it is also important that the tax relief measures available should be on par with other countries similar to South Africa.

1.3 PURPOSE STATEMENT

The main purpose of this study is to critically compare the tax relief measures for SMEs in South Africa with the tax relief measures for SMEs in New Zealand and to determine if those of South Africa are on par with the measures available in New Zealand.

1.4 RESEARCH OBJECTIVES

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

- to critically analyse research studies and the literature relating to tax relief measures available for SMEs in South Africa in order to establish the theoretical construct for this study;

- to critically analyse research studies and the literature relating to tax relief measures available for SMEs in New Zealand in order to establish the theoretical construct for this study; and
- to critically compare the tax relief measures of South Africa and New Zealand using the theoretical construct as underpin to determine whether the measures in South Africa are on par with those of New Zealand.

1.5 IMPORTANCE AND BENEFITS OF THE PROPOSED STUDY

SMEs will benefit from this study by the discussion of the tax relief measures available in South Africa. By having knowledge of what these tax relief measures are and implementing them accordingly, SMEs can save time, which can rather be invested into the business. According to Webb (2007:5), additional tax incentives may result in more after-tax profits, which will be retained in the business. The additional retained income can then be applied to future growth of the business or to declare dividends to the shareholders. Arendse, Karlinsky, Killian and Payne (in Smulders 2006:4) furthermore, state that the incentives provided by government to small business may be a way to compensate for the tax compliance cost.

The legislator will further benefit from the study by firstly determining whether the current legislation is on par with other countries similar to South Africa and secondly, by identifying possible areas of improvement, if any, of the current legislation.

1.6 DELINEATION AND LIMITATIONS

Only tax relief measures in terms of the Income Tax Act (58/1962), the Value-Added Tax Act (89/1991) and the Tax Amnesty Act (9/2006) will be evaluated. Therefore any tax relief measures in terms of any other Act will not be investigated.

The purpose of this study will not be to evaluate tax relief measures from the perspective of the SMEs and their opinion regarding these tax relief measures.

Only tax relief measures available for SMEs in South Africa and New Zealand will be evaluated. New Zealand was chosen as a basis for comparison due to the fact that the 350 000 or so SMEs in New Zealand make up more than 99% of all businesses and account for about 60% of employment (New Zealand Centre for SME research, 2010).

1.7 UNDERLYING ASSUMPTIONS

Due to the fact that a literature review will be conducted based on the available literature only, no assumptions are made.

1.8 OVERVIEW OF CHAPTERS

In Chapter 2, a small business from both a South African and New Zealand perspective is defined. Thereafter, the available literature relating to tax relief measures available for SMEs in South Africa and New Zealand is evaluated in Chapters 3 and 4 respectively. A critical comparison of these tax relief measures as well as a detailed analysis of the tax relief measures in South Africa and New Zealand are provided in chapter 5. Chapter 6 concludes on the matters contained in the previous chapters and highlights any additional tax relief measures that may be implemented by the South African Government.

CHAPTER 2

SMALL BUSINESS

2.1 INTRODUCTION

In order to perform the study as set out in the previous chapter, it is important to understand what is meant by small business and what the criteria are to be classified as a small business. In this chapter, the small business definition from a South African as well as a New Zealand perspective will be examined.

2.2 SMALL BUSINESS FROM A SOUTH AFRICAN PERSPECTIVE

The White paper on small business, published by the Department of Trade and Industry, was tabled in Parliament on 20 March 1995, of which the outcome was the National Small Business Act (102/2006). The main objective of this Act is to regulate, stimulate and promote small business activities in South Africa (Herbst, 2001:113).

The National Small Business Act (102/2006) defines a *small business* as: "a separate and distinct business entity, including co-operative enterprises and non-governmental organisations, managed by one owner or more which, including its branches or subsidiaries, if any, is predominantly carried on in any sector or sub-sector of the economy mentioned in column 1 of the Schedule and which can be classified as a micro-, very small, a small or a medium enterprise by satisfying the criteria mentioned in columns 3, 4 and 5 of the Schedule opposite the smallest relevant size or class as mentioned in column 2 of the Schedule."

This definition was later amended in the National Small Business Amendment Act (19/2004). *Small business* was replaced by *small enterprise*, which was defined as: "a separate and distinct business entity together with its branches or subsidiaries, if any, including co-operative enterprises managed by one owner or more predominantly carried on in any sector or sub-sector of the economy mentioned in column 1 of the Schedule and classified as a micro-, very small, a small or a medium enterprise by satisfying the criteria mentioned in columns 3, 4 and 5 of the Schedule."

Thus *small enterprise* can be further classified as a micro, very small, small or medium enterprise depending on whether it complies with the requirements as set out in table 2.1.

Table 2.1: Schedule of the National Small Business Act (102/1996)

Column 1	**Column 2**	**Column 3**	**Column 4**	**Column 5**
Sector or sub-sector in accordance with the standard industrial classification	*Size of class*	*The total full-time equivalent of paid employees*	*Total turnover*	*Total gross asset value (excluding fixed property)*
Agriculture	Medium Small Very small Micro	100 50 10 5	R5m R3m R0,50m R0,20m	R5m R3m R0,50m R0,20m
Mining and quarrying	Medium Small Very small Micro	200 50 20 5	R39m R10m R4m R0,20m	R23m R6m R2m R0,10m
Manufacturing	Medium Small Very small Micro	200 50 20 5	R51m R13m R5m R0,2m	R19m R5m R2m R0,10m
Electricity, gas and water	Medium Small Very small Micro	200 50 20 5	R51m R13m R5,10m R0,20m	R19m R5m R1,9m R0,10m
Construction	Medium Small Very small Micro	200 50 20 5	R26m R6m R3m R0,20m	R5m R1m R0.50m R0,10m

Retail and motor trade and repair services	Medium Small Very small Micro	200 50 20 5	R39m R19m R4m R0,20m	R6m R3m R0.60m R0,10m
Wholesale trade, commercial agents and allied services	Medium Small Very small Micro	200 50 20 5	R64m R32m R6m R0,20m	R10m R5m R0.60m R0,10m
Catering, accommodation and other trade	Medium Small Very small Micro	200 50 20 5	R13m R6m R5,10m R0,20m	R3m R1m R1,90m R0,10m
Transport, storage and communication	Medium Small Very small Micro	200 50 20 5	R26m R13m R3m R0,20m	R6m R3m R0.6m R0,1m
Finance and business service	Medium Small Very small Micro	200 50 20 5	R26m R13m R3m R0,20m	R5m R3m R0.50m R0,10m
Community, social and personal service	Medium Small Very Small Micro	200 50 20 5	R13m R6m R1m R0,20m	R6m R3m R0.60m R0,10m

Source: National Small Business Act (102/2006)

From the above definition it is clear that the following three sets of criteria needs to be taken into account for a business to be classified as a medium, small, very small or micro business:

- full-time equivalent of paid employees;
- total turnover; and
- total gross asset value (excluding fixed property).

2.3 SMALL BUSINESS FROM A NEW ZEALAND PERSPECTIVE

According to the New Zealand Centre for SME research (2010), there is currently no universally accepted definition of a small firm, nor is there an official New Zealand definition. The criteria most commonly used to distinguish between large and small firms are the number of people employed within the firm. SMEs are therefore defined in the following way:

Micro enterprises	Five or fewer full-time equivalents (FTE)
Small enterprises	Six to 49 FTEs
Medium enterprises	50 to 99 FTEs

2.4 CONCLUSION

It is clear that the only common factor in the South African and New Zealand definitions whether a business will classify as a micro, small or medium entity is the number of full-time employees employed by that business. The South African definition is more extended and also takes into account turnover and asset value.

