

A comparative study of tax incentives for small businesses in South Africa, Australia,
India and the United Kingdom

by

PETER SSENKYONJO

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SUPERVISOR: Mrs. MSI Wentzel

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DECLARATION

Name: PETER SSENKYONJO

Student number: 47056053

Degree: MASTER OF PHILOSOPHY: ACCOUNTING SCIENCES (98587)

Exact wording of the title of the dissertation as appearing on the copies submitted for examination:

A COMPARATIVE STUDY OF TAX INCENTIVES FOR SMALL BUSINESSES IN

SOUTH AFRICA, AUSTRALIA, INDIA AND THE UNITED KINGDOM

I declare that the above dissertation is my own work and that all the sources that I have used or quoted have been indicated and acknowledged by means of complete references.

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DATE

ABSTRACT

This study discusses South Africa's tax incentives for small businesses and identifies shortcomings and areas of concern within the tax incentive regimes. A comparison of small business tax incentives provided by Australia, India, and the United Kingdom is made with South Africa's small business tax incentives to identify similarities and differences, and new lessons are learned from the approaches of other countries. As a result of the comparison with the tax dispensations available to small businesses in other countries, the study recommends additional tax incentives that could be implemented by South Africa. Only those tax incentives that are available in other countries but not in South Africa that were deemed worthwhile were recommended to be introduced in the Republic. Recommendations were also made based on the gaps identified in South Africa's small business tax incentives.

KEY TERMS

Small businesses; micro-businesses; Small Business Corporations; tax incentives; small business tax incentives; Income Tax Act; turnover tax; Income Tax Assessment Act of Australia; Income Tax Act of India; progressive rate of taxation; gaps and areas of concern within the small business tax incentives

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LIST OF ACRONYMS AND ABBREVIATIONS

ABS	Australian Bureau of Statistics
AIA	Annual Investment Allowance
ATO	Australian Tax Office
BER	Bureau for Economic Research
BRICS	Brazil, Russia, India, China and South Africa
CC	Close Corporation
CGT	Capital Gains Tax
CIR	Commissioner for Inland Revenue
CTA	Corporation Tax Act
DOR	Department of Revenue
DST	Department of Science and Technology
DTC	Davis Tax Committee
DTI	Department of Trade and Industry
ESVCLP	Early Stage Venture Capital Limited Partnership

ETI	Employment Tax Incentive
EU	European Union
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Service
GDP	Gross Domestic Product
GEAR	Growth, Employment and Redistribution
GST	Goods and Services Tax
HMRC	Her Majesty's Revenue and Customs
IDZ	Industrial Development Zone
IEG	Independent Evaluation Group
IFC	International Finance corporation
IMF	International Monetary Fund
IT	Income Tax
ITAA	Income Tax Assessment Act
ITR	Income Tax Return
MSME	Micro, Small and Medium Enterprises
MSMED	Micro, Small and Medium Enterprises Development
NCR	National Credit Regulator
NDP	National Development Plan
NSB	National Small Business
OECD	Organization for Economic Co-operation and Development
R&D	Research & Development
SADC	Southern African Development Community
SAMAF	South African Microfinance Apex Fund
SARB	South African Reserve Bank
SARS	South African Revenue Service
SBC	Small Business Corporation
SDL	Skills Development Levy
SEDA	Small Enterprise Development Agency
SEFA	Small Enterprise Finance Agency
SETA	Sector Education and Training Authority

SEZ	Special Economic Zone
SME	Small and Medium Enterprise
SMME	Small, Medium and Micro Enterprise
TAA	Tax Administration Act
UK	United Kingdom
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
USAID	United States Agency for International Development
VAT	Value Added Tax
VCC	Venture Capital Company
VCLP	Venture Capital Limited Partnership

CHAPTER 1

INTRODUCTION

1.1 OVERVIEW OF THE STUDY

Small businesses contribute significantly to the development of an economy and thus the government finds it essential to assist their development and growth (SARS 2017a: 2; National Treasury 2013: 12). The National Treasury (2013: 12) acknowledged that Small and Medium Enterprises (SMEs) play a key role in the development of the South African economy and are a significant generator of employment. From the start of democratic South Africa in 1994, the government recognised its important role in fostering an enabling environment for the creation and growth of small enterprises (Department of Trade and Industry (DTI) 2005: 3). The government's release of the 1995 White Paper on a national strategy for the development and promotion of small business in South Africa was a clear indication that the foundation had been laid to provide comprehensive support to the development of small businesses (DTI 1995: par 3.1).

In 1996, the National Small Business Act (No. 102 of 1996) (South Africa 1996) was enacted to provide guidelines on the promotion of small businesses in South Africa and it was later amended by the National Small Business Amendment Act of 2004. In its efforts to creating an enabling environment for small businesses, the South African government has formed institutions such as the Small Enterprise Development Agency (SEDA), the Khula Enterprise Finance, and the South African Microfinance Apex Fund (SAMAF) (DTI 2008: xxiv). One of the most recent developments is the Small Enterprise Finance Agency (SEFA) which was started by the South African government in 2012 and its duty is to oversee the survival, growth, and development of small businesses that shall contribute towards poverty eradication and job creation (National Treasury 2013: 12). The National Treasury's

2013 budget speech was also a reinforcement of the supportive role that the South African government had taken towards small businesses. Much has been put in place to pave the way for the development of a sector that has proven to be an engine, the fuel, and a key driver of economic development in South Africa as identified by several scholars and organisations (Abor and Quartey 2010: 218; Chimucheka 2013a: 157; South African Reserve Bank (SARB) 2015: 1).

The DTI (2008: xxvii) reported that there were 421 644 Small, Medium and Micro Enterprises (SMMEs) by 2004. This number excluded all small businesses in the informal sector as well as sole proprietorships and partnerships that were considered to be significantly very small. The gist here is that there was still much work to be done for more small businesses to be nurtured as well as bringing them to the formal sector. Creating an enabling environment for business with future prospects of growth has to include the addressing of tax matters. The South African Revenue Service (SARS) offered small businesses the small business tax amnesty in 2006 which offered small businesses an opportunity to regularise their tax affairs. Successful applicants to the amnesty would have their tax liabilities wiped clean in relation to business income earned in the tax years prior to 2006 (SARS 2006: SBA 001). In an open letter to small business owners in 2006, the Commissioner of SARS had this to say:

“Without small businesses, many more of our people would be without jobs and an honest way to make a living. Without small businesses, we would not be able to see South Africa grow and prosper as it has. Without small businesses, there would be no big businesses! That is why throughout government, we are working hard to find ways to make it easier to start and grow a small business. The tax amnesty is one way we are helping.”

(SARS 2006: SBA 001)

In this letter, Pravin Gordhan (the then commissioner of SARS) was appealing to small business owners to apply for the tax amnesty. In his message, he re-affirmed the importance of small businesses and what a flourishing small business sector can

do for an economy (SARS 2006: SBA 001). It is also clear that he was passing on the same message of government being ready to support small businesses.

It is important to note that the South African economy has grown and economic activity has increased but it is still not enough to substantially lower the levels of unemployment (World Bank 2018: iv). South Africa's competitiveness on the global scale has also been questioned while employment growth faces challenges of skills shortage and a lack of entrepreneurial capacity. It is also still proving to be an overwhelming task to integrate previously marginalised individuals and informal sector enterprises into the formal economy (DTI 2008: xxiv). Rungani and Potgieter (2018: 1 - 2) point out that small businesses make a significant contribution towards the Gross Domestic Product (GDP) of South Africa at approximately 42 per cent and an even greater input towards employment. They also recognise that most SMEs (more than 85 per cent) are in the survival category and have little potential for growth.

The government has not yet succeeded in creating an entirely enabling environment for small businesses to prosper. FinMark Trust (2010: 31) conducted a survey in which small business owners were asked about the obstacles they face towards growth and many cited the lack of access to finance, crime, and theft, as well as the high cost of finance among other challenges. To compound the challenging business environment, small businesses are also faced with a tax compliance burden (Smulders and Naidoo 2011: 264). However, with the creation of the Department of Small Business Development in 2014, the South African government has significantly increased its support towards small businesses to ensure an enabling environment for their growth (Dhanah 2016: 13). The government has also come up with tax incentives for small businesses as a way of providing support to small businesses such as the Section 12E allowance for Small Business Corporations (SBCs) and turnover tax for micro-businesses.

Tax incentives for small businesses in democratic South Africa could be traced back to the Katz Commission of 1995, which provided a report on the comprehensive review of the country's tax systems and structure (National Treasury 1995: 28 - 30).

This report was followed by the Growth, Employment, and Redistribution (GEAR) document of 1996 (National Treasury 1996: 13 - 14) which saw the introduction of an accelerated depreciation scheme, tax holiday scheme (later phased out in 1999) and a set of incentives for small businesses enterprises (Barbour 2005: 18). Tax incentives have their own shortcomings and have been criticised by many scholars (Klemm 2009: 12; Bird 2008: 10; Zolt 2014: 10 – 12) while other researchers such as Mabhoza (2011: par 4) have questioned whether tax incentives yield the desired results. Mabhoza pointed out that South Africa should pursue tax incentives bearing in mind that it has limited resources and therefore there is a need to assess the impact of those particular tax relief measures timeously. This could enable the government to discontinue any tax incentives that are not contributing to the required output. Mabhoza (2011: par 4) also added that the incentive programs that are implemented in South Africa are generally not reviewed to determine their success.

The lack of awareness on the side of small businesses regarding tax incentives available to them has also been raised. Smulders, Stiglingh, Franzsen and Fletcher (2012: 212) noted that some small businesses in South Africa were ignorant, not updated or had no knowledge of the existing tax incentives for which they would qualify. This cannot be underestimated because several renowned scholars and economic organisations of note (for example the Organisation for Economic Co-operation and Development (OECD)) have identified that if tax incentives are to contribute to the development of small businesses, they have to be well designed, rightfully selected, periodically reviewed, and the public must be aware of their availability (Zolt 2014: 9; OECD 2013: 3 - 4). Through identifying the available tax incentives for small businesses, this study could contribute to the taxpayers' awareness of the availability of tax relief measures for which they would qualify. From a taxation perspective, small business tax incentives have been provided to enable the development of small businesses to grow and create more jobs. It is for this reason that this study chose to identify South Africa's small business tax incentives and also find out whether there are any gaps and areas of concern with them, which would not enable the achievement of the government's objectives of providing support to the small businesses.

The government's instruments used in supporting small businesses need to be compared with those used in other countries whose small businesses are flourishing. This comparison would enable us to draw lessons and learn from how other countries are achieving success through the use of fiscal instruments. This explains why the study sought to compare South Africa's small business tax incentives with those offered by other countries. The process of comparison would lead to recommendations being made on the introduction of new tax incentives for small businesses.

1.2 BACKGROUND

This section presents the fundamental pillars upon which this study is based. The study relates to small businesses and tax incentives for small businesses. It is therefore essential that the background looks at the size and nature of small businesses in South Africa, the importance of small businesses to the South African economy, the burden of compliance costs to small businesses, and the importance of tax relief initiatives for small businesses.

1.2.1 The size and nature of small businesses in South Africa

In its annual review of small businesses in South Africa, the DTI released a report relating to the period 2005 – 2007 (in reference to data from the Statistics SA Integrated Business Register), in which it explained that the size categories were determined on the basis of the annual turnover figures of enterprises (DTI 2008: 57). The report indicated that 36 per cent of the registered active businesses were micro enterprises while about 82 per cent were a combination of the micro and the very small entities. It was noted in the DTI report, however, that the figures for micro and very small businesses were limited to only those businesses that operated in the formal economy. The figures also did not include sole proprietors and partnerships which tend to be significantly smaller (DTI 2008: 60). Thus, if all small businesses in the informal sector were to be included, as well as sole proprietors and partnerships which could have been even smaller than micro-businesses, the figures could have

been higher than presented below. Table 1.1 below shows the numbers and percentages of small businesses in their respective size categories in relation to the numbers of large businesses in the years 2004 and 2007 respectively.

Table 1.1: Statistics SA Integrated Business Figures by enterprise category, 2004 and 2007 compared

Enterprise Category	Integrated Business Register 2004		Integrated Business Register 2007		% Growth 2004 - 2007
	Count	Per cent	Count	Per cent	
Micro	212 161	50.3%	200 377	37.4%	-5.6%
Very Small	170 338	40.4%	251 920	47.0%	47.9%
Small	32 397	7.7%	63 193	11.8%	95.1%
Medium	6 748	1.6%	20 750	3.9%	207.5%
Total SMME	421 644	100%	536 240	100%	27.2%
Large	4 596	--	17 251	--	275.3%
All Enterprises	426 240	--	553 491	--	29.9%

Source: DTI – annual review of small businesses in South Africa (2008: 63)

The data in the above table clearly indicates that the majority of small businesses in South Africa are either micro or very small with 50.3 and 37.4 per cent being micro in 2004 and 2007 respectively. In 2004, 40.4 per cent of all SMMEs were categorised as very small and this figure increased to 47.0 per cent in 2007.

Although Venter and De Clercq (2007: 119) agree with the DTI that the most significant indicator of the size of small businesses is annual turnover, they argue that the number of employees is the most effective measure. They explain that this is because the number of employees could be used across all sectors with the exception of agriculture. In addition, Venter and De Clercq (2007: 119) argue that the information regarding the number of employees is usually easy to obtain.

FinMark Trust (2010: 8) conducted a survey about small businesses in South Africa and identified that 78.7 per cent of small businesses were involved in retail while only 21.3 per cent provided services to their clients. The survey further indicated that

while less than two in five retailers added value to a product before selling, one out of two small business owners bought products and sold them in the same form. In a broader perspective, the study identified that 62 per cent of service providers were rendering a skilled service and 6 per cent providing a professional service. Only 5 per cent were engaged in construction, 3 per cent in travel and tourism services, and the remaining 24 per cent involved in other kinds of services such as car wash, gardening, etc. It should be noted that in the more recent figures available as reported by SEDA, there were approximately 2 443 163 small businesses in the first quarter of 2018 (SEDA 2018: 2).

1.2.2 The importance of small businesses to the South African economy

The contribution of small businesses to the South African economy has been acknowledged at different levels by researchers, scholars, government officials, and renowned politicians. Small businesses can be seen as an important vehicle to address the challenges of job creation and economic growth in South Africa (DTI 2005: 7; Rungani and Potgieter 2018: 1). The development of small businesses is one of the government's priorities aimed at poverty alleviation and job creation (DTI 2008: xxiv). This explains why Venter and De Clercq (2007: 115; Dhanah 2016: 11) argue that the small business sector plays an important role in the creation of wealth and job opportunities, hence contributing to the accelerated and shared growth strategy. In addition, Rungani and Potgieter (2018: 1) recorded that small businesses account for an estimated 60 per cent of South Africa's employment.

Furthermore, Chimucheka (2013a: 157) regards the small business sector as the driving force in economic growth and job creation on a global scale. Abrie and Doussy (2006: 1; Dhanah 2016: 10) argue that it is globally recognised that small businesses are vital in enhancing a country's economic growth. Smulders and Naidoo (2011: 33) also confirm that small businesses have the potential to spearhead the growth of an economy and contribute to poverty alleviation.

Chimucheka (2013a: 157), Abrie and Doussy (2006: 1), as well as Smulders and Naidoo (2013: 33) are of the opinion that small businesses form the backbone of South Africa's economy. Chimucheka (2013a: 157), Abor and Quartey (2010: 223); Rungani and Potgieter 2018: 3) argue that small businesses immensely contribute to South Africa's GDP. The DTI (2008: xxv) also lauded small businesses for their substantial contribution to South Africa's GDP.

Policymakers, economists, and business experts agree that small businesses are efficient drivers of economic growth. The National Credit Regulator (NCR) (2011: 13) believes that a healthy SME sector is a prominent contributor to the economy through increasing the production of goods, export volumes, as well as improving entrepreneurial skills. Chimucheka (2013b: 786) agrees with the NCR (2011: 13), and he also recognises that small firms are a crucial source of invention and innovation which is at the heart of the generation of new products, services, and technologies. Although small businesses are arguably the engine of economic growth in South Africa (Rungani and Potgieter 2018: 1), the government has not yet succeeded in creating an entirely enabling environment for the SME sector to flourish. One of the stumbling blocks from a taxation perspective is the burden of tax compliance costs (Smulders et al 2012: 185). The following paragraph provides an insight of the tax regulatory burden faced by South Africa's small businesses.

1.2.3 The burden of tax compliance costs to small businesses in South Africa

The United States Agency for International Development (USAID) (2008: 17) defines tax compliance costs as all those costs incurred in the course of ensuring proper compliance with relevant tax regulations. Compliance costs include recordkeeping costs, costs for preparation and submission of tax returns, time-related costs spent in visiting tax offices, payments for tax practitioners and accountants, and all other costs incurred in the course of ensuring compliance, including incidental and travel costs. Smulders and Naidoo (2013: 267 – 271) concur with the findings of the USAID and indicate that the costs of tax compliance are too high for small businesses.

Smulders and Naidoo (2013: 267 – 271) identified tax compliance burdens faced by South Africa's small businesses to include the complexity of the tax registration process (especially registration for Value Added Tax (VAT)) and burdensome taxes such as Skills Development Levy (SDL). They also identified that there were too many forms and procedures in filing for tax returns, high frequency of submissions, tax laws written in a very complex language and regressive compliance costs which take more from small businesses than large corporates. In addition, they also lamented the issue of slow SARS response rates in terms of time taken to answer incoming calls and processing of tax returns and the high burden of employees' tax on small businesses.

Several studies have been conducted regarding tax compliance costs and their respective burden to small businesses, such as Chamberlain and Smith (2006: 5), Smulders and Stiglingh (2007: 4), Abrie and Doussy (2006: 6 - 7), Smulders et al (2012: 185) and Smulders and Naidoo (2013: 267 - 271). Abrie and Doussy (2006:1) pointed out that tax compliance requirements in South Africa are a stumbling block for small businesses. Smulders and Naidoo (2013:267- 271) also lamented the difficulties faced by these businesses which include huge tax compliance costs although small businesses are capable of growing the economy, generating jobs, and reducing poverty.

