SECOND AND FINAL REPORT ON

SMALL AND MEDIUM ENTERPRISES

FOR THE MINISTER OF FINANCE

Intended use of this document:

The Davis Tax Committee is advisory in nature and makes recommendations to the Minister of Finance. The Minister will take into account the report and recommendations and will make any appropriate announcements as part of the normal budget and legislative processes.

As with all tax policy proposals, these proposals will be subject to the normal consultative processes and Parliamentary oversight once announced by the Minister.

DTC

THE DAVIS TAX COMMITTEE

April 2016

Dear Minister

We, as the Members of the Davis Tax Committee, have the honour and privilege to provide you with this report which has been:

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And the Secretariat for the Davis Tax Committee

Contents

List of abbreviations

CGT:	CAPITAL GAINS TAX
DSBD:	DEPARTMENT OF SMALL BUSINESS DEVELOPMENT
DTC:	DAVIS TAX COMMITTEE
DTI:	DEPARTMENT OF TRADE AND INDUSTRY
ETI:	EMPLOYMENT TAX INCENTIVE
FSB:	FINANCIAL SERVICES BOARD
FTA:	FORUM ON TAX ADMINISTRATION
INCOME TAX ACT:	INCOME TAX ACT, 1962 (ACT NO. 58 OF 1962)
NT:	NATIONAL TREASURY
NDP:	NATIONAL DEVELOPMENT PLAN
PAYE:	PAY-AS-YOU-EARN
RCR:	REFUNDABLE COMPLIANCE REBATE
SARS:	SOUTH AFRICAN REVENUE SERVICE
SBFE:	SMALL BUSINESS FUNDING ENTITY
SBC:	SMALL BUSINESS CORPORATION
SME:	SMALL AND MEDIUM ENTERPRISES
TAA:	TAX ADMINISTRATION ACT, 2011 (ACT NO. 28 OF 2011)
VAT ACT:	VALUE-ADDED TAX, 1991 (ACT NO. 89 OF 1991)
VCC:	VENTURE CAPITAL COMPANY

Summary of Recommendations

Introduction

The Department of Small Business Development (DSBD) was established in May 2014, shortly before the publication of the first Interim Davis Tax Committee report on the taxation of small and medium enterprises.

The DSBD has identified five critical areas that hinder the promotion and development of the sector. These areas are: public sector procurement, building access to market into the public sector value chain, **regulatory constraints,** access to finance and support of township and rural enterprises.

The above concurs with the first interim report where the DTC clearly states that no tax intervention can act as a 'silver bullet' that would miraculously solve the difficulties of micro business in RSA today.

The DSBD is largely supportive of the recommendations made in the first report.

The Turnover Tax system

National Treasury (NT) has reviewed the Turnover Tax thresholds and generously increased the thresholds in the 2015/16 National Budget proposals. The DTC recommends that the Turnover Tax package is sufficient for the time being.

Although criticism has been levelled at the Sixth Schedule to the Income Tax Act, in particular arguing that it might result in a small tax liability when the taxpayer is in a loss position, it is important to emphasise that registration in terms of the Sixth Schedule is a voluntary election by the taxpayer. There is nothing to prohibit a taxpayer from registering as a sole trader and being subject to taxation at personal income tax rates. Alternatively, the taxpayer is at liberty to register a small business corporation in terms of Section 12E of the Income Tax Act.

Taxpayers should be allowed to elect to exit the Turnover Tax system on an annual basis.

All taxation liability determined under the Turnover Tax system should be discharged by way of an annual declaration made on, or before, 31 May each year.

Micro businesses face many challenges other than taxation issues. Hopefully, these issues will be addressed by the newly established DSBD.

In order to allay the fears of micro business relating to registration and arrear taxation, a separate voluntary disclosure programme for micro business should be implemented for micro businesses that qualify for registration in terms of the Sixth Schedule. Registration in terms of the Sixth Schedule should automatically result in the waiver of any arrear tax claims relating to the period prior to 1 March 2015.

SARS and NT should investigate measures that require a micro business to be tax registered before they can make use of electronic payment facilities.

Small Business Corporations (SBCs)

The SBC tax system is fundamentally ineffective, with a large proportion of the tax benefit being enjoyed by service-related SBC's (such as financial, education real estate, medical and veterinary services) that were never the intended primary target of the SBC initiative.

The following options remain:

1. Retain the current SBC allowance and accept the potential for abuse and the enforcement problems this will entail.

2. Remove the SBC incentive completely and redeploy the resource within the DSBD or DTI by way of targeted interventions. In this regard, it is noted that the DSBD has recently received an annual budget of R3 billion.

3. Extend the current SBC resource to all tax compliant SBCs through the RCR system.

Consideration should be given to substantially extending the current capitalisation threshold for allowance assets of small businesses to beyond the current level of R6000 per asset.

VAT

The compulsory VAT registration threshold compares favourably to international standards. There does not appear to be any justification for raising the compulsory registration threshold.

The DTC accepts the submissions of SARS and NT that there is good reason to maintain the current threshold for the cash basis of VAT reporting at its current level of R2,5 million per annum.

However, the distress caused to SMEs by long outstanding debts cannot be ignored. The DTC recommends that NT should investigate the introduction of a debtors' allowance where SMEs are allowed to adjust the VAT computation when debtors' balances exceed 90 days.

The DTC VAT sub-committee should consider time limits to be imposed on SARS with regard to all tax refunds.

SARS should actively monitor all VAT declarations made by small businesses in order to combat tax evasion committed by larger businesses masquerading as survivalist businesses. In particular, annual Turnover Tax declarations should be compared to the banking activity of the taxpayer.

SARS should rigorously examine the data received from financial institutions to detect unregistered taxpayers who are obviously trading and in receipt of income exceeding the Turnover Tax threshold of R1 million per annum.

Small Business Funding Entities (SBFEs)

The tax deduction granted to the benefactor of an SBFE is of primary importance. Accordingly, it is suggested that all Entrepreneurial Development spend of any measured entity should be deductible in terms of Section 11(a) read with Section 23(g). This recommendation is to be considered by the DTC sub-committee currently addressing taxation issues relating to public benefit organisations.

Venture Capital Companies (VCCs)

Recent amendments may make the concept of tax deductible VCCs in small business a more attractive proposition for investors. In fact, the number of registered VCC's has increased from 3 at the time of publication of the first report to 24 by December 2015.

The effect of recent amendments should be monitored in years to come.

Nonetheless, the amendments do little to provide a mechanism to encourage the growth of micro businesses in SA as the provisions are primarily targeted at established SMEs. Thus, the DTC reaffirms its suggestion that NT consider the implications of the creation of a separate tax incentive to encourage angel investors in SMEs. This may be achievable through the extension of the Bad Debt Allowance to allow for the full write-off of failed investments in micro businesses, which might act as an encouragement to angel investors.

The Employment Tax Incentive (ETI)

Initial indications are that ETI has to date had little impact on the SME sector. The DTC recommends that the evaluation of the specific effect of ETI on the SME sector become an important part of the on-going investigations into the scheme.

Co-operative societies 'stokvels'

The DTC recommends that further investigation of the taxation implications of co-operative societies is necessary.

Tax clearance certificates

A substantial overhaul of government procurement procedures is currently in progress. This will dispense with the current requirements for original tax clearance certificates.

Every effort should be made to ensure that tax compliant SMEs are not unduly hindered by the obligation to furnish tax compliance certificates.

Tax administration

SARS has recently established 138 small business desks at branches countrywide to service taxpayers who operate small and micro enterprises. This is in line with the commitments made by former Finance Minister Mr Nhlanhla Nene, during his Budget Speech on 25 February 2015.

In presentations to the DTC, SARS has affirmed that still more attention is to be directed towards the SME sector as part of the overall SARS strategic plan.

The DTC recommends that progress with regard to the new SARS initiatives relating to the SME sector should be closely monitored and evaluated.

Skills Development Levy (SDL)

The current SETA refund system has resulted in a high degree of impoverishment of the SME sector for the benefit of funding training in larger businesses. Given the objectives of the NDP towards growth in the SME sector this is simply unacceptable.

Substantially increasing the SDL threshold, beyond the current R500 000 levels, could provide an immediate solution to the present problem of small businesses effectively funding training within the larger businesses. However, this would not address the need for training incentives within the SME sector.

The DTC recommends that high priority should be given to making skills development incentives accessible to the SME sector.

Consideration should be given to allowing tax compliant small businesses separate access to a Small Business SETA mandatory and discretionary spend, without the implementation of comprehensive Work Skills Plans, Annual Training Reports and pivotal training plans.

Chapter 1

Introduction

The first interim report of the Davis Tax Committee (DTC), SMALL AND MEDIUM ENTERPRISES TAXATION CONSIDERATIONS, was released for public comment in July 2014.

Given that government has accepted the parameters of the National Development Plan (NDP), it stands to reason that the DTC seeks to prioritise the examination of the tax system and its impact upon the promotion of small and medium size businesses (SMEs), including an analysis of tax compliance costs, a possible streamlining of tax administration, the simplification of tax legislation and the role of incentives.

The purpose of this second interim report is to respond to the input received by the DTC on the first report and to update that report, taking into account developments since that date.