In the next two chapters, the tax relief measures available to small business in South African and New Zealand will be discussed. Furthermore, it will also be evaluated whether the tax relief measures available for small business will be automatically obtained if a business complies with the definition of a small business as discussed in this chapter.

CHAPTER 3

TAX RELIEF MEASURES AVAILABLE FOR SMALL BUSINESSES IN SOUTH AFRICA

3.1 INTRODUCTION

The Government of South Africa recognised the vital role that small businesses play in stimulating economic activity, creating jobs, alleviating poverty and improving the living standards of all South Africans. The South African Revenue Service (SARS) and the National Treasury have therefore introduced a number of initiatives to empower small businesses by simplifying tax and company administrative matters (SARS in Webb 2007:5).

This chapter will focus on the tax relief measures that are available to small business corporations (SBC) exclusively. Furthermore, it will focus on the tax relief measures available to all small businesses in South Africa as well as the specific tax relief measures available relating to assets and lastly, this chapter will discuss the tax amnesty that is available to small business.

3.2 TAX RELIEF MEASURES AVAILABLE FOR SBCS

3.2.1 Qualification as an SBC

A *small business corporation* is defined in Section 12E(4) of the Income Tax Act as follows:
"any close corporation, co-operative or any company registered as a private company in terms of the Companies Act, 1973 (Act No 61 of 1973), all the shareholders of which are at all times during the year of assessment natural persons, where –

a) the gross income for the year of assessment does not exceed an amount of equal to R14 million: Provided that where the close corporation or company during the relevant year of assessment carries on any trade, for purposes of which any asset contemplated in this Section is used, for a period of which is less than 12 months, that amount shall be reduced to an amount which bears to that amount, the same ratio as the number of months (in the determination of which part of a month shall be reckoned as a full month), during which that company or close corporation carried on that trade bears to 12 months;

b) none of the shareholders or members at any time during the year of assessment of the company, close corporation or co-operative holds any shares or has any interest in the equity of any other company as defined in Section 1, other than

   i. a company contemplated in paragraph (a) of the definition of “listed company”;
   ii. any portfolio in a collective investment scheme contemplated in paragraph (e) of the definition “company”;
   iii. a company contemplated in Section 10(1)(e)(i), (ii) or (iii);
   iv. less than 5 per cent of the interest in a social or consumer co-operative or a co-operative burial society as defined in Section 1 of the Co-operatives Act, 2005 (Act No 14 of 2005), or any other similar co-operative if all the income derived from the trade of that co-operative during any year of assessment is solely derived from its members;
   v. any friendly society as defined in Section 1 of the Friendly Societies Act, 1956 (Act No 25 of 1965);
   vi. less than 5 per cent of the interest in a primary savings co-operative bank or a primary savings and loans co-operative bank as defined in the Co-operatives Banks Act, 2007, that may provide, participate in or undertake only the following –
      1. in the case of a primary savings co-operative bank, banking services contemplated in Section 14(a)(a) to (d) of that Act; and
      2. in the case of a primary savings and loans co-operative bank, banking services contemplated in Section 14(2)(a) or (b) of that Act; or
   vii. a venture capital company as defined in Section 12J;
   viii. any company, close corporation or co-operative of the company, close corporation or co-operative –
      1. has not during any year of assessment carried on any trade; and
      2. has not during any year of assessment owned assets, the total market value of which exceeds R5 000;

c) not more than 20 per cent of the total of all receipts and accruals (other that those of a capital nature) and all the capital gains of the company, close corporation or co-operative consist collectively of investment income and income from the rendering of a personal service; and

d) such company is not a personal service provider as defined in the Fourth Schedule."

The requirements that have to be met to qualify as an SBC are explained in Interpretation Note, No. 9, and are summarised below. It is important to note that all these requirements must be met in order for a company to qualify as an SBC.

3.2.1.1 Company, co-operative or close corporation

SARS (2007:3) states that an SBC is limited to a private company, a co-operative or a close corporation. Webb (2007:7) therefore emphasises that public companies, trusts, individuals, partnerships and companies registered in terms of foreign legislation will therefore not be regarded as SBCs:

3.2.1.2 Shareholding

All the shareholding or members' interest of an SBC must be held by natural persons at all times during the relevant year of assessment. Thus according to SARS (2007:3), if part of the shares were held by a trust or another company, the small business will not qualify as an SBC.

3.2.1.3 Gross income

The SBCs gross income may not exceed R14 million during the year of assessment (12 months). Where the company did not trade for a period of 12 months, the R14 million must be reduced proportionately in order to determine whether the gross income received/accrued would have exceeded R14 million (SARS, 2007:4).

Gross income is defined in Section 1 of the Income Tax Act as all amounts received or accrued by the person during the year of assessment, which are not of a capital nature.

3.2.1.4 Limitations on shareholders

The shareholders, who must all be natural persons, may not at any time during the year of assessment hold shares or have any interest in the equity of another company. Even if they hold shares for just one day, the company will not qualify as an SBC.

Excluded from the above limitation are shares or interest held in:

- a listed company;
- any portfolio in a collective investment scheme;
- a company listed in Section 10(1)(e)(i), (ii) or (iii), which is:
  - a body corporate
  - a share block company
  - any other association of persons (excluding companies, co-operatives, close corporations and trusts, but including companies incorporated under Section 21 of the Companies Act (61/1973));
- any friendly society; and
- co-operatives registered as a social co-operative, a consumer co-operative or a co-operative burial society, but only if all the income is solely derived from its members (SARS, 2007:5).

3.2.1.5 Limitations on investment income and income from rendering a personal service

The aggregate income from investments and personal service should not exceed 20% of the company's total receipts or accruals (SARS, 2007:7).

Investment income is defined in Section 12E of the Income Tax Act and includes income derived from dividends, royalties, rental in respect of immovable properties, annuities, Section 24J interest, any amount contemplated in Section 24K and any other income subject to the same treatment as income from money lent.

Personal service is also defined in Section 12E of the Income Tax as any service in the field of accounting, actuarial science, architecture, auctioneering, auditing, broadcasting, broking, commercial arts, consulting, draftsmanship, education, engineering, entertainment, health, information technology, journalism, law, management, performing arts, real estate, research, secretarial service, sport, surveying, translation, valuation or veterinary science,

a) which is performed personally by any person who holds an interest in that SBC; and
b) the SBC does not employ three or more full-time employees (other than connected persons) who are on a full-time basis engaged in the business of the SBC.

Thus if all the other provisions are met, a company primarily engaged in the providing of a personal service will be able to qualify as an SBC if the company, throughout the year of assessment, employs three or more full-time employees who are on a full-time basis engaged in the business of that company (SARS, 2007:7).

3.2.1.6 The company may not be a personal service provider

Personal service provider is defined in Paragraph 1 of the Fourth Schedule of the Income Tax Act and means any company where the services rendered on behalf of that company are rendered personally by a person who is a connected person to the company and

- the person would be regarded as an employee of the client if the services were rendered directly to the client;
- the duties of the person must be performed mainly at the premises of the client and the person is subject to the control or supervision of the client; or
- more than 80% of the income of the company is directly or indirectly received from one client.

Even though the above conditions are met, a company would not be seen as a personal service provider where the company employs three or more full-time employees. The employees may not be the shareholders of the company or connected persons in relation to the shareholder and the employees must be engaged in the business of the company on a full-time basis.

3.2.2 Deductions available for SBCs

The deductions available for small business corporations are set out in Section 12E of the Income Tax Act and are:

- assets used directly in the process of manufacturing;
- other assets; and
- tax rates.