The National Treasury (2005: 11) acknowledged the burden of tax compliance costs to small businesses in South Africa and said that they had directed attention at the costs and complexity for small businesses in as far as tax compliance was concerned. To this end, the National Treasury was convinced that there were simplified arrangements which could be made to assist significantly in creating a more conducive environment for enterprise development.

The above statement is a clear indication that the South African government had to come to the rescue of small businesses by identifying simplified mechanisms to create an environment conducive for enterprise development. This explains why Smulders and Stiglingh (2007: 2) argued that the year 2005 was the beginning of a

process of structural change in SARS that was intended to assist small businesses to reduce compliance costs and red-tape and to provide training in tax matters.

Furthermore, Chamberlain and Smith (2006: 1) argue that on a global scale, tax compliance costs are key stumbling blocks to small business development. They add that governments have realised that although regulation is necessary, the related costs of compliance should be monitored and kept to minimum levels, most especially for small businesses. Chamberlain and Smith suggested that the focus should rather be to move to smart regulation than no regulation. These views are also echoed by Smulders and Naidoo (2013: 264) in their study in which they attempted to provide a few guidelines to SARS which could be used in addressing the small business tax compliance burden.

1.2.4 The importance of tax incentives for small businesses in South Africa

Qabaka (2011: par 1) argues that a tax system which supports small business has always been a popular cause. He points out that the National Treasury has recognised the importance of small businesses in economic development and employment creation and has come up with several SME tax incentives. He adds that SME tax incentives were meant to improve the cash flows of growing small businesses and further enhance the potential for the SME sector to create jobs. The importance of small businesses to the South African economy is also strongly put in the limelight by the SARB(2015: 11) who insist that a flourishing SME sector is a key factor to the future of the country. Besides reinvigorating the views of Qabaka (2011: par 1), the Davis Tax Committee (DTC) (2014: 5) prioritised the evaluation of the South African tax system and how it impacts on the promotion and growth of small businesses. The arguments that follow hereunder look at how the tax system supports small businesses.

According to Section 12E of the Income Tax Act, a qualifying small business called a Small Business Corporation can claim the cost of its assets over a shorter period as compared to the normal deduction periods available in Section 12C and 11(e) of the

Income Tax Act. Qabaka's (2011: par 1) opinion is that this could improve the cash flows of the small business. Stols (2013: 7) agrees with Qabaka (2011: par 1) and adds that cash flow is one of the essential elements for the growth of any small business.

Turnover tax for small businesses (businesses with a turnover of up to R1 000 000 a year) reduced the administrative burden on small businesses through dramatically lowering the time and costs of submitting tax returns (SARS 2017a: 27). The innovative system replaced income tax, provisional tax, Capital Gains Tax (CGT), secondary tax on companies, and VAT (apart from cases of voluntary VAT registrations) (SARS 2017a: 2). It could be argued that this initiative has the potential to boost entrepreneurship and create an enabling environment for small businesses to grow.

Maritz (2013: 35 - 36) noted that SARS followed the international trend in 2009 and introduced a tax incentive to encourage prospective investors to invest through the Venture Capital Companies (VCC) regime. She elaborated that VCCs have been successful in attracting potential investors. Ramusetheli (2011: 37) argues that the VCC tax relief attracts investors to come on board and in the end, the process enables small businesses to obtain finance.

The Research and Development (R&D) tax incentive encourages investment in innovation, space science and technology, energy security and the bio-economy, nanotechnology, robotics, photonics, and the indigenous knowledge systems (Department of Science and Technology (DST) 2018: 68). According to Castellacci and Lie (2013: 3), R&D tax incentives are important for the growth and competitiveness of national economies. In addition, Castellacci and Lie (2013: 3) concur with DST (2018: 68) that the R&D tax incentive encourages innovation among small businesses. Tax incentives for renewable energy, such as the carbon emissions incentive, energy efficiency incentives, and environmental incentives, promote the production of renewable energy from wind, solar, biomass, geothermal, and hydropower. These incentives also support related areas such as increased

energy efficiency, carbon capture systems, and storage technologies (DST 2018: 57 & 96).

1.3 THE PURPOSE OF THE RESEARCH

The purpose of this study is to identify the areas of concern within South Africa's small business tax incentives and to identify new small business tax incentives that SARS could introduce to assist South Africa's small businesses. The study, therefore, looks into tax incentives for small businesses offered in other countries (Australia, India, and the United Kingdom) and seeks to compare the tax incentives implemented in these countries to those offered in South Africa to small businesses. Small business tax incentives available to South African small businesses are discussed and evaluated and from the knowledge gathered from tax incentives available to small businesses in Australia, India, and the United Kingdom, recommendations are made with a view of potentially improving South Africa's approach.

The aims of this study are to:

- Identify and discuss the small business tax incentives available in South Africa;
- Consider if there are gaps and areas of concern within South Africa's small business tax incentives;
- Identify and discuss the small business tax incentives offered by Australia, India, and the United Kingdom, and compare them to those offered by South Africa; and
- Consider if there are small business tax incentives available in Australia, India, and the United Kingdom that could be introduced in South Africa.

1.4 RESEARCH QUESTIONS

This study investigates the following research questions:

- Are there any areas of concern within South Africa's small business tax incentives?
- Are there any small business tax incentives available in Australia, India, and the United Kingdom, that are not available in South Africa, which could improve South Africa's small business tax system?

The above research questions were addressed by discussing in detail and evaluating the small business tax incentives offered by South Africa to its small businesses, as well as comparing South Africa's small business tax incentives with those offered by Australia, India, and the United Kingdom.

1.5 SCOPE OF THE STUDY

The demarcations stated hereunder relate to the context of the study and they should be considered when evaluating the scope of the research:

- The study focuses on small business tax incentives available to South Africa's small businesses and their implementation.
- The study compares small business tax incentives available to Australian, Indian, and United Kingdom small businesses to those available to South African small businesses.
- The small business incentives implemented by the South African, Australian, Indian, and the United Kingdom governments, which are not tax-related; do not fall within the scope of this study.

- South Africa's small business tax incentives were discussed in line with SBCs and Micro-businesses. Other small business tax incentives that do not specifically relate to either SBCs or micro-businesses but may apply generally to all small businesses in South Africa were also presented.
- Small business tax incentives available in Australia, India, and the United Kingdom were discussed generally as tax incentives for all small businesses in those respective countries.

1.6 ASSUMPTIONS OF THE STUDY

- The term small businesses were assumed to be applicable to SMEs, SMMEs, SBCs, and micro-businesses. It was, therefore, used synonymously in the respective context of the category of small businesses being discussed in a particular paragraph or chapter.
- The main objective of small business tax incentives is to foster the growth and development of small businesses which in turn create jobs.

1.7 IMPORTANCE AND CONTRIBUTION OF THE STUDY

The study has the potential to contribute towards addressing the gap in knowledge of small businesses on the available tax incentives for small businesses in South Africa. The identification of tax incentives could be beneficial to small business owners as the study could make them aware of all the available tax incentives in order to fully utilise them and continually grow and expand their businesses.

The study looks into areas of concern within the small business tax incentives. The information presented from this objective of the study could be beneficial to SARS as well as small businesses in the process of reviewing the available tax incentives and in laying a foundation for proposing new tax relief mechanisms for small businesses.

The comparison of tax incentives for small businesses from Australia, India, and the United Kingdom with those offered by SARS provides information that could lead to the improvement and potential further simplification of the South African small business tax system. This could enable more businesses to flourish, create more jobs, and support the economy. New tax incentives for small businesses have also been identified by the study as a result of comparison with what is offered elsewhere and the ones deemed important to South Africa's small businesses, are emphasised for SARS's consideration.

1.8 LIMITATIONS OF THE STUDY

- The NCR (2011: 20) explains that as a study methodology, the literature review relies heavily on already researched information and therefore in the absence of any, the questions on the new study might not be substantially addressed. This limitation was, however, mitigated prior to the actual research through conducting a thorough review of the literature on the topic of the study.
- The main focus of the study from a South African perspective is tax incentives for small businesses. The focus is, however, limited to income tax, CGT, incentives for small businesses and small business tax incentives that are VAT related. These incentives are discussed and possible gaps or concerns are identified. Other general tax incentives for all kinds of businesses in South Africa are only considered (refer to paragraph 3.3) briefly to lay a more detailed background of the study and to shed more light on the investment climate of South Africa. Non-tax incentives (although crucial for the growth and development of small businesses), were completely omitted from the study.

1.9 DEFINITION OF KEY TERMS

The term 'the Act' refers to the South African Income Tax Act (58 of 1962).

In this study, the term 'small business tax incentives' also refers to small business tax relief/s, small businesses tax relief initiatives, small business tax concessions, small business tax dispensations, small businesses tax benefits, and small business tax credits.

1.10 RESEARCH METHODOLOGY

This Section describes the approach that was followed in compiling the study, explains the choice of countries whose small business tax incentives were compared with those of South Africa, and the steps that were followed in conducting the research.

1.10.1 Research design

The study is based on a review of literature. A literature review is a systematic, explicit, and reproducible method for identifying, evaluating, and synthesising the existing body of completed and recorded work produced by researchers, scholars, and practitioners (Fink 2010: 3). As a noun, a literature review is an organised critical account of information that has been published on a specific topic and provides an organised synthesis of the information, ideas, and knowledge (NCR 2011: 18). Information was obtained from journal articles, books, and electronically via worldwide websites.

1.10.2 Choice of countries for comparison purposes

Three countries were chosen to be used in the study alongside South Africa. Australia, India, and the United Kingdom were selected for the reasons explained below and the small business tax incentives in these three countries were compared with those offered by South Africa. The selection of countries was not based on statistical data, but the decision was based on choosing countries that would provide information specifically needed for this study. It is therefore acknowledged that the outcome of the study might differ if other countries were to be selected.

Australia, like South Africa, applies a similar approach to determining what constitutes a small business for tax purposes. Both South Africa and Australia use the level of turnover figures to determine what should and what should not be classified as a small business (DTC 2014: 8). This was considered significant in establishing a comparison between the taxation approaches in the two countries that use a similar approach in defining their small businesses. Another similarity between Australia and South Africa is that these countries are located in the southern hemisphere, whose fundamental tax administrative procedures are very similar except that there is a difference in the period of assessment (Marchbank 2012: 79). South Africa's usual tax year begins on 1 March and ends on 28 February of the following year, whereas Australia's tax year begins on 1 July and ends on 30 June of the following year.

India was chosen because historically and presently, the Indian economy has always had an impact on that of South Africa. In fact South Africa and India connote that they are united by legacy and unified for prosperity and one of the reasons for this is that there are over 130 Indian companies doing business in South Africa (approximate investment is US \$8 billion) which employ an estimated 18 000 South Africans (DTI 2018: 1). The DTI also reported that South Africa boasts 29 Foreign Direct Investments (FDIs) in India worth approximately US \$1 billion in a shared strategic partnership that is over 200 years old. Another point of economic importance linking India and South Africa is that they are both member countries of Brazil, Russia, India, China, and South Africa (BRICS) group of countries (Stander 2013: 3). India also has a very high population (International Monetary Fund (IMF) 2015: 33) (like South Africa - in relation to other SADC countries, although much lower than India's) and the citizens, therefore, are bound to start their own businesses and be creative to survive, hence the probability of many small businesses.

The United Kingdom was chosen based on the history of the two countries. The United Kingdom is the former colonial master of South Africa and the tax code of the latter has some similarities with that of the former master. Income tax treatment of

the United Kingdom depends on the residency status of an entity, similar to South Africa, as well as Australia and India which are already selected. The United Kingdom has one of the largest economies in the world and is a member of the G8 as well as the Commonwealth countries. The economy is dominated by small businesses as 99.9 per cent of the 5.6 million private sector enterprises at the start of 2018 were small or medium-sized businesses (Federation of Small Businesses 2018: par 1 & 2). With this background, the United Kingdom was included as one of the three countries that South Africa could learn from with regard to small business tax incentives.

1.10.3 Ethical considerations

The study was conducted according to the approved proposal which obtained ethical clearance (Ref: 2016_CAS_013) from the Research Ethics Review Committee of the university. The study is based on a review of literature and therefore no interviews were conducted. Unisa's policy for copyright infringement and plagiarism was taken into account. All chapters of this study were submitted to the Turnitin software programme and the overall similarity percentage is within acceptable limits.

1.11 THE RESEARCH PROCESS

The dissertation includes the following chapters:

Chapter 1

This chapter includes the introduction, the literature review as the background of the study, the research methodology including an explanation of the choice of countries selected for comparison purposes, as well as a breakdown of the steps of the research.

Chapter 2

In this chapter, the concept of small businesses and their taxation in South Africa are considered. Different definitions referring to small businesses are given, both local

and international. The chapter also elaborates on the significance of small businesses to a developing economy, tax consequences of different forms of small businesses in South Africa, as well as the designing of an effective small business tax regime.

Chapter 3

This chapter presents an overview of tax incentives. It pays attention to the definition of tax incentives, tax incentives offered to all companies in South Africa, the rationale of tax incentives, the advantages, and disadvantages of tax incentives, and their design, monitoring, and administration.

Chapter 4

Small business tax incentives offered by South Africa are discussed in detail and their respective gaps and areas of concern are identified in this chapter. Tax incentives for SBCs, micro-businesses, as well as other tax incentives relevant to small businesses, in general, are presented.

Chapter 5

This chapter presents a discussion of the small business tax incentives provided by Australia, India, and the United Kingdom.

Chapter 6

A comparison of tax incentives for small businesses in South Africa, Australia, India, and the United Kingdom is presented in this chapter. The comparative elements within the small business tax incentives offered by the different countries are discussed while identifying the new concessions that South Africa may need to introduce or the amendments which may need to be made to the existing reliefs so that they could be more favourable to small businesses. Recommendations are made in relation to which new small business tax incentives should be introduced by South Africa, as well as the amendments to be made to the existing concessions.

CHAPTER 2

THE CONCEPT OF SMALL BUSINESSES AND HOW THEY ARE TAXED IN SOUTH AFRICA

2.1 INTRODUCTION

This chapter introduces and elaborates on the concept of small businesses in South Africa. It looks at the different definitions of small businesses in South Africa, both from an industrial landscape perspective and the taxation perspective. Internationally recognised definitions of small businesses are considered as well as the significance of small businesses to a developing economy. The taxation consequences of the different forms of small businesses are presented and attention is also drawn to the approach to be followed in designing a tax system for small businesses.

2.2 GENERAL DEFINITIONS OF A SMALL BUSINESS IN SOUTH AFRICA

The DTI (2008: 1) explained that the concept of small businesses is broad and can be looked at differently from the literature perspective as compared to the economic point of view. The DTI argued that in some cases the focus is on the entrepreneurial dimension (creating new entities in response to new needs), whereas in other cases, the distinguishing characteristic is ownership and management. While some studies concentrate on whether or not the business operates in the formal or informal sector, the size of the business entity is the criterion most frequently adopted on a global scale for small business studies (DTI 2008: 2). In South Africa, small or micro entities are sometimes referred to as businesses with annual gross income or turnover that is below a specific limit (DTI 2008: 2). It is worth noting that all these criteria do not significantly correlate with the definitions and categorisation of small businesses within the National Development Plan (NDP), and neither do they fit exactly with the official definition that is recorded in the National Small Business (NSB) Act of 1996 as amended in 2004.

2.2.1 Non-tax definitions of small businesses in South Africa

The DTC (2014: 6) categorises businesses in the SME sector into three distinct groups, which are referred to as survivalist, lifestyle, and entrepreneur.

- Survivalist businesses

The DTC (2014: 6) defines a survivalist business as either home-based or one that operates on the streets. They argue that such entities are predominantly cash businesses and are not capital intensive. To the DTC (2014: 6), these businesses compile only the basic financial records and examples may include taxi operators, hawkers, taverns, gardeners, informal sub-contractors, and tuck shops.

- Lifestyle businesses

According to the DTC (2014: 6), a lifestyle business can be categorised to mean those entities that are home-based or those which have a single office and are found in middle and upper-class areas. Examples of such businesses include those run by a doctor, plumber, electrician, artisan, engineer, accountant, broker, consultant etc.

- Entrepreneurial businesses

These are businesses whose main focus is expansion. They are normally led by an ambitious entrepreneur whose main aim is to develop an exclusive brand, have a bigger share in the market or even develop a franchise. Entrepreneurs may invent new processes, new products, or new markets. To the DTC, such businesses have the potential to attract venture capitalists to invest and they are considered very successful in creating employment opportunities (DTC 2014: 6).

The NSB Act of 1996 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 carried on in any sector or sub-sector of the economy.

The definition in the Small Business Amendment Act of 2004 is mainly the same as in the NSB Act of 1996, except that it refers to a small business enterprise as opposed to a small business as referred to in the NSB Act. The definition in the Small Business Amendment Act of 2004 adds that small business enterprises can be classified as micro, very small, small, or medium enterprises.

2.2.2 Definition of a small business according to South African tax law

In South Africa's tax legislation, small businesses are defined differently with reference to Section 12E, Paragraph 2 of the Sixth Schedule, and Paragraph 57 of the Eighth Schedule of the Act.

According to Section 12E of the Act, a SBC can be a close corporation, a co-operative, or a private company. For a business to qualify as a SBC, it has to meet the following requirements of Section 12E of the Act:

- All the holders of shares in the company or members of the close corporation or co-operative must be natural persons throughout the year (Section 12E(4)(a) of the Act);
- Holders of shares or members should not hold any shares or have any interest in the equity of any other company other than those companies that are specifically excluded, (Section 12E(4)(a)(ii) of the Act);
- The gross income of the entity for the year of assessment may not exceed R20 million (SARS 2015a: 38). Gross income is defined in Section 1 of the Act to mean the total amount in cash or otherwise, received or accrued, excluding receipts or accruals of a capital nature;
- The total revenue receipts and accruals, as well as the capital gains of the entity, may not be made up of more than 20 per cent of investment income or income from rendering a personal service (Section 12E(4)(a)(iii) and (iv)); and

- The entity may not be a personal service provider (Section 12E(4)a(iv) of the Act).