The following graphic, developed by the DTC in the first interim report, illustrates the range of entities that fall within the applicable definitions of SMEs:

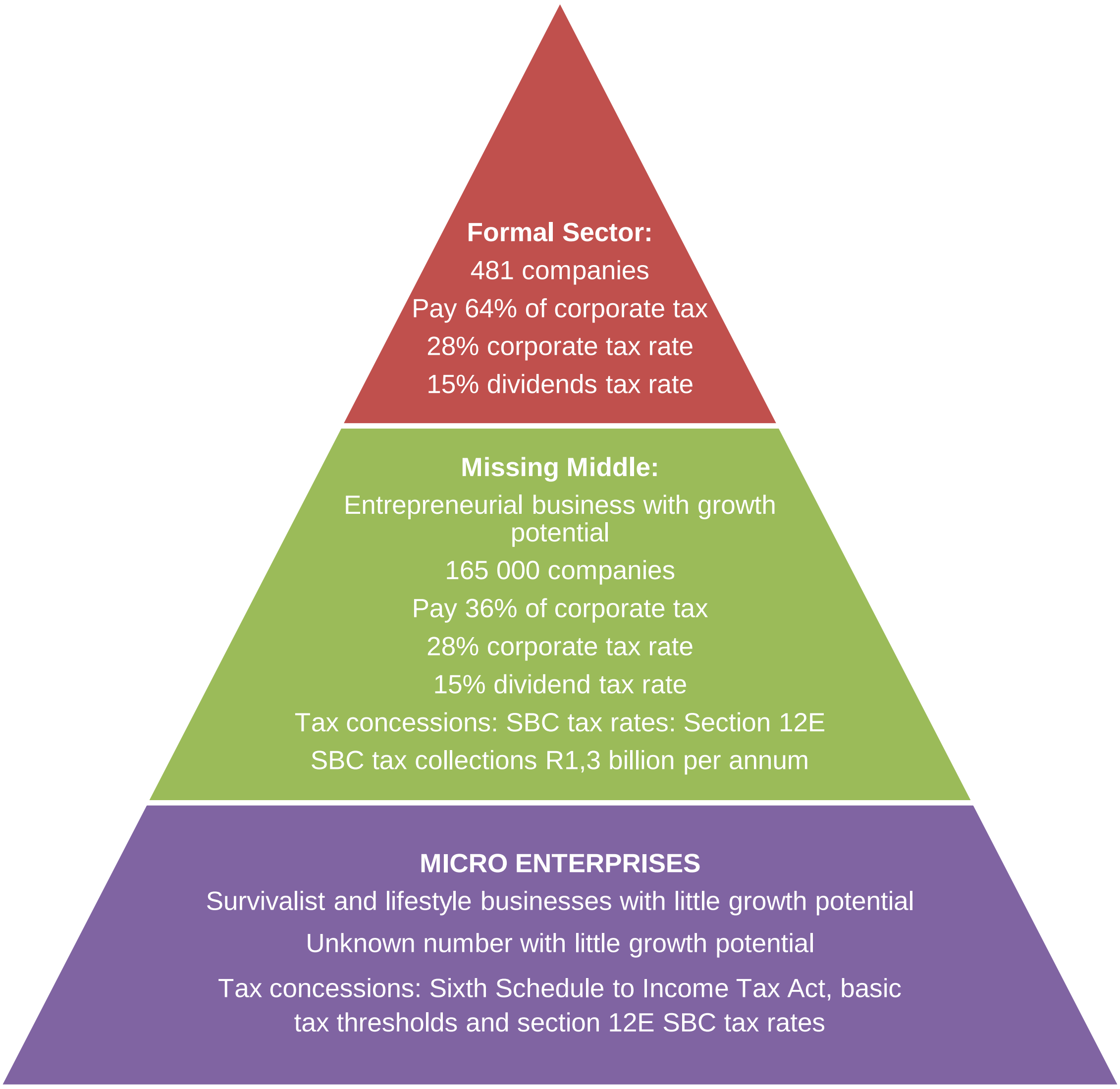

Table 1: Range of SMEs

The first report identified the need for separate tax regimes to address the needs of the informal sector and the 'missing middle.'

In the graphic, the concept of the 'missing middle' is employed to mean entrepreneurial businesses with growth potential. The very thrust of the NDP is predicated on the assumption that small and expanding firms must become more prominent and generate the majority of new jobs. However, the NDP notes that total early-stage entrepreneurial activity rates in South Africa are about half of what is reported in other developing countries.

The observations in the NDP are reinforced by research conducted on behalf of the Economic Policy Division of National Treasury (NT), which noted that South Africa has disturbingly low levels of growth in the SME sector, notwithstanding extensive institutional organisational infrastructure established by government for SME financing and development. The NDP notes that, based on preliminary research which employed data from Statistics South Africa, it is estimated that SMEs accounted for a mere 8.5% of the total investment by non-financial corporations in 2012 compared with 12.9% in 2010. The decline in investment occurred mainly in the trade and manufacturing sectors over this period.[1]

Accordingly, the challenge is to ensure that this 'missing middle', the entrepreneurial business, plays a critical role within the economy. This can be achieved by, first, creating a more enabling environment for these enterprises to grow and expand their operations and employ more people. Secondly, conditions must be created under which 'start ups' are able to flourish and more entrepreneurs are encouraged to enter the market.

Within this context, the specific question of excessive regulation and its attendant costs becomes an important consideration for analysis. Neil Rankin[2] contends, pursuant to his research, that there are significant costs associated with regulation. Of particular importance are the costs of staff time spent dealing with regulations and the cost of paying for outside consultants. The cost of regulation falls disproportionately on smaller firms, particularly with respect to tax costs. Smaller firms have similar levels of tax costs to those of the larger firms, but these costs comprise a greater proportion of the total regulatory costs. According to Rankin,[3] tax compliance costs in respect of employees are much higher for smaller firms as are the costs associated with complying with local authority regulations. Furthermore, 80% of firms in his sample reported that regulatory costs had increased in the two years immediately preceding his study.

The DTC's concern is to ensure that the existing tax system best promotes the kind of small and medium-size activity prefigured in the NDP and that where necessary, it is designed to ensure that the costs of compliance (discussed in Chapter 6) do not retard growth in this important sector. This view is supported by studies undertaken by the World Bank, *Tax Compliance Burden for Small Businesses* (2007) and *Counting the Cost of Red Tape for Business in South Africa* (2004) by the SBP (originally Small Business Project).

At the other end of the scale are the micro businesses. This sector consists in the main of survivalist and lifestyle businesses as defined by the NDP.

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[1] *Research conducted on behalf of the economic policy division dealing with the contribution to small and medium size enterprises to investment and employment in South Africa and the role of development in finance institutions (2013: Internal Document made available by National Treasury to the DTC.*

[2] *Neil Rankin_'The Regulatory Environment in SME's: Evidence from a South African Firm Level Data: Development Policy Research Unit: University of Witwatersrand: Working Paper 06/113'*

[3] *Ibid.*

Micro businesses have little prospect of making a significant direct tax contribution as the taxable income of businesses seldom exceeds the 2015/16 personal income tax threshold (R73 650 per annum)[4] or the Turnover Tax threshold (R335 000 per annum).[5]

The above is not to say that the informal sector makes no tax contribution. Indirect tax collections are substantially bolstered by non-refundable VAT and duties paid on informal sector inputs.

At the time of publication of the first report the Department of Small Business Development 'DSBD' had only been recently established. The DSBD has now considered the first report and its comments and suggestions have been included in this report.

In order to expedite Government services to SMMEs and Co-operatives, the DSBD has identified five critical areas that are a hindrance to the promotion and development of the sector. These areas are: public sector procurement, building access to market into the public sector value chain, regulatory constraints, access to finance and support for township and rural enterprises.

The above concurs with the first interim report where the DTC clearly states that no tax intervention can act as a 'silver bullet' that would miraculously solve the difficulties of micro business in RSA today.

The DSBD is largely supportive of the recommendations made in the first report.

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[4] *National Treasury 2015/16 Budget Review*

[5] *This comment excludes the potential contribution of the 'grey economy' operating within the informal sector.*

Chapter 2

The Turnover Tax system

The first interim report of the DTC examined the Turnover Tax Regime as contained in the Sixth Schedule of the Income Tax Act.

As per the SARS tax register at 4 July 2013 there were 7 827 active micro businesses registered as Turnover Tax taxpayers, 139 with addresses unknown, 59 dormant, 74 in estates, 345 inactive and 49 suspended.

Although the level of registration of taxpayers in terms of the Sixth Schedule is disappointing, the DTC recommended that the Sixth Schedule be retained and extended so as to allow micro-businesses to register for tax purposes with the absolute minimum compliance burden.

The DTC recommended that the Turnover Tax thresholds be increased above the levels for the 2015 tax year as follows:

2. Davis Committee Proposal					
-	335 000	0%			0% of turnover
335 001	500 000	2%			2% of the amount above R335 000
500 001	750 000	4%		3 300	plus 4% of the amount above R500 000
750 001	1 000 000	5%		13 300	plus 5% of the amount above R750 000

The maximum Turnover Tax payable at a turnover of R999 999 was R25 800.

National Treasury has reviewed the Turnover Tax thresholds and generously increased the thresholds in the 2015/16 National Budget proposals.[6]

3. Alternative Proposal (Assume 10% Net Margin)					
-	335 000	0%			0% of turnover
335 001	500 000	1%			1% of the amount above R335 000
500 001	750 000	2%		1 650	plus 2% of the amount above R500 000
750 001	1 000 000	3%		6 650	plus 3% of the amount above R750 000

The new thresholds will completely exempt all micro businesses with a turnover of less than R335 000 per annum from taxation. The maximum Turnover Tax payable at a turnover of R999 999 is currently R14 150.

[6] *National Treasury Budget Review 2015/16*

The DTC recommends that the Sixth Schedule Turnover Tax bands currently extending to the R1 million turnover level should be maintained at the current level as the Turnover Tax system is primarily directed at micro businesses.

The DTC is of the view that the tax thresholds within the Sixth Schedule have now been sufficiently refined to achieve the objective of providing a most reasonable tax package that allows for tax registration of micro businesses with the minimum of compliance requirements. To go further may invite widespread abuse of the concession. Attention is drawn to the recent SARS initiative to substantially increase service delivery to the SME sector. Chapter 6 refers.

The first interim report observed that micro businesses face many challenges other than taxation issues. Hopefully, these issues will be addressed by the newly established DSBD.

The increased Turnover Tax bands implemented in 2015, coupled with the recent SARS initiative and the endeavours of the DSBD will address most of the shortfalls within the tax system relating to micro business in the future.

Although criticism has been levelled at the Sixth Schedule, in particular that it may result in a small tax liability when the taxpayer is in a loss position, it is important to emphasise that registration in terms of the Sixth Schedule is a voluntary election by the taxpayer. There is nothing to prohibit a taxpayer from registering as a sole trader and being subject to taxation at personal income tax rates. Alternatively the taxpayer is at liberty to register a small business corporation in terms of Section 12E of the Income Tax Act.

DSBD feedback and recommendations

The DSBD is supportive of the above proposals. In particular, the DSBD emphasises the importance of the DTC recommendation to temper the provisions of section 22 and 25 of TAA where a taxpayer has a turnover of less than R1 million per annum and has not registered for tax but no liability actually exists.

The DSBD is in the process of designing two new specifically designed incentives to encourage micro business.

Further recommendations of the DTC regarding the informal sector made in the first report

The recommendations contained in the first report of the DTC extended beyond the issues of the tax rates and thresholds contained in the Sixth Schedule to the Income Tax Act.