3.2.2.1 Assets used directly in the process of manufacturing

The cost of plant and machinery, which is either owned by the taxpayer or which is acquired by the taxpayer in terms of an "instalment credit agreement" as defined in Section 1 of the Value-Added Tax Act, can be written off in full in the year that the asset was brought into use.

3.2.2.2 Other assets of an SBC

If these assets were acquired under an agreement formally and finally signed by every party to the agreement on or after 1 April 2005, the SBC would be entitled to an accelerated write-off period. The write-off period will stretch over three years and the SBC can write-off 50% of the cost of the asset in Year 1, 30% of the cost of the asset in Year 2 and 20% of the cost of the asset in Year 3.

It is important to note that the accelerated write-off period will only be available for assets which would have qualified to be written off in terms of Section 11(e), 12B or 12C of the Act.

The cost of an asset shall be deemed to be the lesser of:

- actual cost to acquire the asset;
- the direct acquisition cost a person would have incurred if the asset was acquired under an arm's length cash transaction on the date on which the transaction was concluded; or
- the actual cost less any recoupments in terms of Section 8(4)(e).

The above cost excludes interest and finance charges, but includes the direct cost of installation or erection of the asset. The above deductions will not be available where the taxpayer acquired the asset for no consideration, for example, by means of donation, inheritance or as a dividend in specie. In this case, the taxpayer would be allowed a wear and tear allowance based on the value of the asset in terms of Section 11(e) (SARS, 2007:14).

3.2.2.3 Tax rates for qualifying SBC

In terms of schedule 1 of the Small Business Tax Amnesty and Amendment of Taxation Law Act (9/2006), the tax payable on taxable income for qualifying SBCs will be calculated as follows:

- 0% on the first R40 000;
- 10% where the taxable income exceeds R40 000 but does not exceed R300 000; and
- 29% where the taxable income exceeds R300 000.

The above provisions have been amended in the Taxation Laws Amendment Act (17/2009) in respect of any year of assessment ending on 31 March 2010:

- 0% on the first R54 200;
- 10% where the taxable income exceeds R54 200 but does not exceed R300 000; and
- 28% where the taxable income exceeds R300 000.

3.3 TAX RELIEF MEASURES AVAILABLE FOR ALL SMALL BUSINESSES IN SOUTH AFRICA

The following tax relief measures are available for all small businesses in South Africa:

3.3.1 Capital gains

The disposal of small business assets is dealt with in Paragraph 57 of the Eighth Schedule of the Income Tax Act. According to the provisions of this paragraph a natural person my disregard R750 000 of the capital gain made where he/she disposed of an “active business asset” of a “small business” owned by him.

Active business asset is defined in Paragraph 57 of the Eighth Schedule of the Income Tax Act as any asset (movable or immovable) used for business purposes but excluding financial instruments and assets held mainly to derive income in the form of annuity, rental income, foreign exchange gains or royalty or income of a similar nature.

Small business is also defined in Paragraph 57 of the Eighth Schedule of the Income Tax Act as a business of which the market value of all assets do not exceed R5 million. In the case of owning more than one small business the total market value of all assets of all those businesses combined may not exceed R5 million, otherwise the provisions of this paragraph will not apply (Paragraph 57(6)).

The disposal of micro business assets is dealt with in Paragraph 57A of the Eighth Schedule of the Income Tax Act. In terms of this paragraph, a registered micro business must disregard any capital gain or loss made on the disposal of any asset (movable or immovable) that was used for business purposes.

3.3.2 Turnover tax

Turnover tax is an elective tax, which is incorporated in the Sixth Schedule of the Income Tax Act and is applicable for all years of assessment commencing on or after 1 March 2009. The incorporation was proposed in the 2008 budget review and is a way to reduce the tax compliance burden for micro businesses (Stiglingh, 2009:692).

This system entails a package where income tax, capital gains tax and secondary tax on companies are substituted with one tax called turnover tax (SARS, 2010:4).

Only persons that qualify as micro businesses may elect the turnover tax system. According to Paragraph 2 of the Sixth Schedule of the Income Tax Act, a person (natural person or company) will qualify as a micro business if the qualifying turnover of that person does not exceed R1 million in the year of assessment. If the person carried on a business for less than 12 months, the R1 million is reduced proportionately taking into account the number of full months the person did not carry on a business.

Qualifying turnover is defined in Paragraph 1 of the Sixth Schedule of the Income Tax Act as the total receipts from carrying on a business but excludes any amounts of a capital nature and amounts which are exempt from normal tax in terms of Section 10(a)(y), (zA), (zG) and (zH).

According to SARS (2010:9), a person who is a “personal service provider” or a “labour broker” and who does not have an exemption certificate from SARS is disqualified from being a micro business.

3.3.2.1 Benefits available for persons who have elected the turnover tax system

The following benefits are available for persons who have elected the turnover tax system:

Calculation of taxable turnover

Turnover tax will be calculated on the taxable turnover (receipts) of a micro business, which includes:

- 50% of all receipts of a capital nature from the disposal of immovable property and any other assets used for business purposes;
- investment income other than dividends (in the case of a company); and
- allowances claimed in a previous year that are required to be included in the following year, but only if the micro business became a registered micro business during the year of assessment (Paragraph 6 of the Sixth Schedule of the Income Tax Act).

The following are, however, excluded from taxable turnover:

- investment income (in the case of a natural person);
- amounts exempt from normal tax in terms of Section 10(a)(y), (zA), (zG) and (zH); and
- amounts received by the micro business, which accrued to it prior to registration and which amounts were subject to normal income tax (Paragraph 7 of the Sixth Schedule of the Income Tax Act).

Tax rates applicable to registered micro businesses

Tax rates for registered micro businesses are set out in the Taxation Laws Amendment Act (17/ 2009) and are as follows:

- 0% on the first R100 000;
- 1% where the taxable turnover exceeds R100 000 but does not exceed R300 000;

- R2 000 plus 3% where the taxable turnover exceeds R300 000 but does not exceed R500 000;
- R8 000 plus 5% where the taxable turnover exceeds R500 000 but does not exceed R750 000; and
- R20 500 plus 7% where the taxable turnover exceeds R750 000 up to R1 million.

Capital gains tax

SARS (2010:11) states that 50% of the amounts received from the disposal of business assets will be included in taxable turnover and a micro business that have elected the turnover tax system will furthermore be exempt from capital gains tax.

Dividend distribution

Companies will be exempt from secondary tax on companies (STC) to the extent that the dividend distribution does not exceed R200 000 in a year. Any excess will be subject to STC (SARS, 2010:11).

Value-added tax

The compulsory VAT registration threshold was increased from R300 000 to R1 million effective from 1 March 2009. Micro businesses that register for turnover tax are not permitted to register for VAT.

If a small business is registered for VAT and wishes to register for turnover tax, it will have to deregister for VAT. But according to the Value-Added Tax Act this will be a deemed disposal in terms of Section 8(2) and the small business will have to pay output VAT on the lesser of the cost or market value of all assets held immediately before deregistration.

However, the micro business will be allowed to pay the output VAT over a period of six months. Furthermore, it will also receive a deduction of R100 000 from the value of the assets held immediately prior to registration (SARS, 2010:5).

3.3.3 Value-added tax

In terms of Section 23 of the Value-Added Tax Act a person becomes liable to register for VAT if his/her taxable supplies in a 12-month period exceed or are likely to exceed R1 million. Furthermore, a person may voluntarily register for VAT, if his/her taxable supplies exceed or are likely to exceed R50 000 in a 12-month period, except if he/she has chosen to register for turnover tax.