A personal service provider is a company or trust whereby any service rendered to a client of that company or trust is rendered personally by any person who is a connected person in relation to that company or trust (Paragraph 1 of the Fourth Schedule of the Act). If the duties were performed at the premises of the client, then the client must have been involved in the supervision and control of the manner in which the service must be rendered. Also, more than 80 per cent of the income from services rendered must consist of amounts received directly or indirectly from any one client or associated institution of the company. A company that falls within the above definition of a personal service provider may still qualify as a SBC and therefore be eligible for tax relief if it employs at least three full-time employees who are fully engaged in rendering the specific services of the company throughout the year of assessment. The employees must neither be shareholders nor persons connected to the shareholders (SARS 2009: 11).

According to Paragraph 2 of the Sixth Schedule of the Act, a micro-business is defined as a natural person or a company whose qualifying turnover does not exceed R1 million for the year of assessment. If a person meeting the above description is involved in a business for less than 12 months during the relevant year of assessment, the qualifying turnover is proportionately reduced considering the number of full months in which no business was carried on. 'Qualifying turnover' is defined in Paragraph 1 of the Sixth Schedule of the Act as the total receipts from carrying on business activities excluding any amount of a capital nature and amounts exempt from normal tax.

With reference to CGT, Paragraph 57 of the Eighth Schedule of the Act defines a small business as a business whose market value of all the available assets at the disposal date of an asset or interest in each of the active business assets of a qualifying small business, does not exceed R10 million.

2.2.3 Internationally recognised definitions of a small business

Differences in small business definitions exist all over the world. Definitions by international institutions, national laws, and industries seem to all disagree in certain instances or on certain criteria of what should be classified under SMEs and what should not. It is still a problem for economists, academics, and industrialists to find a universal standard. A few definitions by international organisations are given below.

The European Union's (EU) definition of small businesses includes both incorporated and unincorporated independent micro, small, and medium-sized enterprises. According to the EU, small businesses comprise of a very diverse segment that ranges from single unincorporated entrepreneurs to medium-sized companies listed on a stock exchange. The EU's definition is an economic rather than a legal classification and therefore it encompasses a wide spectrum (Bergthaler, Kang, Liu & Monaghan 2015: 6). Figure 2.1 below presents a figurative definition of small businesses in the EU.

Figure 2.1: Definition of Small and Medium Enterprises: European Union standards

Enterprise category	Headcount: Annual Work Unit (AWU)	Annual turnover	or	Annual balance sheet total
Medium-sized	< 250	≤ €50 million	or	≤ €50 million
Small	< 50	≤ €10 million	or	≤ €10 million
Micro	< 10	≤ €2 million	or	≤ €2 million

Source: Berisha and Pula (2015: 19).

The World Bank uses the number of employees, total assets, and annual sales (in U.S. dollars) as the three criteria which should be met for a business to be categorised as a small business (Independent Evaluation Group 2008: 4). There are similarities in the number of employees to be employed by what could be termed as a small business between the World Bank and the EU, however, with regard to total assets held and annual sales made by a small business, the World Bank's standards

are much lower as compared to the European Union (refer to figures 2.1 & 2.2). Figure 2.2 below presents the World Bank's definition of small businesses.

Figure 2.2: Definition of Small and Medium Enterprises: World Bank standards

Enterprise indicators (2/3)	Number of employees	Total assets	or	Total annual sales
Medium	> 50; < 300	>\$3,000,000; <\$15,000,000	or	>\$3,000,000; < \$15,000,000
Small	> 10; ≤ 50	>\$100,000; ≤ \$3,000,000	or	>\$100,000; ≤ \$3,000,000
Micro	< 10	≤ \$100,000	or	≤ \$100,000

Source: Berisha and Pula (2015: 19).

The OECD (2005: 17) defines small businesses as non-subsidary independent entities which employ less than a given number of employees. They add that the number of employees varies across countries and that the most common higher limit workforce of a small business is 250 employees, as in the EU. The OECD is aware that some countries set their maximum limits to 200 employees while the United States considers small businesses to employ fewer than 500 employees. Small firms are generally those that employ fewer than 50 employees, while micro-entities have at most 10 or even 5 workers (OECD 2005:17).

The International Finance Corporation (IFC) (2007: 39) agrees with the OECD that a small business would employ fewer than 50 employees although they also consider SMEs to hold less than \$3 million in assets and to make annual sales of less than \$3 million. However, the IFC definition does not consider the number of employees as a compulsory criterion for an enterprise to qualify as a small business (USAID 2007: 6). The United States Agency for International Development (USAID) (2007: 19) recommended that the employment threshold should be a mandatory indicator that any enterprise must fall within, in order to be defined as a small business. They explain that small businesses are those enterprises that employ between 10 and 99 employees; where small enterprises have between 10 and 49 employees, and while medium enterprises would have between 50 and 99 employees.

The existence of different definitions of small businesses in South Africa and internationally has been highlighted by several contemporary scholars and some have also indicated that this aspect is a cause for concern in the small business society. Studies such as those of Chamberlain and Smith (2006: 7) and Ramusetheli (2011: 21) and Stols (2013:16) have pointed out that there are either various definitions or there is no consistent requirement of small businesses in the South African legislative framework. On a similar note, the NCR (2011: 21) lamented the existence of differing definitions of small businesses and pointed to the confusion and difficulty in small business measurement and the general understanding that this could cause.

2.3 THE SIGNIFICANCE OF SMALL BUSINESSES TO DEVELOPING ECONOMIES

The significance of small businesses to any economy, whether developed or developing, cannot be underestimated. Even some of the advanced economies of this world such as China, Germany, and Japan, laud the contribution of small businesses to the development of their economies (Frimpong 2013: par 4; Welsh, Munoz, Deng and Raven 2013: 30). Welsh et al, in particular, argue that small businesses are very important to the Chinese economy, while Frimpong points out that SMEs are the drivers of industrial development in Asia and the developing African economies. Chimucheka (2013a: 157) concurs with Frimpong and he argues that small businesses are the driving force in economic growth on a global scale and that they contribute to making economies wealthier.

The SARB (2015: 1) firmly believes that small businesses are crucial in a thriving economy as they play an integral part in the renewal process that defines a market economy and contributes to innovation technology advancement and growth in production. In addition, the SARB (2015: 1) argues that small businesses are seen as a conduit through which multitudes of people enter the mainstream economy, creating opportunities for women and minority groups. It is estimated that small

businesses contribute 42 per cent to South Africa's GDP and 60 per cent to employment (Rungani and Potgieter 2018: 2).

Small businesses are the engine of the modern economy. According to Robu (2013: 86), small businesses are considered the backbone of any country both within borders and internationally, as they represent an essential source of economic growth, dynamism, and flexibility in advanced and developing economies. The views put forward by Robu (2013: 86) are in agreement with the opinions of Frimpong (2013: par 8) who identifies that small businesses in Ghana contribute 70 per cent to the GDP and 92 per cent of the country's overall businesses, while 70 per cent of Nigeria's manufacturing sector is also made up of SMEs. Robu (2013: 86) adds that Small businesses bring new products and techniques into the market as well as bringing competitiveness within an economy and against other economies.

It could be argued that small businesses represent a nursery bed for large multinational corporations and carry the seeds of innovation and invention. Savlovschi and Robu (2011: 278) argue that from small businesses, large corporates emerge, while for individuals in the entrepreneurial world, SMEs represent the first step towards entrepreneurship. In addition, in the macro economy, small businesses are seen as the launchers of new innovative ideas. Although, on this note, the Bureau for Economic Research (BER) (2016: 8) identified that innovation among South Africa's small businesses is lower than when compared to elsewhere in developed countries and they attribute this to the lack of sufficient upward linkages with larger corporates. They argue that the lack of such strong linkages stifles technology diffusion opportunities among entities.

Small businesses are a huge source of employment as highlighted in several research studies. According to Abor and Quartey (2010: 218) and Welsh et al (2013: 30), small businesses are efficient job creators. To Savlovschi and Robu (2011: 278), Small businesses are a source of employment and have marked the beginning of many people's careers. Chimucheka (2013b: 784), the BER (2016: 5), and SARB (2015: 5) concur with Savlovschi and Robu (2011: 278) and point out that small

businesses constitute an important source of jobs and contribute to the reduction of unemployment.

The government of South Africa has taken note of how important small businesses are in the economy by establishing the Small Business Development Ministry in 2014 to facilitate the promotion and development of small businesses (BER 2016: 5). South Africa is struggling with a 26.7 per cent national unemployment rate (National Treasury 2018: 7). Therefore, supporting and promoting the development of small business is among the main options available to the government of South Africa in an effort to creating more employment opportunities. With South Africa's GDP growth in 2014 and 2015 estimated at a disappointing 1.5 per cent (SARB 2015: 2), the government has indeed put more emphasis on supporting the development of SMEs to boost the national output.

The significance of small businesses to both developing and developed economies cannot be underestimated. South Africa, like any other African, South American, and some Asian countries, is still a developing economy and it has identified small businesses as one of the key drivers of economic development (BER 2016: 5). However, for small businesses to flourish and drive economic development, the government and other key stakeholders have to create an enabling economic environment. Robu (2013: 86) argues that the level of development of an economy depends heavily on its capacity to provide a suitable environment for small businesses to flourish and supply first class services as well as low-cost products.

It is against this background that, from a taxation perspective, this study chose to launch an inquisition into the support given to South Africa's small businesses. The support, in this case, is in the form of tax incentives offered by SARS. The small business tax incentives from the government of South Africa are meant to create an enabling environment (in as far as tax is concerned) for SMEs to flourish and in turn, foster economic development. The tax incentives for small businesses in South Africa are linked to the way in which the particular entities are treated for tax purposes. For this reason, the study deemed it of critical importance to look into the manner in which the different forms of small businesses are taxed in South Africa.

2.4 THE TAXATION OF THE DIFFERENT FORMS OF SMALL BUSINESSES

According to SARS (2015a: 2), there are different types of entities that could be seen as small businesses and the tax consequences of operating a given form of business differ from one type to the other. Small businesses are categorised by SARS (for purposes of taxation) into different forms. The most common are Sole Proprietorships, Partnerships, Close Corporations (CCs), Private Companies, and those described by the Income Tax Act (58 of 1962) as Micro-businesses and SBCs.

2.4.1 Taxation consequences of a Sole Proprietorship

A sole proprietorship is a business that is owned and operated by a natural person (SARS 2015b: 2). This form of business has no existence separate from the owner (proprietor), hence the owner must include all the income from such business into his/her own personal income tax return (SARS 2015a: 2). The owner is liable for paying tax on any taxable income made by the business and so, he/she reflects a combination of his/her own income together with the income of the sole proprietorship. The income of sole proprietorships is submitted to SARS using the ITR12 return which is an income tax return for individuals, hence cementing the fact that the business has no separate existence from the owner. Sole proprietorships are therefore taxed at the same progressive rate used for natural persons, which is from 18 per cent to 45 per cent, depending on the amount of taxable income of the natural person, as shown in Table 2.1 below:

Table 2.1: Tax rates for taxable income of natural persons for the 2019 year of assessment (1 March 2018 - 28 February 2019)

Taxable income (R)	Rates of tax
0 – 195 850	18% of taxable income
195 851 – 305 850	R35 253 + 26% of taxable income above R195 850
305 851 – 423 300	R63 853 + 31% of taxable income above R305 850
423 301 – 555 600	R100 263 + 36% of taxable income above R423 300
555 601 – 708 310	R147 891 + 39% of taxable income above R708 310
708 311 – 1 500 000	R207 448 + 41% of taxable income above R708 310
1 500 001 and above	R532 041 + 45% of taxable income above R1 500 000

Source: SARS 2018a: 2

Normal tax payable would be calculated as a result of a combination of the owner's personal taxable income and the taxable income of the sole proprietorship business which are combined and taxed in accordance with the above tax rates, as one. If the owner of the sole proprietorship is less than 65 years old, he/she would be allowed to deduct an annual rebate of R14 067 from the normal tax payable. The sole proprietorship would qualify for an extra annual rebate of R7 713 if the owner was 65 years and older and R2 574 extra in case the owner was 75 years and older (SARS 2018a: 2). Any annual taxable income which is less than R78 150 is not taxed if the owner of a sole proprietorship is less than 65 years old, R121 000 is not taxed if the sole proprietor is older than 65 years, and similarly no tax is paid on R129 850 of taxable income for natural persons older than 75 years.

Marchbank (2012: 28) points out that, when a sole proprietorship business commences trading, the sole proprietor is required to register with his/her local SARS office in order to obtain an income tax reference number. She goes further to explain that, after the registration and acquisition of a tax reference number, the sole proprietor should notify SARS that he/she has become liable for registration for provisional tax. With regard to VAT, it is compulsory for the sole proprietorship (like any other business) to register for VAT if its taxable supplies for a 12 month period exceed R1 million. The VAT standard rate is 15 per cent (SARS 2018a: 16), however, the treatment of taxable supplies is not always similar, for example different VAT treatments for accommodation. In dealing with residential

accommodation, the VAT Act provides for a distinctive treatment between what it refers to as commercial accommodation and dwellings. Hiring or letting of a dwelling (any building/structure used primarily as a place of residence) is VAT exempt (Section 12(c)(i) of the VAT Act) whereas commercial accommodation (supply of lodging with domestic goods and services) attracts VAT at a standard rate. However, where the latter is supplied for a period that exceeds 28 days, VAT is only payable on 60 per cent of the total amount charged (Section 10(10) of the VAT Act). A sole proprietorship can elect to voluntarily register for VAT if its taxable supplies for a 12 month period are less than R1 million, but it is not compulsory (SARS 2015b: 2).

2.4.2 Taxation consequences of a Partnership

A partnership (or unincorporated joint venture) is the relationship existing between two or more persons who join together to carry on a trade, business, or profession in return for a share in the partnership's profits/losses and capital (SARS 2015a: 3). The partnership is not a legal person under South African tax law, which means that partners are taxed individually on their share of partnership profits (SARS 2015b: 3). Partners are taxed at their respective normal tax rates. For example, partners who are companies are taxed at a flat rate of 28 per cent and partners who are natural persons are taxed at the progressive rates for natural persons which range from 18 to 45 per cent.

If the partners are companies, they would submit their income tax returns to SARS using the ITR14 return, on which it must be indicated whether the company is a partner in a partnership/joint venture (SARS 2018b: 27). If the partners are natural persons, they would submit their income tax returns using the ITR12 return. Partners share the profits and losses of a partnership in a pre-determined ratio (normally set out in a partnership agreement) which also means that each partner is liable for normal income tax in the same ratio. Partnership income is regarded to be received by each partner on the same date that the income accrued to the partnership. Partnership expenses would also be deemed to have been incurred by each partner in the same pre-determined ratio share and they would be deducted in the same

ratio by each partner, for income tax purposes. Being a partner is different from being an employee of the partnership and therefore partners who are not employees would not be entitled to the usual employee deductions (for example fringe benefits) available to employees in the calculation of normal income tax (SARS 2018c: 53).

With regard to VAT, a partnership is regarded as a separate legal person because it is included in the definition of person in Section 1 (1) of the VAT Act (SARS 2015b: 3). For this reason, a partnership must register as a VAT vendor (if it qualifies for registration or it may voluntarily choose to do so if its taxable supplies do not exceed R1million in a 12 month period). The individual partners are jointly and severally liable for the partnership's VAT (SARS 2017b: 9 – 10).

2.4.3 Taxation consequences of a Close Corporation (CC)

SARS (2015a: 4; 2015b: 5) points to the similarity between a close corporation (CC) and a private company and they elaborate that, for purposes of income tax, a CC is dealt with as if it were a company (refer to 2.4.4 below). A close corporation is a legal entity and must register as a taxpayer in its own right. Members of a CC, whose duties resemble the duties of a director of a company and are involved in the management of the financial affairs of the entity, are personally liable for the CC's VAT, employee's tax, and other penalties to the business, just like a director to a company.

CC's pay income tax calculated at a flat rate of 28 per cent of taxable income and they are responsible for the payment of these taxes because they have legal personality and are treated as separate entities from the owners. Dividends declared by the CC are exempt from income tax in the hands of the beneficial owner; however, the CC must withhold dividends tax from the declared dividends at a flat rate of 20 per cent in accordance with Section 64G (1) of the Act.

2.4.4 Taxation consequences of a Private Company

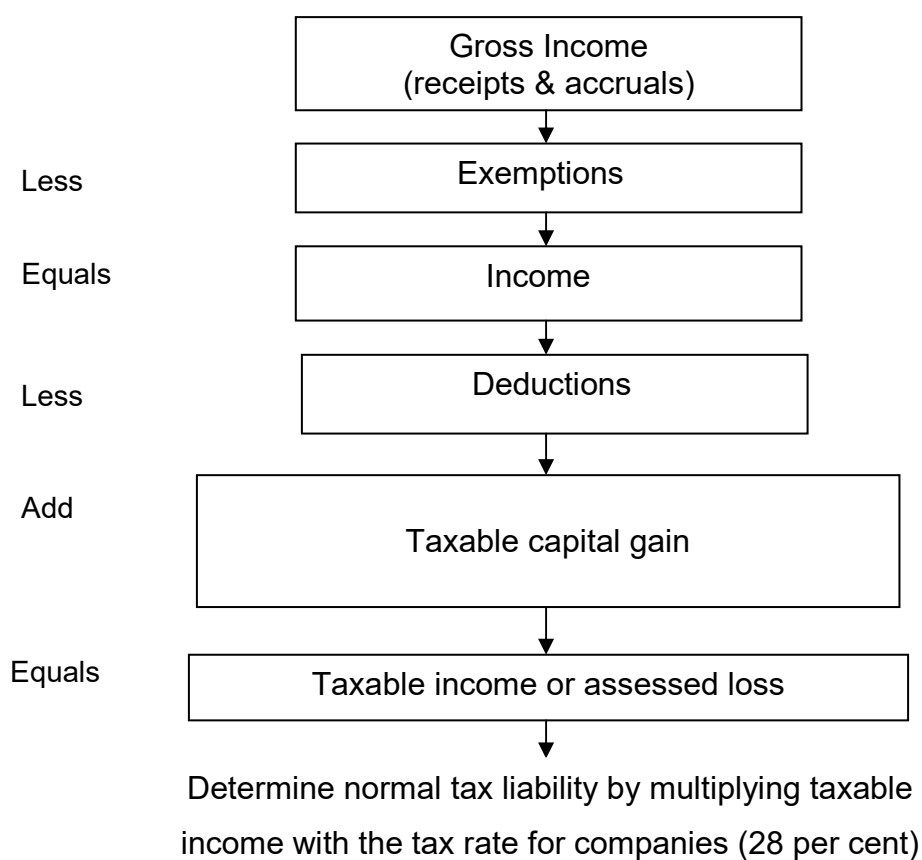
A private company is a legal entity that is separate from its owners and it has to be registered as a taxpayer in its own capacity (SARS 2015a: 4). The company has the responsibility to pay its own taxes and the income tax returns of a company are submitted to SARS using the ITR14 return. To be able to determine a company's tax payable, the taxable income of the company has to be determined and then multiplied by the tax rate (which is currently 28 per cent). The determination of gross income is a fundamental step in the calculation of the taxable income of a company.