(a) Currently, the Turnover Tax system contains the restrictive requirement that the taxpayer 'opt in' for a period of 3 years. This requirement substantially reduces the burden on SARS that would be created if taxpayers were allowed to freely migrate between the Turnover Tax and the income tax basis of taxation. However, the requirement leaves the Turnover Tax system subject to much criticism.

(b) In order to allay the above criticism, the first interim report suggested that taxpayers be allowed to elect to exit the Turnover Tax system on an annual basis.

(c) The current Turnover Tax system allows for bi-annual payments on an elective basis. This creates confusion and an additional administrative burden with no prospect of creating a meaningful revenue stream. All taxation liability determined under the Turnover Tax system should be discharged by way of an annual declaration made on or before 31 May each year.

As yet, NT has to address the above recommendations by way of amendments to the Income Tax Act.

Micro business voluntary disclosure programme

Submissions made to the DTC have often concentrated on the issue of arrear taxation claims that may face SMEs should they register for tax. It is often contended that this is the major cause of non-compliance by SMEs.

The actual tax collections from micro businesses are minimal in the context of general tax collections. The prospects of recovery of arrear taxes from such businesses are also minimal, probably far less than the costs of enforcement.

In order to allay the fears of micro businesses relating to registration and arrear taxation claims, a pragmatic solution may well take the form of a separate voluntary disclosure programme for micro business. In broad terms, the programme could be designed along the following lines:

- The benefits of the programme would be offered to all micro businesses that volunteer for registration in terms of the Sixth Schedule during a specified period. For example (1 March 2016 – 28 February 2017).

- Registration in terms of the Sixth Schedule would automatically result in the waiver of any arrear tax claims relating to the period prior to 1 March 2015, provided that such income could have fallen within the ambit of the Sixth Schedule.

Tax registration requirements relating to electronic payment facilities

A voluntary disclosure programme coupled with the generous Turnover Tax table of the Sixth Schedule should act as an incentive for micro businesses to register for tax purposes. However, it cannot be denied that the prospects of detection of unregistered micro businesses by SARS remain remote. Thus, further measures are needed to reinforce the requirement that even micro businesses must register for tax.

There can be no doubt that the cash economy is in decline. Consumers today have access to electronic payment facilities and prefer the use, savings and security they offer. New technologies are also making it far easier for micro businesses to facilitate payment through various electronic payment facilities provided by financial institutions. It is expected that this trend will continue.

At present there are no tax registration requirements relating to electronic payment facilities.

The DTC recommends that SARS and NT investigate measures that require a micro business to be tax registered before it can make use of electronic payment facilities.

Chapter 3

Small Business Corporations

The Small Business Corporation (SBC) tax incentives were promulgated in 2001.[7]

The first interim report of the DTC concluded that,

> A considerable amount of the benefits of the incentive are legally claimed by taxpayers who were not the specific target of the incentive. It, however, mainly benefit established, profitable, niche SMEs. This represents a tiny minority of the SME sector in South Africa today. The SBC tax incentive is of little or no value in commencing a business or assisting an ailing business in an assessed loss position.
>
> The DTC recommended that the current SBC incentive be withdrawn and the resource redeployed in the form of a new incentive that focuses on rewarding the tax-compliant SBC and that compensates for some of the additional costs incurred due to compliance. Of critical importance is that the RCR will simply redeploy the current SBC incentive at no additional cost to the national budget.

The DTC recommended that the RCR rebate would escalate according to turnover in 4 bands:

0 – R335 000 = R 0
R335 000 – R500 000 = R10 000 per annum
R500 000 – R1 000 000 = R15 000 per annum
R1 000 000 and above = R20 000 per annum

Based on the existing R1,36 billion SBC incentive and the 2013 SBC tax register, the present cost to the fiscus of the existing incentive could be redeployed.

In submissions made to the Joint Standing Committee on Finance and in responses received by the DTC, the RCR recommendation has been criticised: inter alia, that the current SBC system is effective and that the RCR proposal amounts to no more than a handout or grant.

7 S. 12E inserted by s. 12 of Act No. 19 of 2001

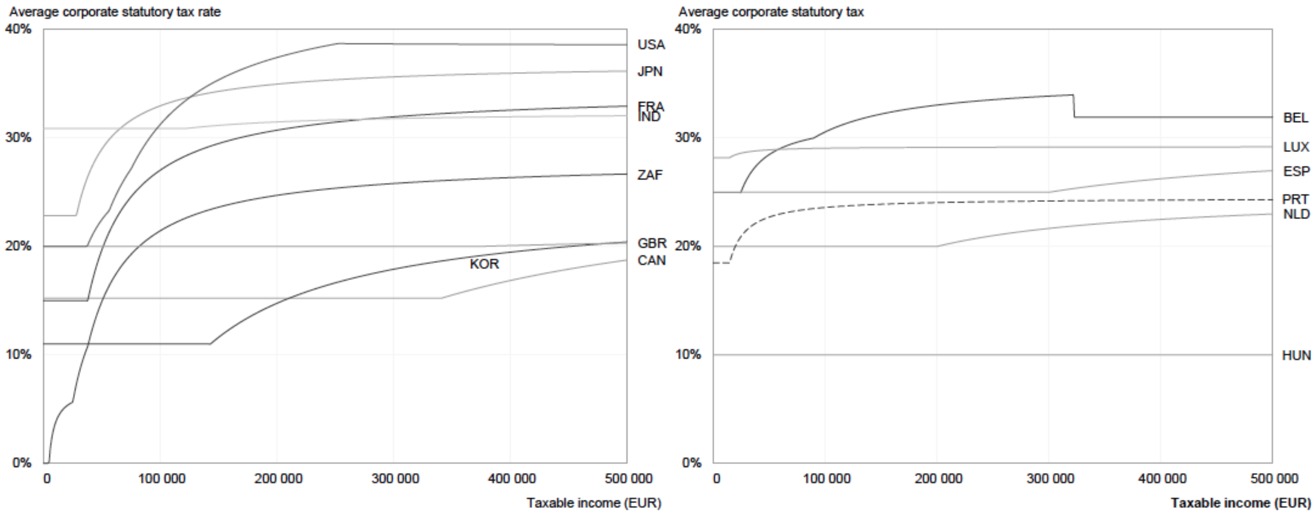
DTC response

International comparisons

The Organisation for Economic Co-operation and Development (OECD) has recently published an international comparison of tax rates.

Figure 3. **Average statutory CIT rates under small-business rates at different levels of business income, 2014**

(G20 countries, left-hand panel; non-G20 OECD countries, right-hand panel)



Source: OECD calculations based on OECD Tax Database, the IBFD database, and questionnaire responses.

The OECD comparison reflects that South Africa is the only country within the sample that allows a total exemption on the lower levels of income. South Africa achieves this by granting the SBC a basic tax threshold equivalent to that of individual taxpayers. Tax rates at higher levels of taxable income also compare very favourably with other countries.

It is further noted that the OECD comparison does not in any way take further tax benefits that SBC taxpayers can achieve through the payment of salaries to members/shareholders that can result in the owners of an SBC enjoying both the SBC and Personal Income Tax marginal rates and basic thresholds.

It is important to note that at the time that the SBC tax table was promulgated (2001), substantial tax arbitrage opportunities existed between corporate and personal tax rates, particularly at lower levels of income where corporate tax was levied at a flat rate of 30% and secondary tax on companies was levied at 12,5%. In short, there was no tax package targeted at micro businesses. This constituted a substantial disincentive to the incorporation of companies within the SME sector.

The Turnover Tax system was only introduced in 2009, providing relief for micro-businesses with a turnover of less than R1 million. Thus, at the time of promulgation of Section 12E, the SBC allowances were the only form of tax relief to the small business sector.

The concessions announced in the 2015 national Budget Speech now provide a generous tax package for the informal sector by specifically exempting micro businesses with a turnover of less than R335 000 per annum from all income tax and providing a most generous tax concession for businesses with a turnover of less than R1 million per annum, where the maximum tax liability is now limited to R14 150. Hence, there is no longer an acute need for the SBC allowance to shield micro businesses from adverse taxation consequences.

The debate concerning the SBC incentive must thus be confined to the 'missing middle' alone.

Since 2001, NT has devoted considerable attention and resources to reducing both Corporate Income Tax (CIT) and Personal Income Tax (PIT) rates.

There is no longer a substantial need to eliminate the tax arbitrage that existed between corporate and personal tax rates at lower income levels.

Subsequent to 2001, the SBC tax table has been considerably enhanced to attain its current levels.[8]

Applicable Tax rates

SBC tax rates for financial years ending on any date between 1 April 2015 and 31 March 2016:

Taxable income (R)	Rate of tax (R)
0 - 73 650	0%
73 651 - 365 000	7% of the amount above 73 650
365 001 - 550 000	20 395 + 21% of the amount above 365 000
550 001 and above	59 245 + 28% of the amount above 550 000

By operating through SBCs, the 'missing middle' now enjoy substantial income tax reductions on two fronts: (1) the elimination of the adverse tax consequence of incorporating a company and (2) the tax incentive to trade through an SBC. It is consequently important to examine the combined effect.

[8] *National Treasury, 2015 National Budget Review*

	2002/3	2006/7	2011/12	2015/16
Maximum SBC threshold	100 000	300 000	300 000	550 000
Tax liability				
Personal	22 520	71 800	58 890	136 326
SBC	15 000	26 000	24 300	59 451
Corporate	30 000	90 000	84 000	154 000
Corporate rate	30	29	28	28
Personal rate at SBC top threshold	37	30	30	36
Saving				
SBC v PIT	(7 520)	(45 800)	(34 590)	(76 875)
SBC v CIT	(15 000)	(64 000)	(59 700)	(94 549)
Adverse tax consequence				
CIT versus SBC	7 480	18 200	25 110	17 674
PIT versus CIT	7 480	18 200	25 110	17 674
Incentive	(7 520)	(45 800)	34 590)	(76 875)

The maximum SBC concession in the 2003 year of assessment was R15 000. The concession may be divided into two components: (1) the elimination of the adverse tax consequence caused by incorporation of the business, R7 480 and (2) the incentive to form an SBC, R7 520.

The maximum SBC concession in the 2016 year of assessment is R94 549. The concession can also be divided into two components: (1) the elimination of the adverse tax consequence by incorporation of the business, R17 674 and (2) the incentive to form an SBC, R76 875.