In terms of Section 27 of the Value Added Tax Act, where the taxable supplies of a vendor do not exceed R1,5 million in a 12-month period, the vendor may apply to be classified as a Category F vendor and if granted, only needs to file VAT returns every four months.

In April 2005, a small retailers VAT package was launched. This was designed to decrease the compliance and cash flow burden on small retailers. The small retailers VAT package was applicable to businesses with a turnover of less than R1 million per year (Webb, 2007:13). This package was, however, withdrawn in 2010 due to the implementation of turnover tax.

3.4 TAX RELIEF MEASURES RELATING TO ASSETS

3.4.1 Write-off of small assets

The cost of small items may be written off in full in the year in which it had been acquired and brought into use. A small item is an item which can function on its own (does not form part of a set) and of which the cost is less that R7 000. The R7 000 threshold applies to any asset acquired on or after 1 March 2009, before this date the threshold was R5 000.

It is also important to note that this immediate write-off is not available to persons who acquired the assets for the purpose of letting. If this is the case, the asset must be written off over its useful life (SARS, 2009:14).

3.4.2 Asset-for-share transactions

De Swardt (2009:448) defines *asset-for-share transactions* as transactions where a person disposes of an asset to a South African resident company in exchange for shares in that company.

The asset which is disposed of may not constitute a restraint of trade or personal goodwill. If the asset is a capital asset, the market value must be equal to or exceeds the base cost, but if the asset is trading stock, the market value must be equal to or exceeds the cost price or net realisable value.

The person who disposes of the asset must hold a qualifying interest in the company, to whom the asset is disposed to, at the close of the day on which the asset is disposed of or the person must be a natural person who will be engaged on a full-time basis in the business of the company of rendering a service.

Qualifying interest is defined in Section 42 of the Income Tax Act as:

a) "an equity share held by that person in a company which is a listed company or will become a listed company within 12 months after the transaction as a result of which that person holds the share;
b) an equity share held by that person in a portfolio of a collective investment scheme in securities;
c) equity shares held by that person in a company that constitutes al least 20 per cent of the equity shares and voting rights of a company; or
d) an equity share held by that person in a company which forms part of the same group of companies as that person."

The company that acquires the asset must acquire the asset as:

- trading stock, if the person who disposed of it held it as trading stock;
- a capital asset, if the person who disposed of it held it as a capital asset; or

- trading stock, if the person who disposed of it held it as a capital asset and the company and the person do not form part of the same group of companies.

The disposal of a capital asset will lead to capital gains tax implications and the disposal of trading stock will lead to income tax implications. The following relief measures are available if the transaction qualifies as an asset-for-share transaction.

3.4.2.1 Relief for the person who disposed of the asset

If the asset is a capital asset the person is deemed to have disposed of the asset for an amount equal to the base cost of the asset. Therefore, no capital gains tax implications will arise on the disposal of the capital asset. The person is also deemed to have acquired the equity shares in the company on the date that the person acquired the capital asset that was disposed of and the person is further deemed to have acquired the equity shares at a cost equal to any expenditure incurred in respect of the capital asset (De Swardt, 2009:449).

If the asset is trading stock, the person is deemed to have disposed of the asset for an amount equal to the cost of the trading stock. Therefore, no income tax implications will arise on the disposal of the trading stock. The person is deemed to have acquired the equity shares in the company on the date that the person acquired the trading stock that was disposed of and the person is further deemed to have acquired the equity shares at a cost equal to the cost price or net realisable value of the trading stock (De Swardt, 2009:450).

3.4.2.2 Relief for the company that acquired the asset

According to De Swardt (2009:450), if the asset is acquired by the company as a capital asset and the person who disposed of the asset held the asset as a capital asset, the company and the person is deemed to be one and the same person in respect of the acquisition date of the asset, the amount and date of incurral of any expenses and the valuation date value of the asset.

However, if the asset is acquired by the company as a trading stock and the person who disposed of the asset held the asset as trading stock, the company and the person is deemed to be one and the same person in respect of the acquisition date of the asset and the amount and date of incurral of any expenses.

De Swardt (2009:451) furthermore, states that if the asset is acquired by the company as trading stock and the person who disposed of the asset held the asset as a capital asset, the company and the person is deemed to be one and the same person in respect of the acquisition date of the asset, the amount and date of incurral of any expenses and the valuation date value of the asset.

The relief measures described above in effect defer the tax consequences to a later stage when the company, in turn, disposes of these assets. These tax relief measures can be utilised where a sole trader forms a company and then disposes of all the assets used by him/her to the company in exchange for equity shares in that company, provided that he/she will be engaged on a full-time basis in the business of the company rendering a service.

3.5 TAX AMNESTY

The Small Business Tax Amnesty and Amendment of Taxation Laws Act (9/2006) was promulgated on 25 July 2006. This Act provides specific relief relating to income tax, pay-as-you-earn (PAYE), value-added tax (VAT), STC, unemployment insurance fund (UIF), skills development levy (SDL), withholding tax on royalties as well as any additional tax, penalty or interest payable to the extent that it relates to one of the above taxes for years of assessment preceding 2006 (Webb, 2007:15). In terms of this Act, the above taxes will not be payable but instead a tax amnesty levy will be payable, which was calculated as follows:

- 0% of the taxable income which does not exceed R35 000;
- 2% of the taxable income exceeding R35 000 but not exceeding R100 000;
- 3% of the taxable income exceeding R100 000 but not exceeding R250 000;
- 4% of the taxable income exceeding R250 000 but not exceeding R500 000; and
- 5% of the taxable income exceeding R500 000.

In calculating the amount of the levy, any balance of assessed loss or assessed capital loss, which was carried forward from years of assessment preceding the 2006 year of assessment, should be disregarded (Section 6 of the Small Business Tax Amnesty and Amendment of Taxation Laws Act).

A person had to submit an application form in order to qualify for the tax amnesty. The period for submitting this form commenced on 1 August 2006 and ended on 31 May 2007 (Section 3 of the Small Business Tax Amnesty and Amendment of Taxation Laws Act). This period was later extended to 30 June 2007 and applicants had until 31 August 2007 to submit the application (Webb, 2007:16).

According to Section 2 of the Small Business Tax Amnesty and Amendment of Taxation Laws Act, the following persons were able to apply for the tax amnesty:

- a natural person (including a deceased or insolvent estate);
- an unlisted company or close corporation where all the shares or members' interest were directly held by natural persons, throughout the qualifying period;
- a trust of which all the beneficiaries were a natural person, throughout the qualifying period, and
- a person whose gross income for the 2006 year of assessment did not exceed R10 million.

Qualifying period is defined in Section 1 of the Small Business Tax Amnesty and Amendment of Taxation Laws Act as follows:

a) with regard to income tax, any year of assessment preceding the 2006 year of assessment;

b) with regard to STC, any dividend cycle which ends in any year of assessment preceding the 2006 year of assessment; and

c) with regard to withholding tax on royalties and any other tax, levy or contribution, the period ending on or before 28 February 2006.

Section 10 of the Small Business Tax Amnesty and Amendment of Taxation Laws Act, however states that the tax amnesty was not available in the following circumstances:

- if before submission of the application the tax had already been paid;
- if the tax was payable in terms of a return submitted to SARS before submission of the application;
- if the tax was payable in terms of an assessment issued before submission of the application; or
- if the tax relates to VAT which was not paid as a result of false declaration of the acquisition, import or export of goods or services that did not actually occur.

3.6 CONCLUSION

Due to the vast number of tax relief measures available to small businesses in South Africa it is clear that the government is committed to assist SMEs to sustain their business in the future.