Paragraph 2.2.2 of this study (third bullet) describes the definition of gross income. In relation to the taxation of private companies, the definition means that residents are taxed on their worldwide income whereas non-residents are only taxed on their income which is from a source within or one that is deemed to be within South Africa. According to the Eighth Schedule of the Act, receipts and accruals of a capital nature are generally excluded from gross income because they are regarded as capital gains and losses. There is however some receipts and accruals that are specifically included in gross income regardless of their nature. The Act allows general inclusions (contained in Section 1) and the specific inclusions (paragraphs (a) to (n) – Section 1 definition of gross income) to be included into gross income. The Act also allows the inclusion of deemed accruals (Section 7), deemed interest (Section 8E), and receipts deemed to be from a source within South Africa (Sections 9 and 9D).

After determining gross income, taxpayers are allowed to deduct income that is free from tax (exempt) as presented in Section 10 of the Act and this would lead to the determination of a taxpayer's income. From the income of a taxpayer, some deductions are allowed which include general expenses of the general deduction formula in Section 11(a), 23(f), and 23(g) of the Act. Other deductions from the taxpayer's income include the specific deductions of Sections 11(c) to 11(x) and Section 12E of the Act, among others. Taxable capital gains are added lastly, leading to the final taxable income or assessed loss. Section 20 (2) of the Act, defines an assessed loss to mean any amount by which the deductions admissible

under Section 11 exceeded the income in respect of which they are so admissible. This calculation is illustrated in Figure 2.3 below, which indeed applies to all tax payers, but in this case used by the study in particular reference to private companies.

Figure 2.3: Illustration of the calculation of the normal tax liability of private companies and close corporations



Source: SARS 2015a: 16

A private company must register for VAT if its taxable supplies for a 12 month period exceed R1 million or can opt to voluntarily register even though its taxable supplies for a 12 month period are less than R1 million. Dividends are exempt from income tax in the hands of the beneficial owner, however, the dividend is subject to dividends tax which is withheld by the company (SARS 2015a: 14).

2.4.5 Taxation consequences of Small Business Corporations and Micro-businesses

SBCs and micro-businesses qualify for certain tax dispensations that are different from those entities described above. Chapter 4 provides a detailed discussion of the tax consequences of SBCs and micro-businesses along with their respective tax incentives.

2.5 DESIGNING A SMALL BUSINESS TAX REGIME

For many small entrepreneurs in Africa, the choice to pay tax or remain in the informal sector is clear: most entities would choose to stay in the informal sector because the perceived benefits of staying in the informal sector prevail over the costs of paying tax. Entities in developing countries hardly ever see their tax contributions pay off in the form of government services (Stern and Barbour 2005: 2; IFC 2009: 4).

However, there are valid reasons for the small business entrepreneur and the government to join the tax net. A small business's participation in a tax system brings an entity into the formal sector and allows it to access credit markets as well as government support. It also allows a small business freedom to public advertisement without fear of being detected by tax administrators and access to markets including exportation of goods (IFC 2007: 21). The IFC (2009: 4) explains that small businesses should know that staying informal also comes with its own costs and they give the example of having to pay authorities to remain informal. From the government's side, by encouraging entities to fully enter the formal sector through registering for and paying taxes, the government promotes a culture of compliance and sets the stage for the firm to grow and become a bigger taxpayer. Entities in the formal sector are also more likely to comply with all other regulations and official obligations than those in the informal sector. It also affords the government an opportunity to increase the state capacity to collect and administer taxes as well as

providing proper accountability to citizen taxpayers (Stern and Barbour 2005: 2; IFC 2007: 27).

The eJournal USA (2006: 11 - 12) explains that a country's tax code presents one of the best tools available for promoting small business growth. They refer to a case in point where in the United States, the tax code is changed often with the idea that certain tax credits, deductions, or reductions can be used to foster growth in one segment or another. A government has a responsibility to ensure that its taxation policies are helping but not hurting enterprises, creating the conditions for small businesses to grow and flourish (eJournal USA 2006: 2). It is therefore of utmost importance that a government designs a small business tax system that attracts small businesses to comply and join the formal sector rather than a tax system that makes compliance look more like a disincentive.

2.5.1 Features of a small business tax system

The IFC (2007: 98) identified the following features of a small business tax system and indicated that a good presumptive tax system should be:

- Well-aligned with the standard tax system to avoid a conflict of rules and obstacles for the move from one system to the other, particularly for moving from the presumptive to the standard tax regime;
- Based on comprehensive data analysis to avoid over and under taxation of small businesses;
- Fair and transparent to be accepted by the small business owners and to avoid disputes between tax authorities and the small business community over the amount of tax payable;
- Accepted by the public to be stable;

- Easy to administer so that they do not require a lot of engagement which would take a large part of the capacity of the tax administration authorities; and
- Supported by taxpayer education and information sessions organised in a manner that reaches the grass-roots of the small business community.

The World Bank (2005: 14) explained that, since small businesses would not be the major source of government revenue, such a system must have goals that are different from those of the normal tax system. They add that the differing focus should necessitate a design of a tax system that is different and encourages firms to join and be part of it. It should be clear to entities that they would benefit from joining a tax regime which enables them to be part of the formal sector. In addition, the tax system should be able to neutralise compliance costs and the high tax burden to ensure that small businesses do not regret joining the tax net. The World Bank (2005: 14) therefore suggested the following best-practice design features of a small business tax system which would enable small businesses to grow:

- Small business taxes and revenue authorities should consider capacity building especially in monitoring the incentives.
- An optimal small business tax regime would include a system of taxation that is supported by education on basic business processes, accounting, and monitoring.
- As capacity and outputs grow, the tax system should become more sophisticated (in the sense that it becomes more difficult to manipulate but rather more user-friendly and easy to comply with while yielding results in terms of revenue collection).
- A simplified alternative tax system should be non-presumptive. A presumptive tax regime is capable of causing cash flow problems, especially for new small businesses.

2.5.2 Considerations in the designing of a small business tax regime

The IFC (2009: 4) argues that a simplified tax regime would increase transparency and reduce corruption as well as reward good behaviour on the side of small businesses. On the same note, the IFC (2009: 5) specifically explains that tax simplification has the potential to improve compliance, substantially lower the cost of tax collection, and encourage investment. The IFC (2007: 96) is of the opinion that, because certain small business entities would still be taxed under the standard tax regime, either voluntarily or otherwise, some simplified tax rules should also be incorporated into the standard tax system. The IFC (2007: 93) identified the following issues to be considered in designing a simplified tax system for small businesses:

- The education level of small business owners: a high level of education among the small business owners allows proper recordkeeping and reduces the need for over-simplifying the tax system.
- The availability of data on small business transactions: the fairness of a small business simplified system for taxation can be based on its ability to analyse business risks and profitability.
- Access to tax consultancy services: small businesses that have access to tax consultancy services are able to follow the normal tax regime because they find it more feasible than for small businesses which are unable to obtain any assistance in complying with their tax obligations.
- Access to computers and information technology: this would make electronic filing of returns more feasible.
- Efficiency and honesty of the tax administration: the design of a tax system for small businesses needs to take into account the capacity of the tax administration to properly administer and monitor the system.

As indicated in paragraph 2.5 and the subsequent subparagraphs, small businesses need favourable tax policies for them to thrive. Favourable in this regard relates to a simplified tax system that enables small businesses to be tax compliant at minimum costs. A simplified tax system or elements of simplification within the standard tax regime could go a long way in enabling small businesses to be tax compliant. It is important for policy-makers to recognise that small businesses need not be compulsorily taxed in the same pool with large entities. A different tax system, that is simplified and has embedded tax dispensations, could be more applicable for small businesses. The system should be designed with an element of being able to attract small businesses to join the tax net (Stern and Barbour 2005: 2) and remain tax compliant while at the same time not being overburdened by the tax liability. The above paragraphs regarding a small business tax system are of importance to this study because of their possible contribution to the understanding that small businesses require their own simplified tax system that is specifically designed to suit them.

2.6 CONCLUSION

Different definitions of what is to be called a 'small business' exist both in South Africa, and internationally. Numerous studies have alluded to the challenges for small business entities as a result of differing definitions. SARS recognises the existence of different forms of small businesses such as sole proprietorships, partnerships, close corporations, etc. and the tax consequences of each form are well documented.

In the South African tax law, there are requirements to be met by businesses and systematic criteria exist that are used to distinguish between different categories of small businesses. Different definitions exist for those different categories of small businesses. These divisions are important because different tax incentives exist for each category of a small business such as SBCs and micro-businesses.

The significance of small businesses to an economy cannot be over emphasised. In particular, small businesses are very important to developing economies such as South Africa. The SME sector significantly contributes to an economy's GDP and it creates employment opportunities hence reducing unemployment. Small businesses also play a key role in terms of their contribution to innovation and development of new ideas as well as leading to the emergence of large corporations. From this perspective, it is very crucial for a government to provide the necessary support for its SME sector to ensure that it flourishes.

A good and effective tax system for small businesses needs to be well researched before implementation. It is evident that small business owners and members of the public need to be given an opportunity to offer their views regarding what they think of the small business tax system being designed or implemented. This would contribute to enabling the tax system to gain acceptance from the small business sector and the general public. Well set and clear objectives for the small business tax system need to be in place and the design should aim to achieve those objectives. As favourable tax policies, systems, and tax incentives are of great significance to this study, chapter three goes deeper in giving a general overview of these dispensations.

CHAPTER 3

OVERVIEW OF TAX INCENTIVES

3.1 INTRODUCTION

As indicated in the previous chapter, this chapter presents a detailed overview of tax incentives. Tax incentives are used by many governments all over the world to lure investment. Despite tax incentives being a growing worldwide phenomenon, their effectiveness in achieving the intended objectives has been widely questioned by

contemporary scholars such as Jordaan (2012: 5). The author acknowledges that the majority of available literature is sceptical about the role of incentives in influencing the decision to invest and he doubts their ability to affect the pattern of investment. Bird (2008: 9) adds that, even though tax incentives are popular, they are characterised by an element of redundancy and ineffectiveness in that they reduce tax revenue and complicate the tax system without achieving their intended objectives. Bird is adamant that while some tax incentives are effective in attracting investors, they are often inefficient and divert scarce resources in a manner that does not yield optimum usage.

Despite having numerous critics questioning their effectiveness, the virtue of tax incentives has indeed been lauded by several researchers. Zolt (2014: 9) argues that, with careful design and rigorous implementation strategies, tax incentives could be a useful tool in attracting investments that would not have been a possibility without the provision of tax benefits. He adds that tax incentives carry a lot of meaning if they correct or compensate for market deficiencies and generate positive externalities. In support of the opinions put forward by Zolt (2014: 9), the United Nations (UN) (2018: iii) explains that the justification for the continued use of tax incentives is to rectify market inefficiencies. The UN (2018: 80) argues that tax incentives could be used to attract mobile investments, act as subsidies for companies during times when their respective sectors could be in recession, as well as create a form of agglomeration economies.

Opinions of policy-makers and scholars differ with regard to the effectiveness of tax incentives. What does not change is that many countries, most especially developing countries, use tax incentives in attracting investments and boosting the growth of their economies (James 2013: v). South Africa is one of those countries that use tax incentives for different reasons with an intention to achieve certain objectives. For example, the country uses small business tax incentives to boost the growth and development of its small businesses. In this chapter, the study looks at the fundamental theory surrounding tax incentives. The different views of various scholars, economists, and international organisations with regard to tax relief measures are also highlighted.

3.2 DEFINITION OF A TAX INCENTIVE

The IMF, the Organisation for Economic Co-operation and Development (OECD), the UN, and the World Bank (2015: 8) jointly define a tax incentive as any special tax provisions granted to qualified investment projects or entities that provide a favourable deviation from the general tax code. Zolt (2014: 4) defines tax incentives as those special exclusions, exemptions, or deductions that provide special credits, preferential tax rates, or the deferral of tax liability. According to Klemm (2009: 3), tax incentives are all types of preferential tax treatments that target certain activities or sectors only, as opposed to general preferential tax treatments applicable to all. Similarities could be traced in the above definitions of tax incentives. The IMF et al (2015: 8), Zolt (2014: 4), and Klemm (2009: 3) use the words special tax provisions, special exclusions, and preferential tax treatment respectively in their definitions of such tax dispensations. The similar element is that they all point to leniency in terms of tax treatment for qualifying entities.

More definitions of tax incentives may include those by the Southern African Development Community (SADC), the United Nations Conference on Trade and Development (UNCTAD), and those by other renowned scholars and economists such as Barbour. The SADC (2002: 4) defines tax incentives as “fiscal measures used to attract local and foreign investments to certain economic activities or designated areas in a country”. According to the UNCTAD (2000: 11), an incentive is a measurable advantage given to specific categories or enterprises by the government in order to encourage them to behave in a certain manner. Barbour (2005: 2) sheds more light on what should be categorised as a tax incentive. He is of the opinion that a reduction in corporate taxation is not an incentive scheme even though it may yield increased corporate investment. Barbour argues that reducing corporate taxes only to firms that are located in a specific region or designated zone or producing certain goods or services, is an incentive scheme. If preferential tax treatment is implemented for example to entice FDI over local investments, then this represents an incentive scheme targeting FDI (Barbour 2005: 2).

This study uses the definition of a tax incentive given by the IMF et al (2015: 8), as explained at the beginning of this paragraph. This is because the study involves four different countries (South Africa, Australia, India, and the United Kingdom) and this definition was put forward by renowned world organisations that link different countries together including those in the study.

3.3 TAX INCENTIVES OFFERED TO ALL COMPANIES IN SOUTH AFRICA

The government of the Republic of South Africa offers a variety of tax incentives to different industry sectors and different kinds of businesses (Jordaan 2012: i). Some tax incentives specifically apply to certain categories of businesses such as small businesses, whereas other tax incentives may generally apply to different kinds of businesses (irrespective of size) that meet the set criteria to qualify for the incentive. This study is based on the tax incentives offered to small businesses in South Africa and chapter 4 presents a detailed discussion of these tax relief measures. To provide a full view of other tax incentives that small businesses may also make use of (although these are available to South African companies irrespective of their sizes), some of these tax incentives are briefly discussed below.

- The R&D incentive provided by Section 11(D) of the Act is a 150 per cent deduction which applies to expenditure incurred with respect to the discovery of non-obvious technological or science related knowledge, creating an invention, a computer-related program, and its corresponding knowledge. The taxpayer must have received approval from the Department of Science and Technology before commencing with such a project.
- According to section 11(e) of the Act, depreciation (wear and tear allowance) may be deducted on machinery, plant, implements, utensils and articles used for the process of the taxpayer's trade if those assets have diminished in value. This excludes assets for which a deduction may be allowed under Sections 12B, 12C, 12DA, 12E (1), 12U or 37B. The allowance is 20 per cent

each year for five years. Section 12B of the Act provides for an accelerated depreciation allowance of 50 per cent in the first year of use, 30 and 20 per cent respectively in the two succeeding years; on machinery and articles used in farming or production of renewable energy. Section 12C of the Act allows a deduction for assets used by manufacturers, hotel keepers and those used for aircraft and ship maintenance. This allowance also applies to assets used in the packaging and storage of agricultural products. New and unused machinery used in a process of manufacture or in a similar process is depreciable at the rate of 40 per cent in the first year of use and 20 per cent in the three following years. If the machinery is not new, an allowance of 20 per cent per year over five years is deductible.

- Section 13quat of the Act allows the deduction of 20 per cent for new buildings in the year in which such property is brought into use and 5 per cent in each of the succeeding 16 years of assessment. In the case of improvements to the building, the Section allows a deduction of 20 per cent of the cost of improvements for five years. The deductions covered by the Section may be for the cost of erection, extension, additions, acquisition, or improvements of any commercial or residential building or part of a building. The building must be located within an approved urban development zone which is to be used solely for the purposes of trade.
- The Infrastructure Development allowance of Section 12D of the Act allows for a deduction to taxpayers who deal in the construction of railways, transmission lines, and pipelines for new or unused assets. The deduction is 10 per cent of the cost per annum for pipelines used to transport natural oil and 5 per cent for transmission and railway lines through the Critical Infrastructure Program.
- Section 12N of the Act allows private parties to a Public Private Partnership to claim capital allowances for improvements made to land or government-owned buildings, even though the private party's rights could be limited to only use or occupation of the land. The lessee in this arrangement is thus deemed

to be the owner of the land and buildings in respect of which the improvements are made, so that he/she may qualify for the usual capital allowances under Section 12N of the Act.