It must be noted that the adverse tax consequence that exists between PIT and CIT rates can be avoided by the payment of salaries to shareholders. Thus, there is no reason to provide a tax regime that shields the small business owner from the adverse tax consequence of incorporation.

On the contrary, the SBC tax tables effectively allow the business owner a ‘double dip’ at the lower marginal tax rates. This practice can also be extended by the possibility of payment of salaries to family members regardless of actual contribution to the SBC.

A further problem exists at the higher income levels where taxpayers stand to attain substantial tax savings through the formation of SBCs.

The 2016 PIT tables now result in the PIT tax rate exceeding the SBC tax rate at a taxable income level of R284 100:

	Personal Tax	SBC	Personal Tax	Corporate Tax @28%	Personal Tax
Income	1 100 000	815 900	284 100	815 900	815 900
Tax per tables	372 054	133 697	59 314	228 452	59 314
Rebate	13 257		13 257		13 257
Net tax	358 797	133 697	46 057	228 452	46 057
Combined	358 797		179 754		274 509
Effective tax rate	33		16		25
Saving of SBC over PIT			179 043		
Saving of Company versus PIT					84 288

The calculations above reflect that a business with taxable income of R1,1 million and paying a basic salary of R284 100 to the business owner stands to **achieve a** tax saving of R179 754 if taxed as an SBC over the PIT rate. The effective tax rate thus declines from 33% to 16%.

	Personal Tax	SBC	Personal Tax	Corporate Tax @28%	Personal Tax
Income	2 200 000	1 915 900	284 100	1 915 900	1 915 900
Tax per tables	823 054	441 697	59 314	536 452	59 314
Rebate	13 257		13 257		13 257
Net tax	809 797	441 697	46 057	536 452	46 057
Combined	809 797		487 754		582 509
Effective tax rate	37		22		26
Saving of SBC over PIT			322 043		
Saving of Company versus PIT					227 288

If **this** scenario is extended to a taxable income of R2,2 million, the payment of a basic salary of R284100 to the business owner stands to attain a tax saving of R322 043 if taxed as an SBC over the PIT rate. The effective tax rate thus declines from 37% to 22%.

These calculations may be contested on the basis that they exclude dividend tax that will be levied if the SBC distributes a dividend. On the contrary, it can also be argued that some SBC's deliberately retain income to avoid dividend tax and enjoy the lower income tax rates on interest earned on retained profits.

However, the DTC has received many submissions to the effect that the SBC allowances should be extended to service-related businesses. This extends the debate even further:

- It **raises** the **key** question: 'is it equitable to distinguish business income tax rates on the basis of source of income alone?'
- Current national budget constraints make it impossible to include service businesses within the SBC regime as it would potentially allow the professions the benefit of the concession.
- The inclusion of service businesses within the SBC regime is open to widespread abuse as was experienced prior to the promulgation of the 'personal service provider' definitions[9]
- Service-related businesses can currently qualify for the SBC tax rates if they employ 3 or more persons who are not 'connected persons' in relation to the owner. This provision is open to abuse and extremely difficult for SARS to enforce. Furthermore, the creation of the employment tax incentive creates a comparatively simple mechanism for service businesses to create 3 employee posts that receive a tax-free subsidy and reclassify the service company as an SBC**.(again spell out why this should not be obtaining a benefit viewed within the overall idea behind the tax concession**
- Submissions received by the DTC propose that the maximum turnover ceiling be extended beyond R20 million per annum. This would bring many more service businesses within the scope of the SBC definition.

Over and above the problems inherent to the SBC concessions, the question must be **asked**: 'is the SBC concession achieving the objective of stimulating growth within the SME sector?'

Some 180 000 SBCs have been formed since 2002. However, the number of active SBCs is in steady decline.[10]

	Number of SBC taxpayers
2012	121 511

9

10 SARS statistics 2015

2013	113 926
2014 (assessed to date)	81 142

Calculations conducted by the DTC based on SARS tax statistics for the 2013 year of assessment, reflect the following (2014 statistics are not yet fully populated):

- Of the 113 926 SBC taxpayers in the 2013 year of assessment **only** 55 561 reported taxable income. This results in 58 365 (51%) of SBC's receiving no benefit at all from the SBC tax table.[11]

- SBC taxpayers reporting taxable income of less than R100 000 per annum number 30 918 (27%) of the 113 926 SBC's, obtain negligible benefit from the SBC tax table. Many of these taxpayers may well be better off by simply electing to follow the simplicity and cost savings offered by the Turnover Tax system or even by being taxed at personal tax rates.

- SBC taxpayers reporting taxable income of more than R100 000 but less than R250 000 number 10 648 (9%) of the 113 926 taxable SBC's, obtain a maximum benefit of R24 848 from the SBC tax table. This is not to say that the same benefit cannot be achieved through the payment of salaries to members. Furthermore, these taxpayers would receive a similar benefit from the RCR proposal if it were adopted.

- This leaves 13 995 (12%) SBC taxpayers of the 113 926 with taxable income exceeding R250 000 per annum enjoying the majority of the tax concession of R1,3 billion per annum and standing to achieve a tax saving of as much as R94 755 per taxpayer, per annum.

- Further analysis of the 13 995 SBC taxpayers reporting taxable income above R250 000 per annum reflects that a large proportion of this small population (4 462 or 32%) lie within the fields of financial, education real estate, medical and veterinary services.

- Out of the total tax payments of R1,542 billion from SBC's for the 2013, R1,454 billion was paid by the 13 995 taxpayers reporting taxable income above R250 000. Of the R1,454 billion, R545 million (38%) was paid by taxpayers in the fields of financial, education real estate, medical and veterinary services.

	Tax at SBC rate	Taxed at Corporate 28%	SBC incentive

[11] *SARS statistics 2015*

Taxable income			
250 000	12 348	70000	57 652
300 000	15 848	84000	68 152
350 000	19 348	98000	78 652
400 000	27 745	112000	84 255
450 000	38 245	126000	87 755
500 000	48 745	140000	91 255
550 000	59 245	154000	94 755

The table reflects the SBC incentive calculated at taxable income bands above R250 000 per annum.

At the very least, each of the 4 462 service-related businesses with taxable income of more than R250 000 per annum receive a tax incentive of R57 652 per annum, resulting in a total SBC annual incentive of R257 million per annum paid to service related businesses.

However, if an average income for the 8 924 service-related businesses of R400 000 is applied, the total SBC annual incentive paid to service related-businesses increases to R376 million per annum.

This analysis demonstrates that the SBC incentive provides a substantial tax benefit to those SBCs whose taxable income exceeds R250 000 per annum. Furthermore, a large proportion of the SBC benefit is enjoyed by service businesses.

In view of the above, the DTC remains adamant that the SBC concession is fundamentally flawed as the recipients of the incentive are, in the main, profitable businesses with income above R250 000 per annum; a substantial proportion of which could never have been the primary target of the incentive.

The remainder of the SBC's within the SME sector (being those with taxable income of below R250 000 are, so to say, left out in the cold.

DSBD feedback and recommendations

The DSBD is supportive of the DTC recommendation that the SBC incentive be replaced with the RCR proposal.

Conclusion and recommendations

The DTC, as noted, remains adamant that the SBC tax system is fundamentally ineffective:

- The tax concessions within the Turnover Tax system eliminate the need for the SBC incentive for micro businesses with a turnover of less than R1 million

- Taxpayers must be allowed to make use of companies when it makes sound sense to do so in the pursuit of a commercial justification or benefit, as opposed to a tax benefit **exclusively** . However, the taxpayer must accept any potential adverse tax consequences. The DTC is of the opinion that, given that salaries can be paid by SBC's to members/shareholders, such adverse consequences are currently confined to issues of compliance cost alone.

- The SBC tax framework is fundamentally based on turnover level, recognising an SBC as a company with a turnover of less than R20 million per annum. The DSBD observes that the maximum registration threshold for medium sized businesses in terms of the Small Business Amendment Act is currently R64 million per annum. Submissions received by the DTC have also suggested that the threshold be substantially increased. However, budgetary constraints make it impossible to substantially extend the maximum turnover threshold beyond its current level.

- Even if the maximum turnover threshold could be extended, this would create the potential to invite further service-related businesses to purse the SBC concession. This could never have been the intention of the incentive.

- The various anti-avoidance provisions within Section 12E are complex, open to abuse and require substantial SARS resources to enforce.

- The SBC incentives have grown over the years and now represent a substantial concession. However, the DTC has been unable to find any substantiated evidence that the SBC incentives are achieving their intended goal. On the contrary, the number of SBCs is in steady decline.

The RCR proposals made in the first report of the DTC were proposed in the interest of retaining some form of concession that is targeted to alleviate the cost of tax compliance within the SME sector. . This promotes the broad objectives of the NDP to create employment and growth in businesses.

The tax compliance burden has been widely identified as the primary tax problem within the 'missing middle.' It is also the stated objective of the NDP to address this issue. Thus, the DTC was of the view that the SBC resource (R1,3 billion) should be specifically targeted as the primary issue.

In view of the above, the following options remain:

1. Retain the current SBC allowance and accept the potential for abuse and the enforcement problems this will entail

2. Remove all service-related businesses from the SBC definition

3. Remove the SBC incentive completely and redeploy the resource within the DSBD or DTI by way of targeted interventions. In this regard, it is noted that the DSBD has recently received an annual budget of R3 billion.[12]

4. Extend the current SBC resource to all tax compliant SBCs through the RCR system.

Other matters concerning SBCs

Basis of reporting of gross income

Submissions have been received by the DTC proposing that small businesses be permitted to determine taxable income on a cash basis, rather than an accrual basis.

The immediate response to such a proposal is to note that accounting practice requires that incorporated small businesses are compelled to prepare annual financial statements recognising the accrual of income. Thus, conversion of income to the cash basis for tax reporting would create additional complexity.

However, it cannot be denied that many small businesses' failures are directly attributable to cash flow difficulties. Thus, it would indeed be unfortunate if tax liability were to contribute to the demise of businesses.

The recent amendments regarding the estimate of the second provisional tax payment create the distinct possibility that any business may be required to effect tax payments prior to the actual receipt of income.

The cash basis of reporting is examined further in Chapter 4, in the discussion on VAT.

Immediate write-off of assets

Submissions have been received by the DTC proposing that small business be permitted to write off capital assets for tax purposes in the year of acquisition. Currently

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[12] *National Treasury. Page 61 of the 2015 Budget Review and page 557 onwards in the 2015 Estimates of National Expenditure*

the framework for the writing-off of capital assets against in the computation of an SBC's taxable income encompasses

- a100% allowance of the cost of any plant or machinery, brought into use in a year of assessment for the first time and used in a process of manufacture or similar process [see Section 12E(1)].