The next chapter will discuss the tax relief measures available to SMEs in New Zealand.

CHAPTER 4

TAX RELIEF MEASURES AVAILABLE FOR SMALL BUSINESSES IN NEW ZEALAND

4.1 INTRODUCTION

In August 2005, the New Zealand Inland Revenue established a small and medium enterprise team to strengthen relationships with the business community, other government departments and related stakeholders in the SME sector (Inland Revenue, 2006a). Policy measures were also implemented to simplify tax for small and medium enterprises (Inland Revenue, 2006b).

This chapter will discuss the tax relief measures as set out in the small business tax relief package. Furthermore, it will also discuss the specific tax relief measures available relating to assets. Lastly, this chapter will discuss the tax relief measures which were proposed by the New Zealand Institute of Chartered Accountants and Tax Management New Zealand.

4.2 SMALL BUSINESS TAX RELIEF PACKAGE

The Taxation (Business Tax Measures) Bill was introduced in Parliament on 10 February 2009 and passed through its final stages on 26 March 2009. This legislation introduced new tax rules, which were aimed at improving the business environment for small and medium enterprises. This legislation is referred to as the small business tax relief package. The Taxation (Business Tax Measures) Act 2009 amends the Income Tax Act (97/ 2007) and the Goods and Services Tax Act (141/1985) and took effect on 1 April 2009 (Inland Revenue, 2009b).

4.2.1 Amendments to the Income Tax Act (97/2007)

4.2.1.1 Legal expenses

As in South Africa, under the current New Zealand Income Tax Act, a person is allowed as a deduction expenditure or losses incurred by him/her in producing assessable income, but excluding expenditure or losses which are of a capital nature (Sections DA 1(1) and DA 2(1) of the Income Tax Act). A new section, Section DB 62 relating to legal expenditure was added to the Income Tax Act. According to this new section, if the legal expenses do not exceed NZ$10 000 per year, the business is allowed an immediate tax deduction without having to distinguish between revenue and capital (Inland Revenue, 2009a). A definition of *legal expenses* was also introduced in Section YA 1 of the Income Tax Act. *Legal expenses* are defined as fees for legal services provided by members of the New Zealand Law Society or an Australian equivalent.

4.2.1.2 Trading stock

In terms of Section EB 3 of the Income Tax Act a business must determine the value of its trading stock at the end of each financial year-end under one of the following methods, as set out in Section EB 4 of the Income Tax Act:

- cost;
- discounted selling price;
- replacement price; or
- market selling price.

However, in terms of Section EB 23 of the Income Tax Act if a person has a turnover of NZ$1,3 million or less during the year of assessment and he/she can reasonably estimate that the value of his/her closing stock is less than NZ$5 000, he/she may use the opening value of his/her trading stock as the value of his/her closing stock. The opening value of trading stock will usually be the cost of acquisition or manufacture. The new amendments increased the threshold from NZ$5 000 to NZ$10 000 (Inland Revenue, 2009a).

4.2.1.3 PAYE payments

According to Section RD 4 of the Income Tax Act, PAYE must be paid over to Inland Revenue twice a month where the prior year total PAYE deductions for all employees are NZ$100 000 or more and once a month where the prior year total PAYE deductions for all employees are less than NZ$100 000. In terms of the new amendments, the NZ$100 000 threshold was raised to NZ$500 000 (Inland Revenue, 2009a).

4.2.1.4 Fringe benefits

When an employer provides a benefit to an employee in connection with his/her employment, the employer is liable to pay fringe benefit tax (Section RD 26 of the Income Tax Act). Where the total prior year PAYE deducted for all employees is NZ$100 000 or more, an employer providing fringe benefits to an employee must account and pay fringe benefit tax on a quarterly basis, but where the total PAYE is less than NZ$100 000, the employer can elect to pay fringe benefit tax annually. The NZ$100 000 threshold was increased to NZ$500 000 with the new amendment (Inland Revenue, 2009a).

In terms of Section RD 45 of the Income Tax Act, unclassified benefits are, however, exempt from fringe benefit tax if:

- the total taxable value of all unclassified benefits to the employee does not exceed NZ$800; or
- the total taxable value of all unclassified benefits to all employees does not exceed NZ$15 000.

Again these thresholds were increased to NZ$1 200 and NZ$22 500 respectively with the new act amendments (Inland Revenue, 2009a).

An unclassified benefit is defined in Section CX 37 of the Income Tax Act as a benefit provided by an employer to an employee in connection with his/her employment but which is not dealt with specifically in this Act.

The fringe benefits dealt with specifically in this Act are:

- private use of a motor vehicle;
- right to use a vehicle;
- subsidised transport;
- employment-related loans;
- contributions to superannuation schemes;
- contributions to sickness, accident or death benefit funds;
- contributions to funeral trusts; and
- contributions to life or health insurances.

4.2.1.5 Provisional tax

Sections RZ 3 and RZ 5 of the Income Tax Act were amended to reduce the standard method uplift for the calculation of the provisional tax liability for the 2008/2009 and 2009/2010 income years.

One of the standard methods of calculating provisional tax is by basing it on taxpayers' residual income tax (RIT) from prior years, specifically by assuming that it is either:

- 105% of the previous year's RIT; or
- 110% of the next preceding year's RIT (for taxpayers that have not yet furnished their previous year's income tax return).

Residual income tax is defined in Section YA 1 of the Income Tax Act as the positive amount that remains after subtracting from the person's income tax liability for the tax year any tax credits available to that person under the provisions of this Act.

The new rules reduced the "uplift" rate to reflect the likelihood of reduced profits as a result of the economic downturn. Accordingly, for remaining provisional tax payments due for the 2008/2009 and 2009/2010 years of assessment, the 105% and 110% uplift rates were temporarily reduced to 100% and 105% respectively.

In addition, 30% tax rate taxpayers (e.g. companies) were previously allowed to use uplift ratios of 95% or 100% (as a result of relief provided following the lowering of the company tax rate from 33% to 30%). The rules now allow such entities to use new uplift ratios of 90% or 95% (instead of 95% or 100%) for remaining provisional tax payments due for the 2008/2009 and 2009/2010 years of assessment when the higher 33% rate is used as the base year.

These changes will reduce the size of taxpayers' provisional tax payments, giving them greater cash flows over the next two years (as a result of lower provisional tax payments). The standard uplift rates of 105% and 110% will apply again from the 2010/2011 income years (Inland Revenue, 2009a).

4.2.2 Amendments to the Goods and Services Tax Act (141/1985)

In terms of Section 15 of the Goods and Services Tax Act (141/1985) where a person’s taxable supplies do not exceed or are not likely to exceed NZ$250 000 in a 12-month period, GST returns need to be filed every six months, otherwise GST returns need to be filed every second month. With the new amendments to the Act, the NZ$250 000 threshold was increased to NZ$500 000.

Section 19A of the Goods and Services Tax Act was also amended to raise the threshold below which GST may be accounted for on a payment basis from NZ$1.3 million to NZ$2 million of taxable supplies in a 12-month period.

This change will allow more taxpayers to account for GST on a payment basis and may assist cash flows as GST only need to be accounted for on the receipt of funds rather than upon issue of an invoice.

Furthermore, Section 51 of the Goods and Services Act was amended to raise the compulsory GST registration threshold from NZ$40 000 to NZ$60 000 of taxable supplies in a 12-month period.

This change means those under the threshold can opt out of the GST system, resulting in lower GST compliance costs and fewer cash management problems associated with making GST payments (Inland Revenue, 2009a).