- Section 12L of the Act allows taxpayers to claim a deduction for most forms of energy-efficiency savings that result from trading activities or in income production, depending on the availability of an energy efficiency savings certificate which is issued by the South African National Energy Development Institute. For assessment years commencing on or after 1 March 2015, the allowance is calculated at R0.95 per kilowatt hour of energy efficiency savings.
- Section 12P (2) of the Act exempts amounts received by or accrued to a person as a beneficiary of any government grant as listed in the Eleventh Schedule of the Act. The grant may also be identified by notice in the government gazette for purposes of exemption from normal tax from a given date.
- The Industrial Development Zone (IDZ) allowance of Section 12I of the Act allows for the deduction of expenditure incurred on industrial policy projects classified as Greenfield projects. According to Section 12I, these are the new industrial projects utilising wholly new assets for manufacturing. The incentive is also available for Brownfield projects (expansion of projects that are already in existence). The incentive is a 55 per cent allowance for qualifying assets or 100 per cent if it is located in a Special Economic Zone (SEZ) in terms of Greenfield projects. For Brownfield projects, the allowance is 55 per cent on qualifying assets for projects with preferred status and 35 per cent for any assets of other projects falling within the Brownfield projects category.
- The Special Economic Zones (SEZ) allowance of Sections 12R and 12S of the Act promotes targeted economic activities and offers a favourable tax regime to entities operating in such zones. The benefits of carrying on trade in a SEZ include a preferential 15 per cent corporate tax rate (Section 12R of the

Act) and a 10 per cent building allowance (Section 12S (2) of the Act). The benefits also include an Employment Tax Incentive and additional VAT and duties relief for businesses operating within a customs controlled area of a SEZ.

- Upon meeting the requirements of Section 9I(2), a headquarters company located in South Africa would qualify for certain tax exemptions. These include exemptions on the headquarters company's dividend distributions and withholding tax on interest in certain circumstances. Other dispensations according to Section 9I(2) include CGT exemption upon the disposal of shares by the headquarters company.

The above tax incentives are generally available to all businesses irrespective of size and therefore they could be used by small businesses. Tax incentives that only relate to small businesses are discussed in chapter 4, specifically identifying those related to SBCs, micro-businesses, and other general tax incentives for small businesses that are implemented in South Africa.

3.4 THE RATIONALE OF TAX INCENTIVES

The importance, significance, and effectiveness of tax incentives in achieving the policy-makers' intended objectives generally divide opinions about this discussion, but nevertheless, they are widely applied by many countries across the world (OECD 2007: 3; James 2013: 3; Zolt 2014: 3). Tax incentives may take different forms (as seen in par 3.3, chapter 4, and chapter 5) and governments normally implement each incentive with a different objective to be achieved. There are also costs (both direct and indirect) involved with the implementation of tax incentive policies and these have the potential to erode the little benefits that would have been realised by an incentive program (Bird 2008: 11 - 12). This explains why James (2013: 3) warns that governments must balance their likely costs and potential benefits when choosing tax incentive policies. The arguments as put forward below point to the importance of tax incentives.

Tax incentives encourage investment in certain sectors and geographic areas (UNCTAD 2000: 12). When a need arises to boost investments in a certain sector or geographic area that could have been identified for some reason such as lack of development of an area, the government may implement tax incentives to lure businesses to invest there and contribute towards the development and rejuvenation of such an area (OECD 2007: 7). A government's objectives for implementing such tax incentives may include support for rural development, building industrial centres away from major cities, reducing environmental hazards, reducing over-urbanisation of one area and reducing over-concentration of population in certain areas (UNCTAD 2000: 12). The IDZ and SEZ allowances, such as those available in South Africa (par 3.3), are good examples in this regard. Barbour (2005: 4) warns that the use of tax incentives as a way of attracting investments in particular areas could be seen as compensating for inadequacies in the investment regime.

Tax incentives that are targeted at a certain activity could contribute to performance enhancement within that particular activity. Tax incentives could be targeted towards different economic activities such as export promotion, manufacturing, job creation, skills training, and infrastructure development, among others (UNCTAD 2000: 13). Policy-makers could implement targeted tax incentives to a selected activity with a view of boosting or improving the performance of that particular activity in the country. Investment incentives which are targeted at export-oriented production could be more effective than most other forms because of the high levels of the mobility of such investments. A tax incentive program that is well targeted could be very successful in attracting specific projects or specific types of investors (Zolt 2014: 15).

Furthermore, Barbour (2005: 7) argues that tax incentives could be used to compensate for government-created obstacles in the business environment. He explains that a tax incentive regime could easily be used to counterbalance government failures (such as low skills base in the country, high regulatory compliance costs, among others) than to engage the inadequacies. Calitz, Wallace, and Burrows (2013: 7) agree with Barbour regarding the use of tax incentive policies

by governments to compensate for inadequacies in the investment environment. Legislators may find it easier to implement tax incentives because they have control over them rather than to tackle the actual challenges that discourage investors. In addition, alternative measures such as subsidies may involve direct expenditure and attract more public scrutiny because of the related costs hence incentives become an easier political tool to be deployed (Calitz et al 2013: 7).

Tax incentives can play a role in the transfer of know-how and technology from the developed world to less developed countries (Zolt2014: 14). Babatunde (2012: 1) concurs that, in the process of tax incentives attracting FDI, technology comes along with it and as a result, technical progress increases in the host country. Easson and Zolt (2002: 18) postulate that tax incentives could be useful in promoting activities such as R&D. They explain that countries may attract technologically advanced investments through providing incentives for carrying out R&D, thereby acquiring technologically advanced equipment and targeting incentives in technologically advanced sectors.

In addition, the Nathan-MSI Group (2004: 7-19) identified that tax incentives contribute to the drive towards employment promotion. They indicated that all countries in the Southern African Development Community considered employment as a genuine goal of tax incentives. The IMF et al added that tax incentives lead to a social benefit in the society in terms of new jobs being created as a result of high investments and hence reducing unemployment (IMF et al 2015: 10). In line with the above sources, Jordaan (2012: 7) is also of the opinion that incentives contribute to employment promotion. This is as a result of the economy-wide benefits of greater employment such as skills transfer which might not have been taken into account by individual business entities.

The greater good of many of the spill-over effects of tax incentives contribute to economic development (IMF et al 2015: 8) and generally benefits the small businesses in the country. Most tax incentives are designed to attract investments either in a certain region or sector (Zolt 2014: 11; Calitz et al 2013: 3). The arrival of mega investment projects in an area would normally lead to better road

infrastructure, population growth in the area, and employment opportunities. It would also lead to better housing facilities, a supply of water, electricity and telephone services, all of which would contribute to making the small business environment more favourable (Calitz et al 2013: 3). Small businesses feed off large corporates or big projects and in certain instances, small businesses partner with the larger corporates on some projects (Schaeffer 2015: 15 -18). The benefits of a small business partnership with a large corporate can be seen to be mutual. Schaeffer (2015: 25) identified scenarios in which start-up businesses contributed to the innovative potential of large entities such as Siemens, IBM, and Air France. All these could be seen as indirect benefits of tax incentives to small businesses.

Well-targeted tax incentives can be used to simplify tax legislation for small businesses, hence making it easier for them to achieve the required levels of compliance. The turnover tax regime in South Africa simplified the taxation of micro-businesses in such a way that the tax payable is calculated based on annual taxable turnover and no deductions are considered (SARS 2016: 14). The presumptive taxation scheme of India also simplified the taxation of small businesses to all qualifying businesses to pay tax at preferential rates. Under the presumptive taxation scheme, qualifying entities pay tax at 8 per cent of gross receipts or 6 per cent on total turnover received through digital means (without involving cash). No deductions are considered and books of accounts are not required unless when providing a professional service (Section 44AD, 44ADA & 44AE of Act No. 43 of 1961 of the ITA-India). This simplification of the tax code, which is a result of tax incentives, is considered to help small businesses to comply with tax regulations while cutting costs on professional accountants and bookkeepers.

Despite their rationale being well documented, tax incentives remain a controversial matter and their effectiveness divides opinions among renowned economists, scholars, and reputable organisations. It is for this reason that this study has attempted to delve deeper into the controversial and uncertain world of tax incentives (Bird 2008: 9 - 10; Calitz et al 2013: 2), although not to determine the effectiveness or ineffectiveness. This study discusses the small business tax incentives in South Africa and points to possible gaps and areas of concern within these tax relief

measures. Several studies agree that if well designed and meticulously implemented, tax incentives could possess the potential to achieve the intended objectives (Klemm 2009: 5; Zolt 2014: 9; IMF et al 2015: 3). Given that the design of tax incentives is a policy issue and tax policies differ from one country to another, the study also sought to compare South Africa's small business tax incentives with those in Australia, India, and the United Kingdom. An investor will also consider the possible advantages and disadvantages before making the decision to invest in a certain area or sector.

3.5 ADVANTAGES AND DISADVANTAGES OF TAX INCENTIVES

According to Barbour (2005: 9), it is a complicated task to identify which incentives may successfully work for an economy and which kind may not work. He explains that each tax relief measure has its own benefits and shortcomings and therefore it depends on the circumstances of the economy. Klemm (2009: 5) expounds the view that tax incentives may work if they are well designed and certain conditions are met, but he also casts doubt on their benefits while pointing to the resultant costs. Several scholars and economists of note agree that despite all the uncertainty and controversy surrounding tax incentives, these instruments are still widely used in different parts of the world (Bird 2008: 9, James 2013: 36, Calitz et al 2013: 3, Zolt 2014: 3). The arguments that follow, present a discussion of the advantages and disadvantages of tax incentives.

3.5.1 Advantages of tax incentives

The Nathan-MSI Group (2004: 3-1) indicates that tax incentives can lead to higher profits on the side of investors. They argue that relief which allows the reduction of imposed tax on income results in a higher return on the investors' investments. James (2013: 41) identifies that businesses could greatly benefit from tax holidays and become more profitable. The IMF et al (2015: 16) agree with James (2013: 41) on tax holidays leading to higher profits for investors. They argue that tax holidays would benefit companies that could start making profits sooner in the holiday period rather than long term investments that could start being profitable in the long run.

Calitz et al (2013: 8) argue that tax incentives play a part in compensating for other shortages in the investment climate. They explain that authorities may consider attracting investment; however, they could be finding it difficult to deal with the main issues that could be discouraging investors. Babatunde (2012: 6) agrees that tax incentives are being used to compensate for other shortcomings in the investment climate. Klemm (2009: 19) also believes that tax incentives can be utilised in compensating for deficiencies in the investment climate. He explains his view with an example that for a country with low investment rates as a result of poor tax administration, the ultimate solution would be to reform the tax department. Klemm also argues that in a case where such reform would be politically impossible, a consideration would be made for the introduction of a special economic zone or a tax holiday.

Furthermore, James (2013: 35 – 37) argues that tax incentives are less complicated to provide than improving the investment climate, infrastructure, or skills. The OECD (2007: 5) argues that in attracting investments, governments could find it easier to provide tax incentives than to correct deficiencies such as the lack of infrastructure and skills shortages. Tax concessions do not involve actual expenditure or cash subsidies to investors and therefore this makes it easier to provide (OECD 2007: 5). In addition, Jordaan (2012: 6) believes that fiscal incentives respond to government failures as much as they do to market inadequacies. He is also convinced that it is harder and takes a longer period to engage investment impediments than using tax incentives to counterbalance the market deficiencies.

According to Klemm (2009: 10 - 11), an incentive-laden system has the potential to reduce the harmfulness of across the border tax competition as it lessens the downward pressure on tax rates. This is contrary to the argument put forward by the Nathan-MSI Group (2004: 3-2) that tax incentives lead to tax competition when several countries wish to attract a similar investment. Klemm (2009: 10) seems to have been aware of the contradiction in his argument that tax incentives could reduce the harmfulness of tax competition hence he denoted it as being paradoxical.

Klemm (2009: 5) argues further that, while there are possibilities of finding circumstances under which tax incentives are worthwhile, the case for most incentives remains doubtful. The Nathan-MSI Group (2004: 3-3) agrees with Klemm (2009: 5); they warn that certain arguments and opinions could be impressive in justifying the use of tax incentives, however, a well-documented analysis needs to be done to balance those considerations. This, therefore, requires an examination of the other side of the story which relates to the disadvantages or arguments and opinions against tax incentives.

3.5.2 Disadvantages of tax incentives

The Nathan-MSI Group (2004: 3-5) identifies loss of revenue by the government as one of the major disadvantages of tax incentives. Indeed a few scholars such as James (2013: 36) and Zolt (2014: 10 -12) have also lamented the costs and loss of revenue associated with tax incentives. The main purpose of tax policy should be revenue mobilisation but instead, tax incentives lead to loss of revenue. The loss of revenue occurs when tax incentives do not significantly affect the investment decision or when they are more generous than necessary (Nathan-MSI Group 2004: 3-5). Zolt (2014: 17) explains that tax incentives lead to loss of revenue by creating opportunities for businesses to engage in tax avoidance. He particularly blames tax holidays for being susceptible to this unscrupulous practice.

The additional investment caused by tax incentives in certain sectors and regions may cause the allocation of resources that may result in too much focus and investment in certain activities and at the same time too little or nothing in other non-prioritised areas. This inequality and imbalance could be brought about by tax incentives attracting investments to certain prioritised areas or sectors (Easson and Zolt2002: 11). Barbour (2005: 3) shares similar sentiments in his argument that providing tax incentives to one group of investors rather than the other, creates inequality in the investment climate surrounding potential investors and leads to an inefficient allocation of capital. Such an 'unlevelled playing field' for potential investors violates the principle of horizontal equity, which is one of the main pillars of a good tax system. Bird (2008: 10) points to the inequity of tax incentives alongside

inefficiency and believes that the two symbols of tax incentives could prevent a tax system from achieving its main objective of funding essential public sector activities.

According to Klemm (2009: 12), tax incentives lead to high administrative costs incurred in preventing fraudulent use of incentive schemes. This is a view that is also echoed by Bird (2008: 10) in his warning against the excessive use of tax incentives. Bird noted that tax incentives complicate tax administration as they facilitate evasion and encourage corruption. Calitz et al (2013: 7) believe that the non-transparent nature of tax incentives promotes tax evasion, complicates tax administration, and encourages corrupt behaviour. Tax incentives pose management problems for tax administration while they also require a well-developed accountability system (Babatunde 2012: 2).

Tax incentives lead to erosion of the revenue base when taxpayers abuse the tax incentive regimes to avoid paying tax on non-qualifying income or activities (Zolt 2014: 11). Zolt adds that a closely linked scenario could be a situation where tax incentives are used by taxpayers to reduce the tax liability on non-qualifying activities and income. A similar view had earlier been echoed by the Nathan-MSI Group (2004: 3-7) when they pointed out that tax incentives lead to revenue leakage through tax avoidance and evasion. The group argues that tax incentives create opportunities for taxpayers to engage in aggressive tax planning, which in essence the Group calls tax avoidance. Calitz et al (2013: 7) also mention in their argument from a fiscal point of view that the real cost of tax incentives is hidden and that they lead to erosion of the tax base.

James (2013: 41) warns that entities could take advantage of loopholes in the tax holiday dispensation to increase their profits. He argues that entities could channel high profits through transfer pricing from a profitable company to another which is covered by the tax holiday scheme and thereby avoid paying tax on either of the two. This would pose a challenge on the side of the policy implementers. Klemm (2009: 10) also identified that a system with tax incentives would lead to many problems such as increased complexity and reduced transparency. Tax holidays also have the potential to increase tax competition among countries. Nathan-MSI Group (2004: 3-

2) are of the opinion that countries end up being pushed into offering tax breaks of their own to match those offered by their neighbours such that they too do not miss out on attracting investments. This is echoed in the views of Zolt (2014: 15) that there is fierce competition among countries in relation to export promotion and the attraction of export-oriented investments particularly among developing countries.

Tax incentives can be capitalised over time and they lose their purpose. Gwartney and Stroup (1986: 119 - 120) argue that when the real incentive benefits are linked to the ownership of the asset, the market value of the asset increases to reflect the present value of the expected income stream. In their assessment of agricultural price support programmes, in relation to the adverse effects of capitalisation of the incentives, Gwartney and Stroup (1986: 119) conclude that the real beneficiaries are the landowners and not the farmers. In this scenario, it could be understood that the incentive should have been meant to provide support to the farmers such that they would increase on their produce. In addition, Coetzee (1995: 59) is of the opinion that tax incentives are rent-generating restrictions because the tax saving that comes along with them is capitalised and thus their only purpose is to expand the consumption of a particular commodity. In essence, the gains of tax incentives are only transitional and after the capitalisation, the original recipients are left in no better position than they were in, before the tax privileges.

Klemm (2009: 5) suitably sums the arguments in favour and against tax incentives in his argument that it could be possible to find circumstances under which certain tax incentives are justifiable, although the case for most incentives remains doubtful. Based on the different views and opinions, both in favour and against tax incentives, it is clear that tax incentives are widely criticised by different scholars and researchers. The fact that proponents of tax concessions exist cannot be ignored. Those in favour of tax incentives gather courage from the reality that tax incentive regimes are still widely used across the world (Calitz et al 2013: 3) to drive much of the tax policy in developed and developing countries. The design of tax incentives could be crucial in determining their success or failure as indeed Zolt (2014: 9) recognises that well-designed tax incentives have achieved success in increasing

investments. The study, therefore, looks at the design of tax incentives in the following paragraphs, together with the requisite monitoring and administration.

3.6 THE DESIGN, MONITORING, AND ADMINISTRATION OF TAX INCENTIVES

Easson and Zolt (2002: 34) are of the opinion that the usefulness of tax incentives depends on their design, implementation, and monitoring. Zolt (2014: 9) argues that tax incentives are useful tools in attracting investments if properly designed and implemented. Both these authors seem to agree that tax incentives could be useful but the design has to be right and the authorities have to put in place thorough mechanisms for monitoring and implementation. It is therefore clear that the design aspects of tax incentives and their monitoring and administration are of paramount importance in ensuring that these tax incentives achieve their intended objectives. This Section discusses matters relating to the design of tax incentives as well as their monitoring and administration.

Tax incentive policies involve three core design issues which include the choice of tax instrument to be used in incentivising investment, the eligibility criteria followed in the selection of qualifying investments, and the reporting and monitoring requirements during different stages of the tax incentive's life cycle (IMF et al 2015: 19 - 23). In his discussion regarding the design considerations for tax incentives, Zolt (2014: 14 - 19) similarly identified eligibility issues regarding the investments to be attracted while he emphasised implementation as well as reporting and monitoring to achieve compliance. Unlike the IMF et al (2015: 19 -20), Zolt (2014: 15) does not place much emphasis on how to make a choice of tax incentives to be offered. He mentions that determining the form of tax incentives is one of the two basic decisions to be made in the designing of the instrument. Several other scholars and economists have also contributed to what they consider important in the design of tax incentives. Klemm (2009: 12 -14) in particular elaborates on the principles to be followed in choosing tax incentives. The three core design issues suggested by the IMF et al are discussed further in the paragraphs that follow hereunder (3.6.1 – 3.6.3).