- Machinery, plants, implements, utensils and articles (other than plant or machinery used in a process of manufacturing or similar process) receive annual allowances of:

    - 50% of the cost of the asset in the year of assessment during which it was first brought into use;

    - 30% in the second year of assessment; and

    - 20% in the third year of assessment,

An SBC can elect to claim either the wear-and-tear allowance under Section 11(e) or the accelerated allowance (50:30:20 deduction) under Section 12E (1A)(b).

Assets which cost less than R6 000 qualify for immediate write-off.

Recent recommendations of an Australian government board of taxation encourage the pursuit of higher write off levels for the capital expenditure of small business.[13] Write off levels of up to Au$6000 (+- R47 000) are being targeted.

The DTC recommends that NT consider substantially extending the current capitalisation threshold to beyond R6 000 per asset.

[13] *Australian Government, The Board of Taxation, Review of impediments facing small business, August 2014.*

Chapter 4

VAT

Registration thresholds

The revised provisions contained in the Taxation Laws Amendment Act, 2013 rigidly enforce the compulsory VAT registration threshold of R1 million per annum. This is in contrast to submissions received by the DTC that the compulsory VAT registration threshold be increased.

The DTC reiterates its opinion that the compulsory VAT registration threshold compares favourably to international standards. There does not appear to be any justification for raising the compulsory registration threshold. Indeed, it is in the interest of any business with a turnover exceeding R1 million to maintain proper books and records, thus being able to recover input tax. The VAT system also acts as an important check against the level of income declared for income tax purposes.

The basis of VAT reporting

In summary, VAT income and expenditure can be reported on a cash basis or an accrual basis. Currently, the VAT system prefers the accrual basis. Small businesses owned by natural persons are offered the concession to report VAT on the cash basis when supplies do not exceed R2,5 million per annum. Many submissions have been received by the DTC to the effect that this threshold has not been revised for many years and is far too low.

An extract from the VAT register 2013/14 reflects:

Active vendors on register	420 877
Vendors registered on the invoice/accrual basis	403 952 (96% of total register)
Vendors registered on the cash basis	16 925 (4% of total register)
Companies registered	298 798 (71% of total register)
Individuals and partnerships	82 725 (21% of total register)
Individuals and partnerships registered	
on the cash basis	15 177 (21% of total register)

Further analysis reflects that 54% of vendors with a turnover of less than R5 million per annum report a net creditor position and would be adversely affected by electing the payments basis of reporting.

International comparisons reflect that most taxation authorities prefer the invoice/accrual basis of reporting, to the cash basis.

The issue of increasing the cash basis threshold has been debated over a number of years. However, in the interim, most businesses with a turnover in excess of R2,5 million per annum have installed computer packages that are designed on an invoice/accrual basis and automatically generate the data required to complete the VAT return. Thus, there would appear to be limited merit to the argument that the invoice/accrual basis of reporting unnecessarily complicates VAT or financial reporting. In fact, the adoption of the cash basis of reporting may complicate matters as financial reporting standards for companies do not permit the cash basis method of reporting.

Furthermore, the use of the cash basis of reporting has the potential to complicate the completion of the IT14SD reconciliations.

By revisiting the experiences of VATCOM surrounding the implementation of VAT in 1991, it was found that the cash basis of reporting:

- Creates various opportunities to defraud the VAT system through mismatching of invoices;
- Invites the manipulation of the VAT system on a group company basis; and
- Results in recovery difficulties in the event of deemed supplies on deregistration of vendors or liquidation of vendors.

The VAT Act already contains anti-avoidance provisions to prevent the exploitation of mismatching caused by the existing cash basis of reporting. However, the enforcement of these provisions is extremely complex.

The DTC has observed that SMEs experience severe financial difficulties as a result of delayed payments by debtors. In acute circumstances, this may lead to SMEs facing business rescue or even liquidation proceedings with the inevitable unemployment consequences.

In the context of the SME sector and VAT vendors with a turnover of below R30 million per annum, the bi-monthly VAT payment cycle affords vendors a debtor recovery period of between 25 and 86 days. In most properly managed businesses this should be sufficient to avert adverse cash flow difficulties. Furthermore, a vendor who properly identifies a bad debt is entitled to adjust the VAT computation. Nevertheless, it would be naïve to suggest that this is sufficient to cover all circumstances.

Recommendations

The DTC accepts the submissions of SARS and NT that there is good reason to maintain the current threshold for the cash basis of VAT reporting at its current level of R2,5 million per annum.

However, the distress caused to SMEs by long-outstanding debts cannot be ignored.

The DTC recommends that NT should investigate the introduction of a debtors' allowance where SMEs are allowed to adjust the VAT computation when debtors' balances exceed 90 days. The allowance claimed in each VAT return:

- Would have to be fully documented, and
- Added back in subsequent VAT returns with a new deduction claimed.

Concerns regarding VAT refunds

The DTC has received numerous complaints concerning delays in the processing of VAT refunds, including claims that delays have contributed to eventual and unnecessary business failure.

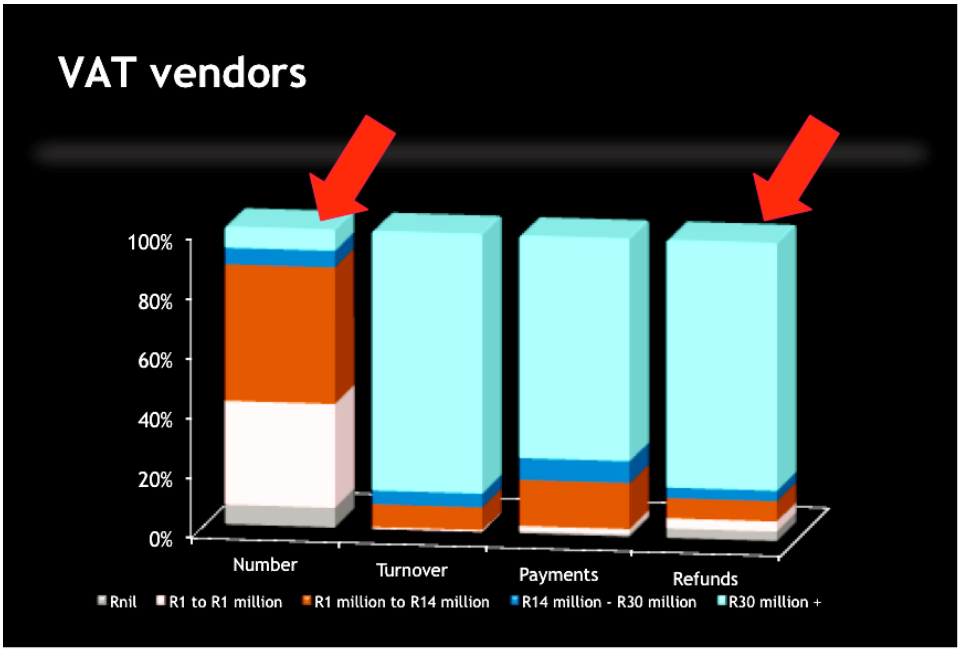
The simple recommendation would be to place stringent time limits on SARS concerning all tax refunds. However, the wider implications of such a recommendation will have to be more fully assessed during the DTC's review of the VAT system in 2016.

SARS has now created a new help desk function for small business. Chapter 6 refers. The DTC hopes that this may lead to some progress in resolving this important issue.

Tax evasion within the informal sector

Submissions received by the DTC again raise the concern regarding levels of tax evasion within the informal sector. These concerns were addressed in the first report.

A recent study of the VAT system by the IMF has concluded that the compliance gap is estimated to be between 5 percent and 10 percent of potential VAT revenues during the period 2007-12, and peaking in 2008 and 2009. The estimated compliance gap for VAT in South Africa between 2007 and 2012 is hump-shaped; the compliance gap increased to 10 percent of potential revenue in 2009, when the South African economy was severely hit by the global financial crisis. The gap has since gradually decreased to the same level as 2007.[14]



Source: SARS Statistics 2014

VAT collections for the 2015/16 fiscal year are budgeted at R286 billion. Even if the VAT gap is at a mere 5%, this represents a substantial potential loss of R14 billion per annum.

74,7% of VAT payments are collected from VAT vendors with a turnover of greater than R30 million per annum. These 28 180 vendors total 7% of registered VAT vendors and are subject to strict SARS enforcement.

By contrast, vendors with a turnover of less than R30 million per annum comprise 93% of the number of registered VAT vendors and contribute 25,3% of VAT payments.

The DTC re-emphasises the following recommendations contained in the first report:

- SARS should actively monitor all VAT declarations made by small businesses in order to combat tax evasion committed by larger businesses concealed under the guise of survivalist business. In particular, annual Turnover Tax declarations should be compared to the banking activity of the taxpayer.

- SARS should rigorously examine the data received from financial institutions to detect unregistered taxpayers who are obviously trading and in receipt of income

[14] *Revenue Administration Gap Analysis Program -The Value-Added Tax Gap. International Monetary Fund, Fiscal Affairs Department, February 2015.*

exceeding the turnover tax threshold of R1 million per annum. SARS should publicise the new initiative relating to profiling and taxpayer selection to encourage taxpayer compliance and to publicise what the key deterrent to tax evasion will be.

Chapter 5

Other developments since the first report

The Small Business Funding Entity: Section 30C of the Income Tax Act

A common suggestion received during the hearings of the DTC was that SA is in dire need of specific public benefit organisations to assist the SME sector.

The Small Business Funding Entity (SBFE) is now defined in Section 1 as any entity approved by the SARS in terms of Section 30C of the Income Tax Act (ITA). (**specify the conditions)**

SBFEs now enjoy preferential tax status:

- Income Tax: partially exempt from income tax. Otherwise subject to tax at corporate income tax rates.
- Dividends Tax: dividends payable to a SBFE are exempt from dividends' tax. Anti-avoidance rules apply.
- Capital Gains Tax: disregard the disposal of assets not used in the carrying on of business or trading activities or for exempt business or trading activities as contemplated in 10(1)(cQ)(ii)(aa), (bb) or (cc).