4.2.3 Other amendments

The reduction in the use of money interest underpayment rate is probably the most welcome change. The interest penalty for underpayment of taxes was reduced from 14.24% to 9.73% with effect from 1 March 2009. The downside of this is that the interest rate for overpayment decreased from 6.66% to 4.23% (Pippos, 2009:2).

4.3 TAX RELIEF MEASURES RELATING TO ASSETS

4.3.1 Write-off of low-value assets

According to Inland Revenue (2004), the cost of low-value assets may be written off in full in the year in which it had been acquired. A *low-value asset* is an asset of which the cost is less than NZ$500. The NZ$500 applies to any asset acquired on or after 19 May 2005, before this the threshold was NZ$200. The above write-off will not be applicable to assets that are purchased from the same supplier at the same time as other assets to which the same depreciation rate applies or if the asset will become part of an asset that is depreciable.

4.4 PROPOSALS

Under the current New Zealand Income Tax Act there are no specific relief measures that relates to SMEs, but similar to South Africa, the tax compliance cost for SMEs is very high.

The New Zealand Institute of Chartered Accountants and Tax Management New Zealand (2009:6-12) recently published a paper in which they propose a tax system that may reduce the tax compliance burden for SMEs. This proposal deals with micro business taxation and small business taxation and is discussed in detail below.

4.4.1 Micro business taxation

A *micro business* is defined as a business or activity that employs no staff and has a turnover that does not exceed NZ$60 000 in a 12-month period. This turnover will, however, not include income received by way of rental or interest.

To avoid excluding people from these rules when their income fluctuates, it is also proposed to allow businesses a safe harbour of 40% of this figure. This would allow a business to remain in the micro business net until its turnover exceeds NZ$84 000. Thus the idea would be that a business could not enter the micro business rules if its annual income exceeds NZ$60 000 in a 12-month period, but if it is already in the system, it could remain there until its turnover exceeds NZ$84 000.

Under this proposal, if the entity elects the adoption of the micro business rules, it will pay a final tax of 15% on its turnover on a monthly basis. The reasoning behind the lower rate is the fact that businesses would otherwise have been entitled to claim certain tax deductions for business expenses, which would now fall away.

One of the transitional issues highlighted in this paper is the fact that people may be worried about income earned in previous years that they have not declared. Therefore, it is proposed that if Inland Revenue has not previously identified undeclared income to which the business activity relates, Inland Revenue will statutorily be prevented from investigating the prior year's income from these sources. The possibility exists that without this amnesty available to taxpayers they will be discouraged from entering the tax system. It is recommended that this transitional rule be available for a period of 12 months.

The introduction of a simplified tax system will lessen the compliance and record-keeping burden for the micro business, but will also benefit Inland Revenue in the sense that audits will be more straightforward and will take less time as Inland Revenue now only has to audit income.

4.4.2 Small business taxation

A *small business* is defined as a business with a turnover of less than NZ$1.2 million in a 12-month period.

As with the micro business taxation proposal, to avoid excluding people from these rules when their income fluctuates, it is also proposed to allow businesses a safe harbour of 40% of this figure. This would allow businesses to remain in the small business taxation net until their turnover exceeds NZ$1.68 million.

There are three main streams to this proposal:

- introduction of a cash basis of accounting for income tax and margining the GST and income tax calculations so they are undertaken on the same forms, at the same time, using the same timing rules;
- for companies, the taxation of the company and the shareholders will be merged by levying tax on the company earnings a tax rate that is equivalent to that faced by the shareholders; and
- eliminating fringe benefit tax and replacing this with private use adjustments.

4.4.2.1 Cash basis of accounting for income tax and margining the GST and income tax

In terms of Section BD 3(3) of the Income Tax Act, income should be recognised either on an accrual basis or on a cash basis, depending on the relevant case law. However, by permitting small businesses to recognise their revenue on a cash basis, income will be represented by cash inflows and therefore the business will have the ability to meet its obligations as they arise. This also means that if a small company follows the GST payment basis, where GST is accounted for on the receipt of funds rather than on the issuing of an invoice, the income tax and GST calculations can be merged.

By merging the two calculations, provisional tax would fall away and it would be replaced by actual tax payments every two months. It would also allow for GST and income tax offsets.

4.4.2.2 Merging the taxation of shareholders and their company

Companies currently pay tax at a rate of 30%, but any income that the company distributes by way of a salary or dividends to a natural person who is an owner of the company is taxed at the personal tax rate of that owner/shareholder, which comes to 38% of income received in excess of NZ$70 000. This leads to the company spending money and time on restructuring payments to shareholders in order to obtain the lower tax rate benefit. However, this restructuring also leads to an increase in compliance cost as well as attracting attention from Inland Revenue as these types of arrangements are an audit risk for Inland Revenue.

It is therefore proposed to merge the taxation of shareholders and their companies, in cases where a natural person hold all the shares, by taxing the company similarly to that of a natural person. The current tax rates that apply to individuals are as follows:

- 12.5% up to NZ$14 000;
- 21% up to NZ$48 000;
- 33% up to NZ$70 000; and
- 38% thereafter.

The benefit of this proposal will be the reduction in restructuring and compliance cost as well as opportunity cost that is lost when a business owner spends time on tax compliance as opposed to the business itself. Another benefit created by this is the fact that sole traders can now become incorporated yet remain taxed similar to a sole trader.

The question does, however, arise what will happen in the case where there are two shareholders. If the above rates were applied, the company would be overtaxed as currently the income is spread between two shareholders. In cases like these, it is proposed that the company be taxed as follows:

- 12.5% up to NZ$28 000;
- 21% up to NZ$96 000;
- 33% up to NZ$140 000; and
- 38% thereafter.

The proposal does not deal with situations where there are more than two shareholders.

4.4.2.3 Eliminating fringe benefit tax

Currently, the employer is responsible for paying fringe benefit tax on any benefits provided to employees, but together with this the employer is also allowed to deduct the cost of this benefit. By merging the taxation of the company and the shareholder, fringe benefit tax is replaced by non-deductible adjustments, meaning that cost of the benefit will be denied as a deduction.

4.5 CONCLUSION

With the implementation of the Small Business Tax Relief Package and the proposals by the New Zealand Institute of Chartered Accountants and Tax Management New Zealand, it is clear that New Zealand is moving towards a system of reducing the tax compliance load on small and medium-sized entities.

The next chapter will aim to draw a comparison and critically analyse the tax relief measures discussed in the previous two chapters.

CHAPTER 5

COMPARISON OF THE TAX RELIEF MEASURES AVAILABLE FOR SMALL BUSINESSES IN SOUTH AFRICA AND NEW ZEALAND

5.1 INTRODUCTION

The tax relief measures available for SMEs in South Africa and New Zealand were discussed in the previous two chapters. In this chapter, a comparison will be drawn between the tax relief measures available in these two countries.

Firstly, a comparison will be drawn between the specific types of taxes in the two countries. Secondly, a comparison will be drawn between the asset-specific tax relief measures available in these countries and thirdly, the tax relief measures relating to specific types of businesses will be compared.

Furthermore, the tax relief measures in South Africa will be critically compared with the tax relief measures available in New Zealand.

For comparative purposes, an exchange rate of NZ$1 = ZAR5,19453 will be used as published on Oanda.com (Oanda, 2010) on 15 September 2010.