3.6.1 Choice of instrument

The choice of alternative tax incentive instruments ought to be considered based on four determining factors, namely: economic efficiency, revenue foregone, and effectiveness in stimulating investment and tax administration (Nathan-MSI Group 2004: 5- 2). Klemm (2009: 13) agrees with the Nathan-MSI Group (2004: 5-2) regarding choosing a tax incentive because of its economic efficiency. Klemm (2009: 13) argues that efficiency plays a part in assessing a tax incentive. He emphasises that, for an incentive to be efficient, it should avoid distortions towards short-lived assets and it should be available to investments which could remain viable after the expiry of the tax instrument. The IMF et al (2015: 19) agree with both the Nathan-MSI Group (2004: 5-2) and Klemm (2009: 13) on the issue of using the efficiency of a tax incentive in assessing whether to implement the tax tool or not. The IMF et al (2015: 19) believe that the efficiency of a tax incentive should require imposing less heavy taxes to more mobile activities than those that are less mobile. They add that efficient tax design also calls for heavy taxation on items with less sensitive tax bases because in such cases tax would have less impact on real decisions.

In choosing tax incentives in relation to following the revenue foregone criteria, Easson and Zolt (2002: 21) seem to bend towards accelerated depreciation instead of tax holidays and investment allowances. They argue that the revenue foregone on accelerated depreciation is less than that on tax holidays and investment allowances because it affects only the timing of tax payable and not the amount. The Nathan-MSI Group (2004: 5-2) explain that the generosity of each instrument should be determined by the amount of revenue foregone per beneficiary. They add that there would be no revenue loss if the incentives were to be targeted to investments that would be lost to the economy. In addition, Zolt (2014: 12) argues that the revenue foregone could be used in implementing a particular tax incentive and it could work by conducting a cost-benefit analysis of the particular incentives involved. In his argument, however, Zolt expresses dissatisfaction that, if this approach were to be considered in choosing a tax incentive, a true measure of efficiency may not be

achieved because only the cost would be measured and not the value of the jobs created.

Klemm (2009: 12 – 13) identified guiding principles to be followed in choosing tax incentives that could be introduced by a government. He identified transparency and predictability and explained that investors would have to be able to understand the tax instruments if their investment decisions were to be based on them. The IMF et al (2015: 23) agree that transparency is important as a guiding principle in the choice of an incentive. However, they believe that transparency is necessary but not sufficient for good governance. Both Klemm (2009: 12 – 13) and the IMF et al (2015: 23) are of the opinion that transparency of a tax incentive could reduce opportunities for corruption.

Tax relief measures may cover different kinds of taxes, which may include income tax, VAT, property tax, and social contributions. The IMF et al (2015: 20) explain that incentives relating to each of the different types of taxes require distinct economic analysis. They give the example that reducing tariffs on capital goods would be good if it would alleviate production complications that lead to high costs of production. They argue that on the same note, a VAT exemption on investment would be unsuitable because VAT input is recovered against VAT output. The IMF et al (2015:20) advise that VAT exemptions could be used if tax authorities find its implementation more of a problem, for example as a result of imperfect and complex VAT refund procedures. Zolt (2014: 13) agrees that incentives require distinct economic analysis. He believes that general tax expenditure analysis and the use of tax incentive budgets could increase accountability and transparency.

Incentives which lead to a decrease in the cost of investment usually take preference over those that are profit-based. They explain that tax incentives that are cost-centred involve certain allowances that are associated with investment expenditure such as accelerated depreciation and specific tax deductions. Tax incentives that are profit-based lower the applicable tax rate to be applied to taxable income and they include, among others, preferential tax rates and tax holiday periods (IMF et al 2015: 20). In relation to profit-based and cost-based tax incentives, Jordaan (2012: 2 – 4)

argues that, with regard to the infant industry, tax incentives can be effective in supporting new business establishments. Therefore, companies prefer to undertake investments with Net Present Values that are greater than zero. A positive Net Present Value could be a result of fewer costs incurred on the new venture and this points to the concurrence between Jordaan (2012: 2 - 4) and the IMF et al (2015: 20) that preference is given to incentives that lead to a decrease in the cost of investment.

Zolt (2014: 16) identified and commented on the use of tax holidays as a tax incentive. He argues that tax holidays are the most common form of investment tax incentives in developing countries. He explains that tax holidays include a tax exemption on profits for a specified period of time, low tax rates, and in some cases could involve a mixture of the two. Both Zolt (2014: 16) and the IMF et al (2015: 20) agree that exemptions of tax are more suitable to mobile activities than long term establishments. They both relate this to the fact that substantial long term investments would normally take some time before beginning to be profitable. Yet during this maturity period, the tax holiday could also expire. They add that firms dealing in short term investments tend to move from one country to another at the expiry of the tax holiday in search of other countries with favourable tax conditions and they believe that this may not benefit the country offering the tax holiday.

3.6.2 Eligibility criteria

The IMF et al (2015: 21) and the UN (2018: 14) explain that tax incentives need to be well targeted and based on clear eligibility criteria. They add that targeting tax incentives serves two purposes, which include identifying the types of investment that a government seeks to attract and reducing the fiscal cost of those incentives. The IMF et al (2015: 21) commented on the special size of tax incentives. They indicated that sometimes tax benefits could be restricted to new investments that meet certain predetermined criteria, such as possession of a given value of assets or creation of a certain number of new jobs. The IMF et al (2015: 21) warn, however, that prejudice favouring large foreign investments could lead to a restriction on the growth of smaller yet economically important domestic enterprises. Their concern is

that such smaller entities may be left out even when they might be more fruitful. This is in line with the Nathan-MSI Group (2004: 4-14) and Zolt (2014: 15) whose studies indicated that preferential tax treatment is granted by several countries to specifically listed activities. They believe that, in the process, tax incentives are being restricted to enterprises that manufacture products that may not have been produced before, in a particular country.

Zolt (2014: 14) identified sectoral targeting as one of the factors considered as an eligibility criterion for tax incentives. He is of the opinion that sectoral targeting is advantageous in such a way that it restricts the benefits of the tax incentives to investments considered most desirable by policy-makers. This is in line with the explanation of the UN (2018: 21) and the IMF et al (2015: 21), who elaborate that different countries apply favourable tax treatment mechanisms to certain sectors of the economy which they consider most desirable. Such sectors should also have the possibility of being influenced by tax policies. James (2013: 14) argues that using tax incentives to attract investments in areas that are not primarily influenced by tax relief would lead to a waste of resources. To James (2013: 14), this is because he believes that investments could still have been made without the incentives. The IMF et al (2015: 21) identified finance and tourism-related establishments, film production and manufacturing as well as pioneer industries among those activities or sectors commonly preferred as a result of their valuable spill-over effects. However, both Zolt (2014: 14) and the IMF et al (2015: 21) warned that identifying special sectors for preferential tax treatment could place investments in other sectors at a competitive disadvantage which could lead to under-development.

Tax incentives could sometimes be targeted at special regions in the form of zones (UN 2018: 21). Easson and Zolt (2002: 23) identify two types of special zones commonly used by countries to attract investments. They indicate that countries either use the duty-free zones, whereby investments in such areas are exempted from customs duties, or SEZs which enable investors to enjoy preferential tax treatment. Such dispensation may not be available in other parts of the country. To supplement Easson and Zolt (2002: 23), the IMF et al (2015: 22) identified success stories where the SEZs have been implemented successfully. Examples given

include Hong Kong, Singapore, Korea, and China, where economic development can be attributed to the availability of such zones. Zolt (2014: 15) elaborates that, in other cases, the incentives are often offered by the government to enhance regional development and to promote investment in less-developed regions of the country or in areas of high unemployment. He adds that sometimes incentives are provided by regional or local governments, in competition with other parts of the same country.

3.6.3 Reporting and monitoring requirements

The IMF et al (2015: 28) recommend that revenue administration should be in charge of the implementation and enforcement of tax incentive schemes. They explain that this is because the revenue authority has the expertise and experience necessary for the execution of the tax law of which incentives should be part. The UN (2018: 38) emphasizes that to avoid abuse of the tax incentive, the tax policy underlying the concession and the administration systems need to be clear and robust. The IMF et al (2015: 28) advise that after a firm has qualified for a certain tax incentive, the tax administration should continue monitoring such firms for continued compliance. These views echo the opinions of Barbour (2005: 9) who commented that a competent tax administration would determine what works and what may not work in as far as tax incentives are concerned. Governments need to consider the capacity of their tax administration before implementing tax incentives. He added that poorly implemented tax relief measures, although well-designed, would still be ineffective (Barbour 2005: 10; Jordaan 2012: 9).

Bird (2008: 14) believes that even the best tax policy in the world could be worth little if it is not implemented effectively. He adds that the manner in which a tax system is administered, affects its yield, its incidence, and its efficiency. In his explanation, Bird points out that unfair and erratic administration may bring the tax system into disrepute and weaken the legitimacy of state actions. On a similar note, the UNCTAD (2000: 24) warns about the consequences of inappropriate administrative behaviour with regard to tax incentives. The UNCTAD advises that to avoid such a situation, the legislation needs to clearly define the incentives package and the

criteria under which incentives may be granted, hence reducing administrative discretion.

With regard to monitoring, the IMF et al (2015: 23) concur with Zolt (2014: 19), when they point out that incentives which are related to ongoing performance may have certain conditions attached to them, such as requirements that a given number of jobs are maintained. In his line of argument, Zolt (2014: 19) indicates that incentives of this kind require continuous monitoring. In addition, he laments the extra administrative burden imposed onto the tax authorities but he lauds its importance in providing an accurate idea to the host government, on the performance of an incentive. He further points to the importance of putting administrative capabilities, to conduct the necessary monitoring, into consideration at the time of drafting incentive legislation, to avoid unnecessary supervision. To the UN (2018: 28), ongoing monitoring is necessary to ensure continued compliance with pre-set conditions and also to detect tax avoidance or evasion. Zolt (2014: 19) suggests that, where non-compliance or abuse is detected, a penalty should be imposed and tax privileges should be denied as a result. After looking at the choice of an instrument, the eligibility criteria to be followed, and the reporting and monitoring requirements, it is important to consider some comments on best practice from different renowned scholars.

3.7 COMMENTS ON BEST PRACTICE PRINCIPLES REGARDING TAX INCENTIVES

Barbour (2005: 9), in his assessment of South Africa's investment incentives, identified a set of guidelines for policy-makers regarding what he considered to be an effective and efficient investment incentive. In Barbour's assessment, an effective and efficient investment incentive should stimulate investment in the desired sector or location with minimal revenue leakage. It should be transparent and easy to understand, should be implemented and administered by a single agency and should have low administrative costs. In rekindling the earlier work done by Barbour (2005: 9), the OECD (2013: 3 – 4) published a set of proposed 'best practice' principles in

an international effort to promote the management and administration of tax incentives. They agree with Barbour in most of the criteria that he put forward, more particularly that tax incentives need to be administered in a transparent manner and that where possible, they should be consolidated under the authority of one body of government.

James (2013: 38 - 39) argues that incentives could have more transparency and subject to little abuse if they were provided and approved by the legislature. He adds that authorities should ensure that incentives are uniformly granted according to pre-determined procedures that are well known to the general public. James warns that there should be clarity about costs. He also advises that best practice could involve budgeting for the amounts of revenue forgone and revealing them to the people to increase discussion from the general public on the costs and benefits of tax incentives. James' arguments borrow a leaf from Barbour (2005: 9) and the OECD (2013: 3 – 4). They both comment on clarity with regard to the costs to be incurred, the administration by a single government body, as well as transparency in administration.

The UN (2017: 3) is of the opinion that what is regarded as best practice in terms of tax incentives, should be considered with caution with regard to developing countries based on experiences with developed countries and optimal tax theory. Optimal tax theory could be defined as tax policy which follows a principles-oriented approach to satisfy certain desirable criteria (Sørensen 2010: 212). The UN cites the example of China, Singapore, and Hong Kong where they believe that the investment climate is favourable and they explain that in such countries, investment incentives could generate expected results. They are sceptical of the same happening in most developing countries. James (2013: 1) shares a similar opinion with the UN with regard to a country's investment climate playing a part in determining whether tax incentives achieve their intended objectives or not. James argues that a country's investment climate has an impact on the effectiveness of tax incentives most especially in developing countries. The UN (2018: 7) rekindles its 2017 study on tax incentives with a similar view which was also highlighted by James (2013: 1), that

the effectiveness of tax incentives has a direct relationship to a country's investment climate.

Tax incentives must be well structured with carefully set goals and objectives with measurable outcomes that have the potential of supporting the evaluation processes (Murray and Bruce 2017: 7 – 8). They urge policy-makers to always apply a combination of conceptual reflections, sound data statistical analysis, and good judgement as they could go a long way in improving the structure of tax incentives. Correa and Gucerri (2013: 6) support the use of a wide variety of metrics such as cost measures based on revenue foregone and indicators of economic benefits to society. They also laud the use of economic theory and econometric techniques in measuring the economic effects of R&D tax incentives. Correa and Gucerri (2013: 6) add that a clear and simple design helps to increase the number of businesses taking up the incentive which could be essential in enabling the tax relief measure to achieve its intended objectives.

3.8 CONCLUSION

Tax incentives are used as instruments by state governments all over the world to attract investors to invest in particular regions, sectors of the economy, or certain enterprise sizes. The positive spill-over effects of attracting investments such as the creation of employment opportunities, the collection of more revenue through taxing of new businesses, cannot be over-emphasised. South Africa, for one, has put in place different categories of tax incentives to direct investment in different sectors, regions, or categories of businesses in which it wishes to see development taking place at a faster rate.

Differing views regarding tax incentives exist and they represent a division in opinions from researchers, international organisations, and scholars. Much criticism has been raised against tax incentives, and their effectiveness and efficiency have been questioned by scholars in numerous studies. Critics believe that investments would still take place even without tax incentives. They point to the costs associated

with implementing tax concessions and revenue foregone in the process and as a result, they are convinced that such tax policies are undesirable. Those that support tax incentives believe that tax dispensations indeed have the potential to attract investments in a particular sector or region. They point to a myriad of positive externalities that could also contribute to the social and economic development of the area.

The reality is that tax incentives have positive and negative attributes and countries are still implementing new tax incentives while discontinuing those deemed ineffective and more costly. Caution should be taken in the design and implementation of tax incentives to ensure that no loopholes are available which could lead to exploitation of the tax system. Armed with the theoretical knowledge regarding the much loved yet equally distrusted tax incentives, the discussion turns to the specific case of South Africa's small business tax incentives which are discussed in chapter 4.

CHAPTER 4

SOUTH AFRICA'S SMALL BUSINESS TAX INCENTIVES

4.1 INTRODUCTION

This chapter presents a discussion and raises concerns of tax incentives available to South Africa's small businesses. Specific attention is given to the discussion and identification of gaps/concerns within the tax incentives for SBCs and micro-businesses. Tax incentives that may generally apply to small businesses, but not necessarily to SBCs or micro-businesses, are also discussed and concerns thereof are raised in this chapter. The tax incentives for small businesses that are discussed relate to income tax, CGT, and VAT.

4.2 TAX INCENTIVES FOR SMALL BUSINESS CORPORATIONS

Before a small business can make use of the tax incentives for SBCs, it must qualify as an SBC. These tax requirements were discussed in paragraph 2.2.2. The South African government has implemented some tax incentives for SBCs as presented below.

4.2.1 Progressive rate of taxation

Normal companies pay tax at a fixed rate of 28 per cent while SBCs are taxed on the basis of a progressive rate for income tax. This means that the rate of tax to be paid depends on the amount of taxable income (the higher the taxable income, the higher the tax rate). ASBC pays no income tax on the first R78 150 taxable income (for financial years ending on any date between 1 April 2018 and 31 March 2019). Table 4.1 below shows the progressive rates of tax for taxable income of SBCs for the year of assessment ending 31 March 2019.

Table 4.1: Tax rates for SBCs: 1 April 2018 - 31 March 2019

Taxable income (R)	Rate of tax (R)
0 - 78 150	0%
78 151 – 365 000	7% of the amount above 78 150
365 001 – 550 000	20 080 + 21% of the amount above 365 000
550 001 and above	58 930 + 28% of the amount above R550 000

Source: SARS 2018a: 12

To demonstrate the benefit to the SBC, the following illustration is provided. Company A is a SBC and company B is a normal corporate company. Table 4.2 shows the tax liability of each company, based on four different scenarios of taxable income.

Table 4.2: Taxation of SBCs compared to the taxation of a normal corporate

Taxable income (R) (Assumed)		Company A SBC – Tax liability (taxed at progressive rate) (R)	Company B Normal corporate – Tax liability (taxed at 28%) (R)
Scenario 1	70 000	0	19 600
Scenario 2	300 000	15 530	84 000
Scenario 3	500 000	48 430	140 000
Scenario 4	700 000	100 930	196 000

Source: Author

Scenario 1 in table 4.2 indicates that company A does not pay any income tax as a result of the progressive rate of taxation (0 per cent for any taxable income not exceeding R78 150). In comparison to this, a normal corporate company B with the same taxable income is taxed at a fixed rate of 28 per cent and is liable to pay R19 600 as normal income tax for the period of assessment. In scenario 2, a SBC in South Africa pays R68 470 less (R84 000 – R15 530) income tax in relation to a normal corporate company. In scenario 3, a SBC pays R91 570 less and in scenario 4, R95 070 less when compared to normal corporate companies. This explanation underlines the importance of the progressive rate basis of tax for SBCs. Such huge savings in taxes would be used in the SBC's business operations, hence enhancing the growth and development of the SBC.