Various administrative and anti-avoidance provisions are included in the ITA to ensure that SBFE activity is limited to the activities intended within Section 30C. These include:

- Entity type: Trust or Association of persons
- Purpose: Sole or principal object is to provide funds for small, medium and micro-sized enterprises
- Manner: on a non-profit basis, with altruistic or philanthropic intent
- Beneficiaries: the funding is provided for the benefit of, or is widely accessible to, small, medium and micro-sized enterprises
- Documentary requirements: founding document must include prescribed restrictions and limitations set out in Section 30C(1)(d).

In order to assist SMMEs to better utilise their gratuitous funding, it is proposed that amounts received by SMMEs from the approved funding entities, in terms of the proposed section 30C of the Income Tax Act, should be exempt from normal tax. In order for SMMEs to qualify for the exemption, the SMMEs will have to meet requirements of a micro enterprise as contemplated in the Sixth Schedule or Small Business Corporation, as contemplated in Section 12E of the Income Tax Act.

Any expenditure incurred in respect of trading stock allowed as a deduction in terms of Section 11(a) or any amount taken into account in respect of the value of trading stock or the base cost of an allowance asset must be reduced to the extent that the amount received or accrued from the SBFE is applied for that purpose.

Donations made to SBFEs do not qualify for **an** income tax deduction in terms of Section 18A. This leaves the deduction of funding grants to SBFEs to be assessed in terms of Section 11(a) read with Section 23(g) of the ITA.

The DTC refers to the Pick 'n Pay judgment[15] in which funding granted to the Urban Foundation was disallowed in the computation of taxable income for the sole reason that: *'PICK 'n PAY did not show, on the probabilities, that in making the donation it did not have a philanthropic purpose as well as a business purpose.'*

The Warner Lambert judgement is also of relevance . This case dealt with expenditure incurred in the pursuance of the objectives of the Sullivan Code by a South African subsidiary of an American Holding company. The Supreme Court of Appeal held that the Sullivan Code expenses were bona fide incurred for the performance of the taxpayer's income producing operation and formed part of the cost of performing it and, therefore, that the social responsibility expenditure had been incurred for the purpose of trade and for no other. It was further found that the social responsibility expenses incurred by the taxpayer were not of a capital nature in that there was no question of the creation or improvement of a capital asset in the taxpayer's hands, **where** the taxpayer's income earning structure had been erected long ago and accordingly, that the social responsibility expenditure at issue was to be allowed in terms of Section 11(a) read with Section 23(g).

Dr Rob Davies, Minister of Trade and Industry, issued the Codes of Good Practice (the codes) under section 9(1) of the Broad-Based Black Economic Empowerment Act, 2003 (Act No. 53 of 2003) by way of NOTICE 1019, Government Gazette of 11 October 2013. The annual value of the Enterprise Development Contributions and Sector Specific Programme spend target is 1% of net profit after tax. Further, an entity must achieve a 40% subminimum of the Enterprise Development target to avoid discounting of the B-BBEE level.

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[15] *Commissioner for Inland Revenue v Pick 'n Pay Wholesalers (Pty) Ltd (44/87) [1987] ZASCA 44; [1987] 4 All SA 432 (AD) (14 May 1987)*

Payments made by a measured entity to suitably qualified and experienced third parties to perform Enterprise Development on their behalf are permitted (Section 9.1.23 of Statement 400). This results in payments made to SBFEs or incubator/ propeller entities being recognised for purposes of the B-BBEE scorecard.

SBFEs or incubator/ propeller entities and their benefactors are now placed in a difficult position in that the income tax deduction for payments to the SBFE is disallowed. Contrastingly, the benefactor stands to benefit from tax deductions if enterprise development expenditure is incurred in respect of its own initiatives. This represents a substantial hurdle for SBFEs.

The income tax exemption applicable to SMMEs in receipt of benefits from SBFEs is obviously welcomed. However, the actual value of the exemption is questionable as many beneficiaries are either below the tax threshold of the tax imposed or would be tempered by the SBC tax table.

The DTC is of the opinion that the tax deduction granted to the benefactor of an SBFE is of primary importance. Accordingly, it is suggested that all Entrepreneurial Development spend of a measured entity should be deductible in terms of Section 11(a) read with Section 23(g).

Regrettably, the majority Pick ’n Pay judgment presents a significant problem in the context of the many worthy initiatives in RSA today that seek to enhance small business. Accordingly, it is suggested that the Income Tax Act be specifically amended to ensure that all expenditure associated with the sponsorship and enhancement of small business is tax deductible. This recommendation is to be further considered by the DTC sub-committee currently addressing taxation issues relating to public benefit organisations.

Venture Capital Companies: Section 12J of the Income Tax Act

The concept of a tax-deductible investment in Venture Capital Companies (VCCs) investing in small businesses was included in the ITA during 2009, with a sunset clause of 2021.

Until the date of the first report there had been little take-up of Section 12J, with only 3 VCCs established by 2014. The principal criticism of the tax regime is that the compliance requirements were far too strenuous.

National Treasury has now removed the principal hurdles by way of amendments contained in the Revenue Laws Amendment Act 2014. In particular,

- The investment ceiling for investee companies has been increased from R20 million to R50 million, and in the case of junior mining companies, from R200 million to R500 million;
- The recoupment of the tax deduction on investment will be waived if the investment is held for more than 5 years; and
- Loans made to VCC's will qualify for tax deduction.

The DTC agrees that the recent amendments may make the concept of tax deductible VCCs in small business a more attractive proposition for investors. In fact, the number of registered VCC's has increased to 24 by December 2015.

The effect of recent amendments should be monitored in years to come.

Nonetheless, the amendments do little to provide a mechanism to encourage the growth of micro businesses in SA as the provisions are primarily targeted at established SMEs. Thus, the DTC reaffirms its suggestion that NT consider the implications of the creation of a separate tax incentive to encourage angel investors in SMEs. This may be achievable through the extension of the Bad Debt Allowance to allow for the full write-off of failed investments in micro businesses, which may act as an encouragement to angel investors.

The Employment Tax Incentive (ETI)

ETI incentives are deducted through the employees' tax system. In the first report the DTC drew attention to the shortfalls of the ETI system that render the incentives inaccessible to the SME sector. Simply put, many SME's are not required to be registered for employees' tax or, if registered, their employees' tax liability is insufficient to absorb the ETI incentive. .

In the 2015 Medium Term Budget Policy Statement 2015, the then **Minister of Finance** announced that ETI expenditure to date totalled R3,9 billion and had reached 36 000 employers and 250 000 employees.

During 2015, SARS implemented an ETI refund scheme that operates outside of the employees' tax system.

The following refunds were made during 2015:

Month	Number	Refund (R)
2015.04	273	3,800,925.30
2015.05	228	4,899,254.39
2015.06	359	9,358,239.20
2015.07	190	3,367,505.38
2015.08	64	1,632,390.83
2015.09	61	1,287,240.30
2015.10	25	1,956,772.12
2015.11	61	3,998,782.45

This table represents a small fraction of the total ETI incentive. This is indicative that, at present, an ETI has little impact on the SME sector.

The DTC recommends that the specific effect of ETI on the SME sector become an important part of the on-going investigations of ETI.

Co-operative societies 'stokvels'

The DSBD has expressed its concern that the first report has failed to address the taxation implications of co-operative societies.

The DTC accepts that co-operative societies are usually taxed at the corporate rate of tax of 28% and distributions to members are taxed at the dividends tax rate of 15%. This rate is, in most instances, above the personal income tax rate of the investors.

The DTC recommends that further investigation of the taxation implications of co-operative societies is indeed necessary and should be conducted by NT in conjunction with DTI.

Tax clearance certificates

The DSBD has made representations to the DTC to the effect that registered SME's experience substantial difficulties in arranging valid original tax clearance certificates that are required as part of the tendering process by all State institutions and related parties. The DSBD is of the opinion that tax clearance certificates should be issued electronically.

Similar representations are contained in the submissions to the DTC by other parties.

The DTC accepts that all efforts should be made to ensure that tenders are only awarded to fully tax compliant taxpayers. However SARS should take all necessary steps to ensure that the compliant taxpayers have efficient access to tax clearance certificates.

It is noted that a substantial overhaul of government procurement procedures is currently in progress and that this will dispense with the current requirements of original tax clearance certificates.

The DTC recommends that all efforts should be made to ensure that tax compliant SME’s are not unduly hindered by the obligation to furnish tax compliance certificates.

Chapter 6

Tax administration

In the first report, the DTC observed that it is apparent that taxpayers are of the opinion that communication and information-sharing from SARS is lacking.

The DTC recommended that SARS develop a communication strategy specifically aimed at taxpayers who could potentially fall within the Turnover Tax system. The strategy could include focussing on issues such as communication by SMS, web-based communication (and e-learning) and the establishment of a unit or desk in SARS Contact centres that would focus on Turnover Tax education.

SARS has recently established 138 small business desks at branches countrywide to service taxpayers who operate small and micro enterprises. This is in line with the commitments made by former Finance Minister, Mr Nhlanhla Nene, during his Budget Speech on 25 February 2015.

The purpose behind the establishment of these desks was to show SARS's commitment towards fulfilling government's policy initiative of supporting small business development through making it easier for these businesses to comply with their tax obligations. This is within the SARS strategy and a way to respond to the Davis Tax Committee report.

SARS had been piloting these desks since August 2014, with the first phase of the project ending in October 2015. Phase 1 pilot took place in the Soweto-Orlando East (New branch) and Pretoria CBD branches.

Small business desks are service counters designed specifically to address the tax affairs of Small Business taxpayers. The desks offer services such as:

- Business Tax advice;
- Business registration and/ Legal Entity Registration;
- Business returns submissions;
- Tax Clearance Certification applications (Tenders application purposes);
- Business detail changes: banking, address and others; and
- General tax queries

The small business desk capability services a minimum of 14 000 small businesses per week.

Small business owners whose annual turnover does not exceed R20 million can use the services of these desks.

SARS reports that there has been an increase in the number of taxpayers using this service, largely due to the public awareness.

In presentations before the DTC, SARS has identified that still more attention is to be directed towards the SME sector as part of the overall SARS strategic plan.

The DTC recommends that progress with regard to the new SARS initiatives relating to the SME sector should be closely monitored and evaluated.