5.2 COMPARISON OF TAX RELIEF MEASURES AVAILABLE

5.2.1 Tax relief measures for specific types of taxes

South Africa	New Zealand
Income tax The following tax relief measures are available specifically for small businesses in South Africa: • where a natural person disposes of an	**Income tax** In terms of the current New Zealand Income Tax Act there is no specific Section dealing with tax relief measures for small companies. However, the following

active business asset of a small business owned by him/her, he/she may disregard R750 000 of the capital gain; and • a registered micro business must disregard any capital gain or loss made on the disposal of any asset that is used for business purposes.	amendments to the Act have been made to specifically aid small companies: • where legal expenses do not exceed NZ$10 000, no distinction needs to be made as to whether these expenses are of a capital or revenue nature; • where a person has a turnover of NZ$1,3 million or less and the value of his/her closing stock is less than NZ$10 000, he/she does not have to revalue his/her trading stock at year end but can use the opening balance of their trading stock as the closing balance; • where the prior year total PAYE deductions for all employees are less than NZ$500 000, PAYE can be paid over to Inland Revenue on a monthly basis as opposed to twice a month; • where the prior year total PAYE deductions for all employees are less than NZ$500 000, fringe benefit tax can be paid over to Inland Revenue on an annual basis as opposed to a quarterly basis; and • the uplift rates used to calculate provisional tax were temporarily reduced from 105% to 100% where the previous year's RIT was used and from 110% to 105% where the next preceding year's RIT was used.

Turnover tax	**Micro business and small business taxation**
The following benefits are available for micro businesses which have elected the turnover tax system: • micro businesses are taxed on a multi-rate system based on their taxable turnover. This multi-rate system is much lower than the multi-rate system applicable to individuals or the flat tax rate applicable to companies; • taxable turnover will include 50% of receipts of a capital nature and furthermore the micro business will be exempt from capital gains tax; • taxable turnover will exclude any investment income in the case of a natural person; and • micro business will be exempt from STC to the extent that the dividend distribution does not exceed R200 000.	Under the current New Zealand Income Tax Act there are no specific relief measures relating to SMEs. However, the following proposal has been made by the New Zealand Institute of Chartered Accountants and Tax Management New Zealand: <u>Micro business taxation</u> • a final tax of 15% will be payable on a monthly basis based on its turnover; and • turnover will exclude income received by way of rental or interest. <u>Small business taxation</u> • small businesses will be allowed to recognise their revenue on a cash basis and therefore obligations can be met as they arise; • where the small business is also registered for GST on a payment basis, the income tax and GST calculations can be merged. Thus provisional tax payments will fall away and actual tax payments will be made every two months; • where the shares in the company are held by natural persons, the company will be taxed using the tax rates applicable to individuals. This will lead to less time and money spent by the company on restructuring payments to

	shareholders to obtain the lower tax rate benefit; and • where the taxation of the companies and that of their shareholders are merged, fringe benefit tax will be replaced by non-deductible adjustments.
Value-added tax With the withdrawal of the small retailers VAT package there are currently no specific tax relief measures available for small business in terms of the VAT Act, except where a vendor's taxable supplies do not exceed R1,5 million in a 12-month period, they may apply for Category F classification and only file VAT returns every four months. However, with the introduction of the new turnover tax system, the compulsory VAT registration threshold was increased from R300 000 to R1 000 000 and companies which have registered as a micro business are not permitted to register for VAT.	**Goods and service tax** In terms of the current New Zealand Goods and Services Tax Act, there are no specific Sections dealing with tax relief measures for small companies. However, the following amendments to the Act have been made to specifically aid small companies: • the compulsory GST registration threshold was increased from NZ$40 000 to NZ$60 000; • where taxable supplies does not exceed NZ$2 million, the person may elect to account for GST on a payment basis as opposed to an invoice basis; and • where a person's taxable supplies do not exceed NZ$500 000 in a 12-month period, GST returns only need to be filed every six months as opposed to every second month.
Tax amnesty Tax amnesty will be granted to successful applicants for all qualifying taxes arising from the tax years preceding the 2006 year of assessment.	**Tax amnesty** No tax amnesty for small businesses in New Zealand was identified. However, it was proposed by the New Zealand Institute of Chartered Accountants and Tax

The relief will include additional taxes, interest and penalties, which relate to the taxes for which amnesty is granted. The deadline for submission of applications was extended to 30 June 2007 and applicants had until 31 August 2007 to submit all documents supporting the amnesty application (Webb, 2007:42).	Management New Zealand that if the proposals relating to micro business taxation should be accepted amnesty should be granted regarding any investigation by Inland Revenue into the prior year's income.

5.2.2 Asset-specific tax relief measures

South Africa	New Zealand
Small asset write-off Where the cost of an asset is below R7 000, the asset may be written off in full in the year in which it has been acquired and brought into use. This provision is available to all businesses in South Africa and does not specifically relate to small businesses.	**Low-value asset write-off** Where the cost of an asset is below NZ$5000, the asset may be written off in full in the year in which it has been acquired. This provision is available to all New Zealand businesses and not only for small businesses.
Asset-for-share transactions Where a person disposes of an asset to a South African resident company in exchange for shares in that company and after the disposal the person who disposed of the asset holds a qualifying interest in the company or will be engaged on a full-time basis in the business of the company of rendering a service, the following relief is available: <u>Relief for the person who disposed of the asset</u> • if the asset is a capital asset, the	**Asset-for-share transactions** Under the current New Zealand Income Tax Act no provisions were identified for any relief regarding asset-for-share transactions.

person is deemed to have disposed of the asset for an amount equal to the base cost of the asset. Therefore, no capital gains tax consequences will arise on the disposal of the asset. The person is furthermore deemed to have acquired the equity shares on the same date and for the same cost that the original asset was acquired; and • if the asset is trading stock, the person is deemed to have disposed of the trading for an amount equal to the cost of the trading stock. Therefore, no income tax consequences will arise on the disposal of the trading stock. The person is furthermore deemed to have acquired the equity shares on the same date and for the same cost that the original trading stock was acquired. <u>Relief for the company that acquired the asset</u> The company who acquires the asset must acquire the asset as: • a capital asset where the person who disposed of the asset held it as a capital asset; • trading stock where the person who disposed of the asset held it as trading stock; or • trading stock where the person who disposed of the asset held it as a	

capital asset, but in this case the company and the person may not form part of the same group of companies. In each of the cases above, the company and the person is deemed to be one and the same in respect of the acquisition date, cost and valuation date (if applicable) of the asset. Thus, in effect, the tax consequences are deferred to when the company then disposes of the asset.	

5.2.3 Tax relief measures for specific types of small businesses

South Africa	New Zealand
Small business corporations (SBC) • SBCs are taxed on a multi-rate system as opposed to a flat tax rate. For years of assessment ending on or after 31 March 2010 this will lead to a tax reduction of R78 780; • assets used in the process of manufacturing can be written off in full in the year that the asset was brought into use; and • other assets of an SBC can be written off using the accelerated write-off period of three years, where 50% of the cost of the asset will be written off in Year 1, 30% in Year 2 and the remaining 20% in Year 3.	**Small enterprises** Under the current New Zealand Income Tax Act, no relief measures relating to specific types of small businesses were identified.

5.3 ANALYSIS OF THE COMPARATIVE STUDY

5.3.1 Tax relief measures for the specific types of taxes

5.3.1.1 Income tax

Currently, South African companies already pay PAYE over on a monthly basis. However, this has only recently been introduced in New Zealand and is only applicable if the prior year total PAYE deduction for all employees is less than NZ$500 000. Otherwise, PAYE needs to be paid over twice a month.

In South Africa, the tax payable on fringe benefits is included in the monthly PAYE, but in New Zealand, separate returns (either annually or quarterly) need to be filed for fringe benefit tax, which will increase the amount of time spent by small business to be tax compliant.