4.2.2 Tax incentives related to Small Business Corporation assets [Sections 12E(1) and (1A) of the Act]

According to Section 12E of the Act, two sets of accelerated capital allowance rates apply to the assets of an SBC. Subject to certain conditions, assets used directly in a process of manufacture or a process of a similar nature may qualify for a 100 per cent write-off in the year of assessment in which the asset is brought into use.

Assets that do not fall into this category may qualify for a write-off over a period of three years at a rate of 50 per cent in the first year, thereafter, 30 per cent and 20 per cent in each of the following two years.

4.2.2.1 Immediate write-off of all plant or machinery used in the process of manufacture or a similar nature [Section 12E(1) of the Act]

A SBC can claim a capital allowance on all plant or machinery in the year that the assets are brought into use for the first time for the purpose of trade (other than mining or farming). The assets must be used by the entity directly in a process of manufacturing or a process of a similar nature in the year of assessment (Section 12E(1)). This capital allowance is equal to 100 per cent of the cost of any plant or machinery that meets the requirements of Section 12E(1). The SBC must be the owner of the asset. The total amount of the allowance available under Section 12E(1) may be limited to less than 100 per cent of the cost of the plant or machinery if funding was received from a small business funding entity or in the form of a government grant. Some terms referred to in Section 12E(1) are explained below.

a. Plant and Machinery

- Plant

SARS (2018d: 22) states that the term “plant” is not defined in the Act, however, it has been considered in various court cases. In the case of *Blue Circle Cement Ltd v CIR*, 1984 (2) SA 764 (A), 46 SATC 21, several English cases were reviewed and it was agreed that applying a functional test and a durability test would be useful in arriving at a definition of “plant”. Using the durability test, the court held that “plant” connoted a “degree of durability and did not include articles that were quickly consumed or worn out in the course of a few operations”. The functional test considers how the particular asset is used and whether it is employed to carry on or promote the taxpayer’s business activities. SARS (2018d: 23) uses *ITC 1468*, (1989) 52 SATC 32 (C) to explain the meaning of “plant” using the functional test. In this

case, the knives and shoe-lasts used in the manufacturing of shoes passed the functional test and were considered to constitute “plant”. This was because they were used by the taxpayer in the course of the business and enabled the machines in the factory to perform their manufacturing function.

- Machinery

SARS (2018d: 23) explains that the term “machinery” is not defined in the Act; therefore the ordinary grammatical meaning is applied having regard to the context in which it is used. SARS uses the Collins Dictionary meaning where “machinery” is defined as “machines, machine parts, or machine systems collectively, particular machine system, or set of machines”.

b. Process of Manufacture or similar process

“Process of manufacture” is not defined in the Act; however, it has been used in a number of court cases. SARS (2018d: 24) points out that in *SIR v Hersamer (Pty) Ltd* 1967(3) SA 177(A) and *SIR v Safranmark (Pty) Ltd* 1982(1) SA 113(A), the term “process of manufacture” comprises activities which constitute the production of a product. In this description, the term “process of manufacture” is different from the materials or components which are used in the production of the product.

c. Owned by and brought into use by the SBC

Section 12E(1)(a) requires that the plant or machinery should be brought into use for the first time by the taxpayer that owns the asset or acquired it as a purchaser under an instalment sale agreement. A lessee of plant and machinery, therefore, does not qualify for a deduction under Section 12E(1) because a lessee does not own the leased asset. The plant and machinery may be new or second-hand, provided it is being brought into use for the first time by the SBC seeking to claim the allowance.

4.2.2.2 Tax incentive related to other assets of the Small Business Corporation - Section 12E(1A) of the Act

According to Section 12E(1A), a SBC has the incentive to elect to deduct either the wear and tear allowance (under Section 11(e)) or the accelerated amount calculated over a period of three years at a rate of 50, 30, and 20 per cent in the respective years. Tangible assets in respect of which a deduction is allowable under Section 11(e), such as machinery, plant, implements, utensil, article, aircraft, or ship (excluding plant or machinery used in a process of manufacturing or similar process) that was acquired on or after 1 April 2005, may all qualify. The taxpayer can choose the more beneficial rate between Sections 11(e) and 12E(1A) per asset - as illustrated further down.

The three years deduction of Section 12E(1A) does not allow apportionment in the case where the asset was used for part of the year of assessment; instead, the full amount is calculated and deducted. The allowance is calculated as follows:

- 50 per cent of the cost of the asset in the year of assessment during which it was first brought into use;
- 30 per cent in the second year of assessment; and
- 20 per cent in the third year of assessment.

SARS (2018d: 28) explains that Section 12E(1A) applies to assets “in respect of which a deduction is allowable under Section 11(e)”. Thus, a SBC will be entitled to a deduction under Section 12E(1A) only if the asset qualifies for a deduction under Section 11(e). A deduction is allowable under Section 11(e) if; any machinery, plant, implements, utensils, and articles owned by the taxpayer are used for the purpose of the taxpayer’s trade and have diminished in value. The reason for the fall in value should be because of wear-and-tear or depreciation during the year of assessment. However, the SBC should be aware that certain exclusions exist and in some instances, an allowance for some assets is prohibited under Section 11(e).

Annexure A of Binding General Ruling No. 7 of income tax presents a schedule of proposed write-off periods of different assets acceptable to SARS (SARS 2012: 13 – 19). The shortest write-off period is one year and it is acceptable for the writing-off of main frames of self-developed computer software, gymnasium spinning equipment, and wire line rods. The longest write-off period is 25 years in relation to absorption type chillers, artefacts, valuable paintings, and portable safes.

In order to claim the allowance, the asset must be owned by the taxpayer or it must have been acquired in terms of an instalment credit agreement as defined in the VAT Act. The depreciable cost of the asset is the lesser of the actual cost to the taxpayer or the arm's length cash price at the time of acquisition. Any foundation structure to which the asset is mounted or affixed forms part of the asset and qualifies for the allowance. The value of the asset is increased by the amount of any expenditure incurred by a taxpayer during any year in moving the asset from one location to another.

To demonstrate the calculation of the allowance according to Section 12E(1A), the following illustration is provided. Assume Company A, a SBC according to Section 12E, had a taxable income of R120 000 (before allowances) in year 1 and is expected to grow by R20 000 per annum for the next four consecutive years. Company A acquired a vehicle under an instalment credit agreement at a total cost of R150 000.

The first illustration reflects the results for the SBC if the company's accountant has elected to deduct the Section 12E (1A) allowance in claiming Company A's vehicle. Using the 2018 - 2019 tax table presented above in table 4.1, over the next 5 years, the Section 12E(1A) allowance would impact company A's tax liability as indicated in table 4.3 below.

Table 4.3: Calculation of normal tax payable if Section 12E (1A) allowance is applied

	Year 1 (R)	Year 2 (R)	Year 3 (R)	Year 4 (R)	Year 5 (R)
Taxable income (before allowances)	120 000	140 000	160 000	180 000	200 000
Less: Section 12E(1A) allowance	(75 000)	(45 000)	(30 000)	-	-
Taxable Income	45 000	95 000	130 000	180 000	200 000
Normal tax payable by the SBC (Tax rates: 1/04/2018 – 31/03/2019)	0	1 180	3 630	7 130	8 530

Source: Author

In the illustration above, the SBC would deduct an allowance of R75 000 (50 per cent of the total cost of the vehicle costing R150 000) in year one, R45 000 (30 per cent) in year two, and R30 000 (representing the remaining 20 per cent) in year three. The allowance has a more significant impact on taxable income in year one, as only R45 000 (R120 000 – R75 000) would remain as taxable income after the allowance is deducted. Therefore, the SBC would not pay any normal tax in year 1 (the taxable income would be below the tax threshold of R78 150 for SBCs). The allowance would be claimed over three years, resulting in no deduction in year four and year five.

Using the same facts and information as in table 4.3, the next illustration reflects the results for the SBC if the company elects to claim the Section 11(e) allowance instead of Section 12E(1A). The vehicle would be claimed over a period of 5 years at 20 per cent in each of the five years. Table 4.4 below shows how company A's tax liability would be impacted.

Table 4.4: Calculation of normal tax payable if the Section 11(e) allowance is applied

	Year 1 (R)	Year 2 (R)	Year 3 (R)	Year 4 (R)	Year 5 (R)
Taxable Income (before allowances)	120 000	140 000	160 000	180 000	200 000
Less: Section 11(e) allowance	(30 000)	(30 000)	(30 000)	(30 000)	(30 000)
Taxable income	90 000	110 000	130 000	150 000	170 000
Normal tax payable by the SBC (Tax rates: 1/04/2018 – 31/03/2019)	830	2230	3 630	5 030	6 430

Source: Author

In the above Section 11(e) illustration, the SBC would deduct an allowance of R30 000 (20 per cent of the cost of the vehicle) for a period of 5 years. As seen above, in year 1, the SBC would pay R830 as normal tax, whereas in the case of the company claiming an allowance of 50 per cent of the vehicle under Section 12E(1A), the SBC would not pay any normal tax in year one. In year two, the SBC would pay R2 230 in normal tax if it elects to claim the Section 11(e) allowance as compared to paying R1 180 in normal tax if it were to claim the Section 12E(1A) allowance.

In comparing the total tax that would be payable over 5 years in both cases, a SBC that elects to claim the Section 11(e) allowance under the above circumstances as per table 4.4, would pay R18 150 as a total tax liability. On the other hand, a SBC that elects to claim the Section 12E(1A) allowance, would pay a total tax liability of R20 470. Therefore, in the long run, the SBC that claims a Section 12E(1A) allowance, would pay more tax than one which claims the Section 11(e) allowance. It is clear that the Section 12E (1A) allowance is preferable in the short run, as less tax would be paid by the SBC in the first year. This is because the allowance significantly reduces the taxable income the first year. This can enable the SBC to

retain more cash flow to utilise in growing its business operations, especially when setting up or expanding the capital infrastructure.

4.2.3 Possible pitfalls, gaps, and concerns with tax incentives for Small Business Corporations

This sub-section identifies and discusses the possible pitfalls within the SBC tax incentive regime, which could point to the gaps left and areas of concern that may need to be addressed. The sub-section is in line with the first research question as well as the first and second aims of the study. The pertinent problems of the tax incentives for SBCs may be as a result of the manner in which the tax incentives were designed or implemented. After a close inspection and a detailed look into the tax incentives for SBCs, the study has identified numerous possible pitfalls with the SBC tax incentives and these are discussed below.

4.2.3.1 The South African Income Tax Act does not define several terms and phrases used in the Small Business Corporation tax incentives

The Act does not provide definite definitions of some terms and phrases which are very crucial to the implementation of the tax incentives. The following terms and phrases are not defined in the Income Tax Act of South Africa, yet they are inherent to the SBC tax incentives: plant and machinery, 'process of manufacture or similar processes, implements, utensils, and articles. SARS (2018d: 22 - 29) acknowledges the lack of definitions of the above terms and phrases in the Act and has provided guidelines on their respective meanings from either the ordinary English dictionaries or case law.

Without undermining case law, Slapper and Kelly (2009: 126) provided a long list of disadvantages of case law as a source of law and among them was 'uncertainty':

"This refers to the fact that the degree of certainty provided by the doctrine of stare decisis is undermined by the absolute number of

cases that have been reported and can be cited as authorities. This uncertainty is increased by the ability of the judiciary to select which authority to follow through use of the mechanism of distinguishing cases on their facts.”

Slapper and Kelly (2009: 126)

The above is an indication that it is possible for case law to create an element of uncertainty. This means that any of the undefined terms may be easily misunderstood and a taxpayer may wrongly claim and deduct an allowance for which it does not qualify. Also, a taxpayer may not claim at all for an allowance for which it would indeed qualify. Uncertainty also has the potential of creating a situation where an opportunistic taxpayer may choose to take advantage of even the slightest loophole in a tax system (Nathan-MSI Group 2004: 3 - 9).

4.2.3.2 The incentive is not beneficial to SBCs with no taxable income

Normal tax is paid on taxable income; therefore if there is no taxable income (especially in the start-up years of the company), there is no tax to be paid. In this case, the tax incentive of a reduced tax rate for SBCs makes no difference and neither does it accord any tax benefit to the SBC. Even if accelerated capital allowances are claimed and the SBC still has a loss, no benefit is received.

In 2014, 47 per cent of the total active population of SBCs had no taxable income (DTC 2014: 17). This means that 47 per cent of the total population of SBCs that were included in SARS records for 2014, did not benefit at all from the tax incentive. The government aims to provide support to small businesses through small business tax incentives. In as far as the government is concerned; a successful small business regime contributes immensely to the Gross Domestic Product as well as the creation of more employment opportunities.

The above statistic (in the previous paragraph) from the DTC means that nearly half of the total number of SBCs are not receiving this tax incentive support from the government and therefore, the objective of creating more jobs cannot be achieved.

Indeed the smaller SBCs that may have no taxable income need more support from the government to ensure that they expand, but it seems that they may not get any support from the current SBC incentive regime.

4.2.3.3 Complications surrounding the definition of a SBC and the requirements to be met

Section 12E defines a SBC and the requirements to be met (refer to paragraph 2.2.2). The complexity of the definition of SBCs is mainly centred around the holder of shares requirement in Section 12E(4)(a) as also pointed out by the DTC (2014: 19). Section 12E(4)(a) prohibits any part of the share capital or members' interest of a SBC from being held by a juristic person such as another company. It adds that contravention of the requirement would lead to disqualification of an entity from being a SBC for the year of assessment, even if it was for one day only that the requirement was not met. Indeed the holding, transfer, and ownership of shares involve a set of documentation or a certain set of records thereof. However, this is information that a taxpayer can decide to keep away from the tax authorities and choose not to declare it. The taxpayer's intention in such a case would be to avoid disqualification or seeking to comply at all costs.

As identified by the FIAS (2015: 40) on the lack of simplicity of the South African tax legislation, a complex tax system undermines the benefits of the incentive and increases compliance costs. The IFC (2009: 4) noted that a system of tax that is transparent with set rules saves investors' time negotiating with a government that approves them on a case by case basis. This kind of a system also reduces the opportunities for administrative corruption.

4.2.3.4 The high costs associated with compliance and administration of the incentive

High costs are incurred by both the SBC (to comply) and the tax authorities (for the successful administration of tax incentives related to SBCs). The SBC has to hire professional advisors to prepare the books of accounts and deal with any other

technical matters relating to compliance. Chamberlain and Smith (2006: 43) noted that 25 per cent of bookkeeping time is spent on compliance, whereas DTC (2014: 18) identified that the SBC tax incentive had cost SARS R1.3 billion per annum to administer. Further to this, a considerable amount of the benefits of the incentive may be legally claimed by taxpayers who were not the specific target of the incentive.

4.3 TAX INCENTIVES FOR MICRO-BUSINESSES

Micro-businesses are presented in the sixth schedule of the Income Tax Act. A micro-business is a natural person or a company whose qualifying turnover does not exceed R1 million for the year of assessment. Refer to paragraph 2.2.2 of this study for a more extensive definition of a micro-business. The tax incentives available to micro-businesses are discussed and possible loopholes within the incentive regime are identified below.

4.3.1 Turnover Tax

Turnover tax is the tax payable by a registered micro-business during a given year of assessment, and it is calculated on the taxable turnover of the business for that particular year of assessment (SARS 2017a: 2). Turnover tax can be seen as a simplified tax system aimed at making it easier for micro-businesses to meet their tax obligations. No deductions are considered therefore the business owner may not need to be knowledgeable about tax deductions (Maritz 2013: 32). The turnover tax system replaces income tax, VAT, provisional tax, CGT, and dividends tax for micro-businesses with a qualifying annual turnover of R1 million or less (SARS 2017a: 2 & 20). A micro-business may, however, be registered for VAT whilst registered under the tax regime for micro-businesses. Turnover tax is optional, meaning that a micro-business still has the option to use the general income tax system.

A registered micro-business is required to make only two interim payments and if necessary, one final payment on assessment. The first interim payment is 50 per cent of the tax calculated on the estimated taxable turnover for the year and it should

be paid within the first six months of the year of assessment. The second interim payment (payable on or before the last day of the year of assessment) is the total turnover tax payable on the estimated taxable turnover for the year, less the first interim payment previously paid by the micro-business (SARS 2017a: 27).

The turnover tax rates are progressive in nature, meaning that a lower taxable turnover of a micro-business will result in a lesser amount of turnover tax to be paid (PKF chartered accountants and business advisers 2018: 6). The intention of the progressive nature of turnover tax rates is to impose as little a tax burden as possible to micro-businesses with a lower taxable turnover. The tax rates for turnover tax are applied to taxable turnover and not taxable income as the case with normal tax. The tax rates are much lower in comparison with the 28 per cent flat rate for normal income tax for general companies. As indicated in table 4.5 below, taxable turnover of less than R335 001 is not taxed. From this amount onwards the rates are progressively phased in and applied accordingly to the taxable turnover.

Table 4.5: Turnover tax rates for financial years ending on any date between 1 March 2018 and 28 February 2019

Taxable Turnover (R)	Rate of tax (R)
R 0 - R 335 000	0% of taxable turnover
R 335 001 - R 500 000	1% of taxable turnover above R 335 000
R 500 001 - R 750 000	R1650 +2% of taxable turnover above R 500 000
R 750 001 - R 1 000 000	R6650 +3% of taxable turnover above R 750 000

Source: SARS 2018a: 13

As indicated in table 4.5 above, micro-businesses are not taxed on turnover from R0 to R 335 000. This tax threshold for micro-businesses was increased from R150 000 in the year of assessment ending 28 February 2015 to R335 000 (PKF chartered accountants and business advisers 2018: 6).