Chapter 7

Skills development

A primary focus of the NDP is skills development. Yet the requirements and incentives offered by the ITA and the Skills Development Act (Act No. 97 of 1998) are, in reality, inaccessible to the SME sector**, primarily for the following reasons :**

- The generous training allowances contained in Section 12H of the Income Tax Act are focused on apprenticeships, learnerships and traineeships. Small businesses cannot afford the costs of the establishment of such programmes.
- Small businesses with employment costs of less than R500 000 per annum are exempt from the payment of the Skills Development Levy (SDL) and are thus precluded from reclaiming training costs through the mandatory or discretionary components of the SETA programme.
- Although small businesses with employment costs of greater than R500 000 per annum are required to pay SDL, the compliance costs of recovery of SDL by small businesses would, in all probability, exceed the actual recovery.

Employers with payrolls of greater than R500 000 are required to pay SDL at 1 percent of payroll. These funds are then forwarded to the various Sector Education Training Authorities (SETA's) to be deployed towards skills development throughout South Africa.

Employers are eligible to apply for a reimbursement of SDL from both the Mandatory and Discretionary funds from the relevant SETA based on their training spend and subject to the successful implementation of their submitted Work Skills Plan evidenced by their Annual Training Report.

In accordance with the new regulations[16], mandatory grants have been limited to 20% of SDL liability. In other words, under this plan an employer is eligible to claim back 20% of the 1% of their SDL levy if all the necessary conditions have been met. This is a significant reduction from the previous level of 50%; employers will now have to claim under the discretionary grant pool.

[16] *SETA Grant Regulation Gazette No. 9867 of 3 December 2012*

Discretionary grant funding now accounts for the remainder of the 69,5% of the SDL allocated to SETAs, with 20% allocated to mandatory grants and 10.5% allocated to SETA administration expenses.

Regulation 6(12) in the SETA Grant Regulation Gazette No. 9867 of 3 December 2012 states that: "At least 80% of discretionary grant funding must be allocated to PIVOTAL programmes". PIVOTAL is an acronym which means Professional, Vocational, Technical and Academic Learning programmes that result in qualifications or part qualifications on the National Qualifications Framework as contemplated in regulation 3(6) and (7), as read with regulation 6(11) to (15).

Academic learning programmes shall mean 'programmes that lead to academic qualifications such as Certificates, Higher Certificates, Diplomas and Degrees.'

In order to obtain discretionary funding for PIVOTAL programmes, the employer must complete and submit a PIVOTAL training plan by the stipulated dates.

The grants available through the PIVOTAL programmes are substantial, as evidenced below.

Approved grants per intervention

Intervention	Amount per Learner (18.1)	Amount Per Learner (18.2)	Stipend for 18.2 learners
Academic Programmes NQF 10 – Doctorates/PhD	R 47 000	R 47 000	n/a
Academic Programmes NQF 9 - Masters	R 47 000	R 47 000	n/a
Academic Programmes NQF 9 – MBA	R 110 000	R 110 000	n/a
Academic Programmes NQF 8 – Post Graduate Diploma	R 42 000	R 42 000	n/a
Academic Programmes NQF 8 – Honours	R 42 000	R 42 000	n/a
Academic Programmes NQF 7 – Bachelors' Degrees & Advanced Diplomas	R 42 000	R 42 000	n/a
Academic Programmes NQF 6 – National Diplomas and Advanced Certificates	R 37 000	R 37 000	n/a
Academic Programmes NQF 5 – Higher Certificates and Advanced National Certificates (Vocational)	R 37 000	R 37 000	n/a
Academic Programmes NQF 4 – Certificate FET (Private and Public)	R 37 000	R 37 000	n/a
Artisan Programme - Apprenticeship	R 42 100	R 42 100	n/a
Artisan Programme – Learnerships	R 15 000	R 15 000	R 24 000
Learnerships – NQF 1 & AET	R 15 000	R 15 000	R 24 000
Learnerships – NQF 2	R 15 000	R 15 000	R 24 000
Learnerships – NQF 3	R 15 000	R 15 000	R 24 000
Learnerships – NQF 4	R 15 000	R 15 000	R 24 000

Intervention	Amount per Learner (18.1)	Amount Per Learner (18.2)	Stipend for 18.2 learners
Learnerships – NQF 5	R 15 000	R 15 000	R 30 000
Learnerships – NQF 6	R 15 000	R 15 000	R 30 000
RPL Programmes	R 11 250	R 11 250	n/a
Skills Programmes	R 7 500	R 7 500	R 8 000
Work Experience & Employment Grant FET (L4) Graduates @ R2000pm for 12 months	n/a	n/a	R 24 000
Work Experience & Employment Grant Degree & Diploma Graduates @ R3500pm for 12 months	n/a	n/a	R 42 000
Work Integrated Learning Placements for FET Final Year Students @ R2500 for 3 - 6 months	n/a	n/a	R 15 000
Work Integrated Learning Placements for HETI Final Year Students @ R2500 for 3 - 6 months	n/a	n/a	R 15 000
Internships @ R2500 pm for 18 Months	n/a	n/a	R 45 000

Source: W&R SETA Website: Discretionary Grant Guidelines 2013

However, it is simply not feasible for an SME, or for that matter, a medium sized business to participate in either mandatory or discretionary spend as the compliance requirements of the system are substantial.

For example, a business with a payroll of R20 million will incur SDL liability of R200 000. Only R40 000 is potentially reclaimable in terms of the mandatory refund and it is questionable whether the compliance costs of claiming such a refund would be worth the effort. Although more is potentially reclaimable through the discretionary grant this would require the implementation of a PIVOTAL skills programme at further substantial cost.

Total SDL collections are budgeted at R15 billion for the 2015/16 fiscal year.

Statistics furnished by SARS from 2014 IRP5 returns reflect the following SDL payments by payroll bands for the period March 2013 to February 2014.

Payroll bands and SDL payments 1 March 2013 to 28 February 2014

Income grouping Employers	Employer Numbers	Cumulative Employer Numbers	SDL Paid	Cumulative SDL Paid
			R Million	R Million
>R500k-< R2 mil	81916	81916	537,7	537,7
>=R2mil- < R5mil	31641	113557	845,5	1383,2
>=R5mil -< R10mil	12692	126249	796,8	2180,0
>=R10mil- < R20mil	6 886	133135	874,7	3054,7
Total	**133135**		**3054,7**	**Total**

The above results in a substantial number of small, and even medium, sized businesses contributing to the SDL programme with little or no real prospect of obtaining any direct benefit. At the same time it is reported that some SETAs are struggling to fulfil the expenditure targets set by government.

Recommendations

The current SETA refund system is skewed against the SME sector. Given the objectives of the NDP towards growth in the SME sector this is simply unacceptable.

Substantially increasing the SDL threshold, beyond the current R500 000 levels, could provide an immediate solution to the present problem. However, this would not address the need for training incentives within the SME sector.

The DTC recommends that high priority should be given to making skills development incentives accessible to the SME sector.

Consideration should be given to allowing tax compliant small businesses separate access to a Small Business SETA mandatory and discretionary spend, without the implementation of comprehensive Work Skills Plans, Annual Training Reports and PIVOTAL training plans.

Appendix A

SUBMITTER	TOPIC	COMMENTS (page numbers refer to the full submissions register)	CONSIDER	DISREGARD
Anon	Registration threshold	SMEs below a certain threshold of R1 million should not be required to register or pay any type of taxes. Pg 1		Considered Rejected Undermines section 22 of TAA
	Cost of compliance	The administrative burden of the collection of taxes in SME is underestimated Pg 1		Noted. RCR has been determined on budget available
Traffic man (Shaun)	Registration threshold	Registration threshold last changed in 2009 and inflation not taken into account Pg 1		
Stephen Timm	RCR	Rebate erodes the capacity to reward the job-creating segment of small businesses (being larger small firms) and amounts to little more than a hand-out Pg 1	Considered. SBC is equally ineffective	
Zeyn Mia	RCR	RCR is simply a re-allocation of the tax savings from the 4 519 successful SBCs towards the tax engineered SBCs. In reality this RCR will be channelled to bookkeepers, accountants and the like Pg 3	Considered. No evidence of job creation	
	Registration threshold	Increase participatory level to maximum R20 million turnover for all enterprises (including sole traders and partnerships). Tweak the current anti abuse measures to exclude undesired professions and reduce the % of service fees and passive income Pg 3	Considered. This would create a massive enforcement issue	
Eric Milner	Cash flow	The reality of small business is that clients pay late (sometimes not at all) whilst suppliers demand deposits and money upfront Pg 4	See recommendations re VAT	
	Cost of compliance	Save taxpayers time and money by making the tax system less complicated Pg 4		
	RCR	Rebate does not constitute tax relief per se, as taxpayers who have paid no tax will qualify Pg 5	Misunderstood. All compliant taxpayers have increased compliance costs	
	Receipt or accrual	Use receipts as basis of taxation for income tax as opposed to the accrual basis for SMEs Pg 5 Revert to the receipts basis of VAT reporting Pg 5	Noted and accepted.	
	Capital expenditure	For income tax consider a 100% deduction for capital Expenditure Pg 5	Accepted Vide Australia AU$ 6000	
	Treasury and SARS prejudice	SARS have prejudged the matter in that the DTC has called for public comments on its proposals 14 whilst SARS have called for comments on the Draft Taxation Laws		

SUBMITTER	TOPIC	COMMENTS (page numbers refer to the full submissions register)	CONSIDER	DISREGARD
		Amendment Bill Pg 6		
Ian Andersen	Receipt or accrual	VAT payment basis not available to all since 1998 Pg 6	Agreed Addressed in budget review 2015	
	Registration threshold	Threshold was last increased in 1992 from R1 million to R2,5 million p/a Pg 6	Agreed	
	Cash flow	Bad debt relief causes a cash flow problem for SMEs on the invoice basis Pg 6	Agreed	
	Tax compliance certificate	New laws mean that a taxpayer can no longer expect to obtain a tax clearance certificate from SARS in a period shorter than 21 business days from the date of application. Pg 6 and 27	Agreed. TCC and RCR should be issued on assessment	
MAZARS	Cost of compliance	DTC report's conservative estimate of costs is very material and these are a significant contributing factor in small businesses failing or delaying profitable and cash-flow positive results Pg 34 Supports no provisional tax returns, or multiple yearly returns Pg 38	Agreed. But cannot be avoided	
	SARS inefficiency	Continuing and extensive changes to tax law, annual, backdated, etc. add to uncertainty of the application of the law, complexity and cost. Pg 38 Insufficient support is provided by SARS to assist the SBC compliance Delayed refunds by SARS. Pg 38	Agreed.	
	Simplification	Simplifying tax returns (number of returns forms), submission and payments processes, qualification criteria, providing dedicated SBC help centre. Leniency required in law for a transitional period during which a business can get its affairs in order without penalty. Pg 38 SARS staff assisting not sufficiently skilled or knowledgeable Pg 38	Agreed.	
	Registration compliance burden	Registrations time-consuming, costly, and unnecessarily onerous. Pg 38	Agreed	
	Registration threshold	If the maximum turnover level for a SBC is increased to R50 million, recommend increasing the threshold for a Category C VAT vendor to R50 million Pg 38		Disagreed. Addressed in report
	Receipt or accrual	Threshold for qualifying to account for VAT on the payments basis needs upward revision Pg 38	Agreed Refer budget review 2015	
	ETI	Cost of compliance higher than benefit Pg 38 The maximum salary levels too low for many industries. Pg 38	Suggest wait for preliminary finding of SARS on ETI.	
	Angel investment support	Support recommendations for deduction of corporate social investment expenditure Pg 38	Agreed. Refer report.	