Recently, a number of additional tax relief measures have been implemented by New Zealand relating to legal expenses and the valuation of closing stock. The South African Government could also consider implementing these tax relief measures, which will lessen the time spent by small business when completing their annual tax returns.

Additional tax relief measures relating to capital gains tax are implemented in South Africa. Where a natural person disposes of an active business asset of a small business owned by him/her, he/she may disregard R750 000 of the capital gain. This is, however, not comparable with New Zealand as currently there is no capital gains tax in New Zealand.

5.3.1.2 Turnover tax

Based on the comparison of the tax relief measures available to micro business, it is evident that the South African Government has greatly contributed in supporting small business by the implementation of the turnover tax system.

The New Zealand government could also consider implementing these tax relief measures by introducing separate tax tables for small enterprises whereby the small enterprise is taxed in terms of the yearly sales as opposed to its taxable income.

5.3.1.3 Value-added tax

The compulsory VAT registration threshold in South Africa is much higher than the compulsory GST registration threshold in New Zealand. However, under the current New Zealand GST Act GST may be accounted for on the payment basis where the taxable supplies in a 12-month period do not exceed NZ$2 million. This provision is applicable to any registered person. According to Stiglingh (2009:924), in South Africa, a registered person may only account for VAT on the payment basis if the vendor is:

- a natural person or unincorporated body of persons of which all the members are natural persons and the total value of taxable supplies in a 12-month period has not exceeded R2.5 million;
- a public authority;
- a municipality;
- a municipal entity that supplies electricity, gas, water, drainage, or services relating to the removal or disposal of garbage or sewage;
- an association not for gain;
- any water board or any other institution which has similar powers to a water board; or
- a regional electricity distributor.

Therefore, it is clear that only sole proprietors will be able to benefit from these provisions and not all small businesses. The South African Government can consider implementing provisions similar to those of New Zealand as accounting for VAT on the payment basis may assist small businesses with their cash flow since VAT only needs to be accounted for when the funds are received and not when the invoice is issued.

In terms of the New Zealand GST Act, where the taxable supplies do not exceed NZ$500 000, GST returns only need to be filed every six months. When compared with

South Africa, Section 27 of the Value-Added Tax Act stipulates the categories of vendors and their tax periods. In terms of this section, small businesses with an annual turnover of R1,5 million or less may file their VAT returns every four months. Otherwise, if their annual turnover exceeds R1,5 million, they will in all probability have to file VAT returns every second month.

With the implementation of turnover tax and the fact that micro businesses which have registered for turnover tax may not be registered for VAT, the South African Government can consider increasing the R1,5 million threshold to allow more businesses to file their VAT returns only every four months instead of every two months.

5.3.1.4 Tax amnesty

SARS assisted small businesses to become tax compliant through the tax amnesty process. No tax amnesty is provided for small businesses in New Zealand.

5.3.2 Asset-specific tax relief measures

5.3.2.1 Small asset write-off

In South Africa, the limitation to obtain the immediate write-off of small assets is much higher than the limit set by the New Zealand government. The New Zealand government could consider increasing the NZ$500 immediate write-off limit to assets. This will benefit all taxpayers, including small businesses.

5.3.2.2 Asset-for-share transactions

Under the current South African Income Tax Act, the normal income tax and capital gains tax consequences are deferred to a later stage where an asset-for-share transaction takes place and the relevant conditions are met. This could greatly benefit sole proprietors where the aim is to form a company to take over the business activities of the sole proprietorship.

The New Zealand government can consider implementing such a provision as this will provide an incentive for sole proprietors to form companies where the business has shown growth but with eliminating the cash flow burden which may arise due to the sale of a capital asset or trading stock.

5.3.3 Tax relief measures for specific types of small businesses

Based on the comparison of the tax relief measures available to specific types of small entities, it is clear that the South African Government is committed to supporting SBCs by reducing the rate at which tax is paid from a fixed rate to a multi-rate system as well as the accelerated write-off periods.

The New Zealand government can consider implementing such a provision, which relates to a specific type of small business. This will reinforce the statement by Prime Minister John Key that he wanted to lighten the load on small and medium-sized entities (Beehive 2010).

5.4 CONCLUSION

From the comparative study performed in this chapter, it is clear that the South African Government assists and empowers small businesses in many aspects. Tax relief measures offered by the South African Government include:

- specific relief measures for companies who qualify as an SBC;
- specific relief measures for companies who have elected the turnover tax system;
- tax amnesty for small businesses; and
- capital gains tax relief for small businesses.

There are instances where the South African Government could refer to the tax relief measures offered to small business in New Zealand, for example:

- GST may be accounted for on the payment basis where the taxable supplies in a 12-month period do not exceed NZ$2 million; and

- where the taxable supplies do not exceed NZ$500 000, GST returns only need to be filed every six months.

The above can be used as guidance for implementing the following tax relief measures in South Africa:

- allowing small business which have not elected the turnover tax system to account for VAT on the payment basis and
- increasing the R1,5 million threshold for Category F vendors allowing small business to only file VAT returns every four months as opposed to every two months.

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CHAPTER 6

CONCLUSION

6.1 INTRODUCTION

Tax relief measures for small business corporations were first introduced in the 2000 budget speech by Trevor Manual, the previous Minister of Finance. He emphasised that the development of SMEs is fundamentally important for the growth and employment potential of the South African economy (Webb, 2007:49).

The aim of this study was to critically compare the tax relief measures for SMEs in South Africa with the tax relief measures for SMEs in New Zealand and to determine if those of South Africa are on par with the tax relief measures available in other countries.

6.2 PURPOSE AND OBJECTIVES

The purpose of this study was to critically compare the tax relief measures for SMEs in South Africa with the tax relief measures for SMEs in New Zealand and to determine whether the tax relief measures in South Africa are on par with the tax relief measures available in New Zealand.

The objectives of the study were:

- to critically analyse research studies and the literature relating to tax relief measures available for SMEs in South Africa in order to establish the theoretical construct for this study. This analysis was done in Chapter 2;
- to critically analyse research studies and the literature relating to tax relief measures available for SMEs in New Zealand in order to establish the theoretical construct for this study. This analysis was done in Chapter 3; and
- to critically compare the tax relief measures in South Africa and New Zealand using the theoretical construct as underpin to determine if the measures in South Africa are on par with other countries. This comparison was done in Chapter 4.

6.3 CONCLUSION

Through the examination of the small business definition in both South Africa and New Zealand, it was found that although there are definitions for classifying a business as a small business, the qualification criteria to obtain the tax relief measures differ for almost each type of tax relief measure. For a small business to be eligible to qualify for these relief measures, there are still a number of specific and unique criteria that need to be met.

From the comparative study performed between the tax relief measures available to small business in South Africa and the tax relief measures available to small business in New Zealand, it is clear that the South African Government has come a long way to assist and empower small business in South Africa.

Furthermore, it is clear that the tax relief measures available to small business in South Africa are on par and in most instances exceed the tax relief measures available to small business in New Zealand.

However, as indicated in Chapter 5, certain tax relief measures available in New Zealand can be used as guidance to implement the following tax relief measures in South Africa, which could provide further aid to small businesses. These are:

- allowing small businesses which have not elected the turnover tax system to account for VAT on the payment basis; and
- increasing the R1.5 million threshold for Category F vendors allowing small business to only file VAT returns every four months as opposed to every two months.

As small business will continue to play an important role in creating jobs and wealth in the economy in South Africa, it is important that the South African Government to continuously assesses the tax relief measures available to small business and ensures that these measures are on par with other countries similar to South Africa. Furthermore, it is imperative that the South African Government ensures that the small businesses are aware of the tax relief measures available to them.

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