SUBMITTER	TOPIC	COMMENTS (page numbers refer to the full submissions register)	CONSIDER	DISREGARD
PKF	RCR	Companies with a higher taxable income will be in a worse off position The rebate of R20 000 is insignificant in relation to the actual costs (Pg 1 of PKF pdf submission)	Agreed but that is all the budget can sustain	
	Threshold	Abandoning the current system due to non-compliance is no basis for change. The SARS costs should have decreased considering the move to an electronic platform (Pg 2 of PKF pdf submission) The original intent to support SME was not based on compliance (Pg 2 of PKF pdf submission)	Agreed but original intention was expressed at a time when higher corporate tax rates were in force	
	Registration threshold	Level needs to be increased from R20m to R50 million (Pg 2 of PKF pdf submission)		Addressed in report
	SARS efficiency	The reference to no information being available for 51 042 taxpayers (page 21 of report) is questionable (Pg 2 of PKF pdf submission) SARS should be subject to some form of time period to release a VAT refund and a late refund penalty should be imposed (Pg 4 of PKF pdf submission) Dissatisfaction with SARS efficiency is not limited to SME and relates to all taxes (Pg 4 of PKF pdf submission)	Agreed. Hopefully SARS help desk will assist	
	Angel investors	The incentive needs to be extended to private equity firms to allow an immediate write-off of investment if it reduces in value – could be capped to prevent abuse. (Pg 2 of PKF pdf submission)	Addressed in amendments	
	Training allowances	Support additional allowance for training but staff family members must be excluded (Pg 3 of PKF pdf submission)	Agreed include	
	PBO changes	This does not form part of the SME report (Pg 3 of PKF pdf submission)		Ignore
	Provisional tax	The basic amount should form the basis of calculation for 1st and 2nd periods (Pg 3 of PKF pdf submission)		
	Complex VAT laws	Permit an input tax deduction on receipt of an invoice from clearing agent and rules for valid tax invoice need to be relaxed (Pg 3 of PKF pdf submission)	Addressed in TAA 2015. Effective 1 April 2015.	
	Cost of compliance	The true cost of compliance needs to be established at today's rates (Pg 2 of PKF pdf submission)		There is a difference between cost of compliance and cost of keeping records for good business reasons
SAIT	Definition of SME	Determining the tax systems function without a coherent formal government policy will create increased risk for failed proposals and create further confusion and uncertainty among the SME		

SUBMITTER	TOPIC	COMMENTS (page numbers refer to the full submissions register)	CONSIDER	DISREGARD
		community Pg 39		
	Amnesty vs. VDP	Disagree that an ongoing tax amnesty for SME's would not be more useful than the current voluntary disclosure programme Pg 39		Considered by DTC.VDP is permanently in place
	Registration threshold	Supports increase, but policy exclusion based on perception that they do not create employment is a concern Pg 40		
	RCR	Policy intention is misplaced as policy should support conducive business environment, including tax, rather than using carrot and stick approaches to good tax compliance Pg 40 Finding that the SBC regime does little to support small business growth is contrary to the findings of a survey by SAIT which indicated that the SBC regime gives a substantial benefit in the form of reduced taxes and upfront deduction of the cost of manufacturing assets. Cash flow of these entities immediately improved Pg 40 RCR is welcomed for SME with a taxable income of R53 574 or less BUT those with a turnover of more will be in a worse off position Pg 41 More research in this area needs to be done Pg 41 Should the RCR be implemented and trade-off needed, the current incentive value of R93 459 should be retained rather than increasing the threshold band to R50 m and reducing the incentive to a negligible R20 000. Pg 42 Eligibility for RCR – considering complex tax environment, proposal only practical if SME is afforded opportunity to fix all compliance in year in which the RCR is payable within 9 months after such year of assessment. Pg 42	Agreed Discussed in report	Proposal far too expensive
	Angel investment support	Facilitating funding needs of SBCs is welcomed Pg 43		But cannot be extended by SARS beyond the tax computation
	Receipt or accrual	Cash basis proposal welcomed Pg 43		
	SARS inefficiency	SARS should be subject to some form of time period to release a VAT refund pg 43	Agreed Hopefully addressed by the new help desks at SARS	
	Elect out by micro business	Proposed that micro businesses able to elect out of the regime on a once-off basis as opposed to being locked into the regime for 3 years pg 43	Agreed Addressed in report.	

SUBMITTER	TOPIC	COMMENTS (page numbers refer to the full submissions register)	CONSIDER	DISREGARD
	Personal service providers	Revisiting of personal service provider regime welcomed but discussion document on continued need for this regime by National Treasury and SARS is needed Pg 43	Discussed in report.	
SACCI	Definition of SME	DTC provide guidance on a preferred methodology to classify SME and to achieve a uniform definition across government departments Pg 44	Addressed in first report. DTC brief does not extend further than the comments on the first report.	
	Job creation potential of SME	Further research into job creation potential of SME be conducted, especially within the context of long term changes to the economic structure of South Africa. Pg 44	Agreed.	
	SARS responsibility to SME	SACCI propose that SARS take an active approach to improving investment conditions in South Africa beyond an instrumental focus administration on managing tax Pg 45		Not within DTC brief
	Personal service providers	Comprehensive tax incidence study needed to test the impact of the proposed withdrawal of the SBC allowance Pg 46		Evidence exists that it is achieving very little
	Cost of compliance	Study should be conducted to measure the administrative charges and associated regulatory costs faced by business Pg 47		Refer Smulders report.
	Angel investment	Supports the 'Angel investor' proposal, but Section 12J to remain in place with increase to the thresholds, design changes to reduce the administrative burden Pg 48	Addressed in ITAA 2014	
	SARS inefficiency	Specific deadline for VAT refunds be introduced. Support separate lines of communication and offices for the SME sector Pg 48	Agreed Refer to SARS help desks.	
	Corporate donations	Support proposal to help to fund micro businesses that struggle to get start-up financing. Pg 50	Section 30C in place. But needs refinement	
ACTUARIAL SOCIETY	SARS efficiency	Delayed refunds cause cash flow problems Pg 51 Important to train civil servants and personnel in other various private institutions within the regulatory framework Pg 51	Agreed. Addressed by help desks at SARS	
	Angel investment	Consideration of creation of a Government Loan Guarantee system for Venture Capital investors to extend risk capital to emerging entrepreneurs Pg 52		Refer to DTI or SME ministry. Outside scope of the SARS act.
	Other support to SME	National Treasury should lead in building confidence in financing sector in dealing with small businesses that do business with Government Pg 52		Not the task of NT but rather DTI or SME ministry
PWC	RCR	Support of the proposed repeal of the		No other proposal

SUBMITTER	TOPIC	COMMENTS (page numbers refer to the full submissions register)	CONSIDER	DISREGARD
		reduced tax rate regime for small business BUT opposed to the RCR proposal in principle Pg 58/59		offered
	Cost of compliance	No reason why any steps taken to alleviate the tax compliance burden for SMEs should be applicable just to such businesses operated in the form of a company and not to sole proprietorships and partnerships Pg 59		Not affordable Addressed in report.
	SARS efficiency	Greater efforts should be made to simplify and reduce the compliance burden for small businesses Pg 59	Refer SARS help desks	
	Receipt or accrual	Allowing the determination of taxable income of small businesses on a cash basis, rather than an accrual basis Pg 59	Discussed in report	
	Capital expenditure	Allowing for the immediate deduction of the cost of all allowance assets Pg 60	Agreed. Discussed in report.	
	Cost of compliance	Provisions that add complexity should not apply to SMEs, e.g. those related to the timing of taxation and deductions such as s 23H, 24I, 24J, 23M Pg 60		Too complex. Affects very few SMEs
	Registration threshold	Concern with the proposed exclusion of SMEs with a turnover of less than R1 million. Pg 60		Misunderstood.
	Angel investment	Concern that a tax policy instrument is not the appropriate instrument to address the externality in relation to the financing of small business. The regime should be withdrawn for small business and replaced with a targeted on-budget expenditure programme for small business. Pg 60 Support for VCC for junior miners but regime should be simplified for junior minors and the best features of the VCC regime and Canadian FTS regime incorporated into a regime that allows for direct investment in junior mining companies. Pg 60	Agreed Refer to national treasury	
SARS Audit	SARS efficiency	SARS can benefit in many ways from a more co-operative relationship with SMEs Pg 52 SARS still has to thoroughly understand the risks, challenges and concerns associated with establishment, operation and sustainability of SMEs Pg 54 Report falls short of emphasis on the need for SARS to robustly focus on the 'Education' aspect of the SARS Compliance Model. Pg 55 Electronic Cash Register System similar to the South Korean Model Pg 55 Fixed Flat Tax Rate for Minibus Taxis similar to the Ghanaian Model Pg 56 Ministry for Small Business Development - critical for whole government view to	Agreed Addressed in part by the new help desk project.	

SUBMITTER	TOPIC	COMMENTS (page numbers refer to the full submissions register)	CONSIDER	DISREGARD
		achieve value chain efficiencies Pg 56		
	SME definition	Recognise no universally accepted definition of SMEs hence a need for an alignment Pg 56	Agreed	
	SME foreign ownership	Report is very silent on the impact made by SMEs owned and operated by non-nationals Pg 57	Agreed	
	TOT	SARS does not have any policies and procedures on TOT; recommends the development of the Turnover Tax policies and procedures for micro businesses as the TOT system is seen as a risk Pg 58	Agreed. Addressed in part through help desk initiative	