4.3.2 Tax benefits (advantages) embedded within the turnover tax system

The turnover tax system presents an added package (besides turnover tax) of tax benefits which could be seen as incentives in their own right, to micro-businesses. It could be possible to document the embedded benefits of the turnover tax system as part of the system itself and consider them altogether as one incentive (Maritz 2013: 32 – 33). However, the added tax advantages (although they come along with turnover tax) to the micro-businesses cannot be overlooked and, therefore, deserve to be mentioned in their own capacity as tax benefits of the turnover tax system (Maritz 2013: 32 – 33). The different added tax advantages that come along with the turnover tax system are discussed below.

a. One form of tax replacing many different types of taxes

The replacement of income tax, VAT, provisional tax, CGT, and dividends tax, means that a huge administrative burden is removed (Maritz 2013: 33). This has an element of reducing the tax compliance burden for small businesses as the current system is more simplified and deals with only one type of tax for the entire business. The exclusion of VAT removes a huge administrative burden from micro-businesses because the VAT system involves intensive record keeping (Rahim 2015: 24).

b. Reduced and simplified records to be kept by the micro-business

The simplification and reduction of records to be kept by micro-businesses is a huge incentive in its own right and it goes a long way into helping businesses to achieve compliance with minimal costs. Micro-businesses are required to keep fewer records compared to the normal tax system in which details relating to different tax types have to be kept. According to paragraph 14 of the sixth schedule of the Income Tax Act, a micro-business is required to keep only records of all amounts received, dividends declared, a list of each asset with a cost price of more than R10 000 at the end of the year of assessment as well as a list of liabilities exceeding R10 000. This could mean that micro-businesses do not need to outsource the tax/accounting function and therefore may save in terms of both funds and time (Maritz 2013: 33;

Rahim 2015: 17). No detailed bookkeeping is required in the case of a standard tax system.

c. Reduced number of returns submitted to SARS by the micro-business

The reduction in the number of returns to be submitted to SARS presents an added tax incentive to micro-businesses, embedded within the turnover tax system. Qualifying micro-businesses are required to submit only two interim payments and one final return for assessment (SARS 2017a: 27). The incentive becomes more vivid when a comparison is made with the standard tax system in which, according to Maritz (2013: 32), close corporations submit nine returns (six VAT returns, two provisional tax returns and one final income tax return) during the year. Therefore, the amount of time and funds saved in this regard by the micro-business could be vital in the further growth and expansion of the business.

d. Registered micro-businesses are specifically exempt from capital gains tax

The exemption from CGT is in relation with immovable assets mainly used for business purposes and movable assets exclusively used to carry on the business of the taxpayer (Du Toit 2012: 67). Proceeds derived from the disposal of an asset that has not been used mainly for business purposes must be excluded from the taxable turnover of a micro-business. Immovable assets are regarded to have been used mainly for business purposes if more than 50 per cent of their floor area is occupied or used for business operations. Proceeds from any other asset disposed of are taken into account if the asset is used for business purposes, for more than 50 per cent of the time. A CGT calculation is not prepared, but the micro-business is only required to add 50 per cent of all receipts of a capital nature to its taxable turnover (SARS 2017a: 19). Paragraph 57A of the eighth schedule also allows a micro-business to disregard any capital gain or capital loss from the disposal of any asset used mainly for business purposes.

- e. Tax incentive available on exiting VAT to register for Turnover tax (exit VAT relief)

Vendors who deregister from the VAT system are required to pay exit VAT on the lesser of the cost or market value of the assets held before deregistering. SARS (2011a: 4) states that vendors that apply to deregister from the VAT system in order to register for turnover tax shall be allowed to pay their respective exit VAT over a six month period. This reduces the burden of having to pay a once off amount which could be too much for the small business.

- f. Favourable/extended tax periods for the submission of VAT returns

From 1 March 2014, registered micro-businesses were allowed to submit VAT returns under Category D (SARS 2017b: 23). This means that micro-businesses are required to submit one VAT return for every six calendar months usually ending on the last days of February and August. Submitting on a six-monthly basis would save the micro-business some valuable time which could be allocated to growing the business. When compared to businesses that submit their VAT returns under category C (monthly basis) or categories A and B (two-monthly periods), it is recognisable that category D is more extended.

4.3.3 Possible pitfalls and gaps within the turnover tax regime for micro-businesses

This sub-section identifies the possible pitfalls of turnover tax as an incentive for micro-businesses. In line with the aims of the study (chapter 1; paragraph 1.1.2 bullets 1 & 2) as well as the questions (chapter 1; paragraph 1.1.3, question 1), this sub-section points to the areas of concern and possible gaps embedded within turnover tax as a tax incentive for micro-businesses.

4.3.3.1 There are very few micro-businesses registered for turnover tax

The tax system is having no effect on the growth of survivalist business (refer to 2.2.1) in South Africa (DTC 2014: 27). The Department of Trade and Industry reported in 2008 in the annual review of small businesses in South Africa, that there were 200 377 micro entities in 2007 (refer to table 1.1). Turnover tax was introduced by SARS during 2009. As at 4 July 2013, there were 7 827 active micro-businesses registered for turnover tax (DTC 2014: 26).

If the 200 377 micro-businesses reported by the DTI in 2007 (before turnover tax was introduced) are compared to the 7827 active micro-businesses registered with SARS by July 2013, then the impact of turnover tax seems to be minimal. Less than 4 per cent of the DTI reported figure of micro-entities in 2007 had been registered for turnover tax in 2013.

4.3.3.2 The Tax Administration Act overrules the sixth schedule of the Income Tax Act

Sections 22 and 25 of the Tax Administration Act (TAA) (Act No. 28 of 2011), read with the public notice issued under Section 66 of the Income Tax Act, require all businesses, irrespective of the size of turnover, to register with SARS within 21 days of commencing trade. According to the Sixth Schedule of the Act, turnover income of a micro-business below the tax threshold (R335 000) is not taxed. If a small business (still dealing with compliance aspects for registration as a micro-business) registers with SARS in line with the requirements of the TAA, this income would also be taxed at the normal rate of 28 per cent. There is a long list of stringent requirements to be met by businesses to qualify as micro businesses and thus it becomes practically very difficult for an entity to satisfy all of them and achieve compliance. For example, a natural person, partner in a partnership or a company does not qualify as a micro business if that person holds shares or interest in the equity of a company. Also, a business does not qualify as a micro business if its aggregate income from investment income and professional services exceeds 20 per cent of the total receipts of the business or if the proceeds from the disposal of assets exceed R1.5

million within a period of three years. The person must have a February year end, the members, partners or shareholders must be natural persons throughout the year of assessment and the entity must not be a public benefit organisation, a personal service provider or a labour broker (SARS 2017a: 8 – 14).

4.3.3.3 Turnover tax is not as simplified as the words may have it

SARS (2017a: i) describes turnover tax as a simplified system aimed at making it easier for micro-businesses to meet their tax obligations. There are some arguments to the contrary based on the limited number of micro-businesses registered with SARS as micro-businesses (refer to paragraph 4.3.3.1). Paragraph 14 of the Sixth Schedule documents the records that should be kept by a micro-business, which include records of all amounts received, records of dividends declared, a list of each asset with a cost price of more than R10 000 at the end of the year of assessment, as well as a list of liabilities exceeding R10 000. In addition, Section 24 of the Companies Act (No. 71 of 2008) also requires all companies (including small businesses) to keep a certain form of records which also include financial records for a period of seven years. It is a possibility that these requirements could increase the compliance costs of the micro-business. Details of who qualifies as a micro-business and who does not, the kinds of income that qualify and those that do not, and the determination of whether or not an asset was used 'mainly' for business purposes - all of these increase the complications in what should be a 'simplified' tax system.

4.3.3.4 Micro-businesses are not entirely set free from the elements of capital gains tax and dividends tax

It turns out that micro-businesses are still tied down by both the elements of capital gains tax and dividends tax, in one way or the other. With regard to capital gains tax, SARS (2017a: 19) indicates that, as a substitute to CGT, a qualifying micro-business is required to add 50 per cent of all receipts of a capital nature to its taxable turnover. This is perhaps similar to replacing a father with his son, the same genealogy, hence similarities in traits and characteristics. CGT does not exist in the turnover tax system, however, 50 per cent of all receipts of a capital nature (refer to par 4.3.2 d

for movable and immovable assets) are included in taxable turnover and still taxed anyway. Not exactly CGT but something similar. A business would also lose its status as a micro-business if its proceeds from the disposal of assets mainly used for business purposes exceed R1.5 million in the current and the two preceding years of assessment (SARS 2017a: 20).

With regard to dividends tax, aggregate cash dividends declared and paid by the micro-business are capped at a maximum of R200 000, meaning that any dividends over and above this amount attract dividends tax to be withheld by the micro-business. Otherwise, it remains the responsibility of the beneficial shareholder to submit a declaration to the micro-business claiming the exemption of those dividends under Section 64F of the Act (SARS 2017a: 20). Section 64F of the Act allows an exemption of a cash dividend from dividends tax in various instances. A micro-business is liable for dividends tax in its own capacity if it declares and pays a dividend in specie according to Section 64EA(b) unless the shareholders of those shares would have qualified for exemption under Section 64F(1)(h) if it were a cash dividend.

The above is a testimony to what seems to be a 'generic statement' that turnover tax replaced CGT and dividends tax, yet indeed clear elements of these types of tax still vividly exist within the tax system for micro-businesses.

4.4 TAX INCENTIVES APPLICABLE TO ALL SMALL BUSINESSES IN GENERAL

This Section presents tax incentives that do not specifically apply to only SBCs or micro-businesses but rather may apply generally to small businesses of different types and categories.

4.4.1 Exemption of capital gains from the disposal of active small business assets

According to paragraph 57 of the Eighth Schedule of the Act, a small business means a business of which the market value of all its assets, as at the date of the disposal of the asset or interest does not exceed R10 million. Paragraph 57 allows the owner of a small business to disregard certain capital gains when determining his/her aggregate capital gain or loss. An exemption exists on capital gains from the disposal of an active business asset, interest in the active business assets of a partnership, or the entire direct interest in a company. The natural person's withdrawal from the partnership must be to the extent of his or her interest while the disposal of direct interest in a company must consist of at least 10 per cent of the equity of that company. The interest being disposed of must relate to the active business assets of a qualifying small business.

The taxpayer must have held the asset, the interest in the partnership or in the company for a continuous period of five years prior to disposal. The natural person must have attained the age of 55 or the disposal must have been as a consequence of ill-health, other infirmity or death. The sum of the amount to be disregarded should not exceed R1.8 million during the lifetime of the natural person. According to Paragraph 57 of the Eighth Schedule of the Act, all the qualifying capital gains to be disregarded must be realised by the natural person within a period of 24 months commencing on the date of the first disposal.

Part IX of the Eighth Schedule also allows taxpayers to disregard any capital gains arising from the disposal of an asset provided the proceeds are to be used in acquiring a replacement asset. For the capital gains to be disregarded, the acquisition of the replacement asset must be concluded within 12 months of the disposal of the original asset. It should be noted that this tax incentive does not specifically apply to small businesses only but to all businesses irrespective of size, however, it was necessary to highlight its availability in this paragraph in the context of the study.

4.4.1.1 Areas of concern with the capital gains tax exemption for active small business assets

The requirements of paragraph 57 of the Eighth Schedule of the Act, subparagraphs (2) (c) (i) and (ii), as well as (3) of the Act, are limiting in nature. Subparagraph (2) (c)(i) requires that, for the aggregate capital gain to be disregarded, the natural person disposing of the active business asset of a small business must have attained the age of 55 years. The challenge with this is that few small business owners in South Africa are 55 years or more. A survey conducted by FinMark Trust (2010: 20) revealed that the age bracket 55 – 59 years had the lowest percentage of small business owners (6.7 per cent); likewise the bracket of 60 years and above also had one of the lowest percentages at 9.9 per cent. The majority of the small business owners were between the ages of 35 – 39 years (14.3 per cent) and 40 – 44 years (14.6 per cent). These figures mean that only 16.6 per cent (9.9 + 6.7) of small business owners would qualify for the capital gains exemption on small business assets.

The subparagraph further indicates that either the above age limit requirement of (2)(c) (i) has to be met or (2)(c)(ii) which requires that the disposal should have been in consequence of ill-health, other infirmities, superannuation, or death. The area of concern with subparagraph (2)(c)(ii) of paragraph 57 of the Eighth Schedule of the Act is that it does not seem to have an intention of providing an incentive to a going concern business. The circumstances being mentioned under which the disposal could have been made do not cater for a small business that is flourishing. The incentive is applicable in the case where a disposal is made as a consequence of ill-health, other infirmity, or death of a person who was involved substantially in the operations of the small business. An incentive should be meant to ensure that a small business prospers.

Paragraph 57, subparagraph (3) of the Eighth Schedule of the Act sets a lifetime limit of R1.8 million in terms of the aggregate amount to be disregarded by a natural person. Indeed so much could happen in a natural person's lifetime including the disposal of so many small business assets. With reference to this lifetime exemption

set at R1.8 million in paragraph 57 of the Eighth Schedule of the Act, the amount could be very limiting and insignificant because it might be used up with a single disposal of an active business asset.

4.4.2 Exemption from Skills Development Levies

An exemption for SDL exists for any employer for whom there are reasonable grounds for believing that the total amount of remuneration paid or payable to all employees during the following 12-month period will not exceed R500 000 (SARS 2014a: 9). These employers are also not required to register as employers for SDL purposes. It is evident that this tax incentive strictly accommodates the micro and very small businesses whose 12 month total payroll may not exceed R500 000. On average, for a business's payroll not to exceed this amount, the monthly total payroll salaries payable to all employees should be less or equal to R41 667 ($R500\ 000 \div 12$ months). It is only the micro or very small businesses that can operate with such meagre aggregated annual payrolls (SARS 2014a: 9).

The tax incentive, in this case, is that such businesses that fall within this bracket do not pay the SDL. This fact that they are not required to register as SDL employers, reduces the record keeping burden. If such businesses were to register for SDL, they would be required to keep a proper record of all submitted returns and ensure that the documents are kept safe for a period of five years (SARS 2014a: 17 - 18). However, this benefit could be very minimal because the business would still potentially have to account for PAYE, which is on the same SARS return and has a similar calculation method.

4.4.2.1 Possible gaps or concerns with the Skills Development Levy exemption

Employers that pay SDL may receive back some funds from their respective SETAs if they provide skills related training to their employees. In reality, skilled employees add value to an organisation and therefore being able to claim and receive back some funds paid through SDL, would be an encouragement to employers to train their employees. Small business employers that are exempt from the levy (SARS

2014a: 9; Section 10 of the ETI Act) may not prioritise training of employees because it might be an outright cost for which no claim may be refunded by anybody. In view of this opinion, it could be plausible to argue that a small business would be better off registering and paying SDL than being exempted.

4.4.3 Tax incentive associated with running a small business from home

Small businesses that operate from home can save on certain deductible expenditure as well as benefiting from the deductions of interest payments on the bond. For home office expenditure to be deducted it must not be of a capital nature (Section 11(a) of the Act) and it must be allowed under Section 23(m) of the Act. This means that, for home office expenditure to be deducted, it must meet the requirements of both Sections 11(a) and 23(m) of the Act. Section 23(m) of the Act prohibits the deduction of expenditure, losses, and allowances relating to employment or the holding of an office. The taxpayer who receives remuneration from employment or uses part of his/her home as an office can claim rental, repairs, and expenses incurred as well as wear and tear allowance. The expenditure must have been incurred in the process of the taxpayer conducting a business.

Section 23(b) of the Act, requires that the part of the home for which a claim is lodged must be occupied for trade purposes, be specifically equipped for that trade, and used regularly and exclusively for that trade. In case of employment or the holding of an office, more than 50 per cent of the total income must be from this trade and most of the taxpayer's duties must be performed in the same part of the home designated for business purposes. The fact that trading is being conducted at home, points to the small size of the business and therefore this tax incentive generally applies to small businesses, particularly those that are home-based.

4.4.3.1 Possible pitfalls and concerns associated with the allowances for running a small business from home

The Section 23(b) of the Act requirement which states that the part of the home for which a claim is being lodged must be specifically equipped for that trade is too strict and inflexible. Many small businesses being operated in homes would simply require free space or a free room without any particular equipment (depending on the nature of the business). Some small businesses may require specific equipment. However, affordability of those assets could be an issue and in some cases, this may not stop the business from operating. Given the fact that the trade is being carried on at home, equipping some part of the family residential home with different gadgets could be somehow problematic.

4.4.4 Employment Tax Incentive

The Employment Tax Incentive (ETI) is a cost-sharing mechanism between employers and government aimed at reducing the liability of employers for employees' tax, provided they meet the requirements of the ETI Act (SARS 2014b: 1). The ETI "reduces an employer's cost of hiring young people through a cost-sharing mechanism with the government while leaving the employee's wage unaffected". It is aimed at encouraging employers to hire young and less experienced job seekers between the ages of 18 – 29. This incentive only applies to qualifying employees employed on or after 1 October 2013 by eligible employers and it has to be claimed within the first two years of employment of an employee.

The salaries or wages and bonuses paid to an employee must not exceed the R6000 remuneration limit for the month in which a claim is made (SARS 2014b: 10). A monthly calculation has to be done by the employer to determine how much must be claimed for each qualifying employee. The calculation caters for the remuneration paid, the period for which the employee is employed in a particular month, and the percentage that may be claimed. Amounts rolled over from previous months may also be added by the employer. Table 4.6 below shows the calculation of ETI in relation to the monthly remuneration received by a qualifying employee.

Table 4.6: Calculation of ETI in relation to the monthly remuneration received by a qualifying employee

Monthly remuneration	ETI per month during the first 12 months of employment of the qualifying employee	ETI per month during the next 12 months of employment of the qualifying employee
R0 – R2 000	50% of monthly remuneration	25% of monthly remuneration
R2 001 – R4 000	R1 000	R500
R4 001 – R6 000	Formula: $R1\ 000 - [0,5 \times (\text{monthly remuneration} - R4\ 000)]$	Formula: $R500 - [0,25 \times (\text{monthly remuneration} - R4\ 000)]$

Source: SARS 2014b: 10

This incentive has been given consideration in this study (whose focus is on tax incentives for small businesses) because it is mainly small businesses that would have a number of employees earning below the remuneration limit of R6000 per month. SME South Africa (2016: par 9) identifies that small businesses that specialise in project work across the country often use a lot of temporary workers. This means that these small businesses can indeed make a saving through claiming back the ETI for the qualifying employees. This is possible because by the time the two years elapse, the temporary employees are already gone and the business replaces them at the onset of a new project.

4.4.4.1 Possible pitfalls of the Employment Tax Incentive

a. Having to comply with the issue of the minimum wage

The eligible employer for the ETI is required to comply with the basic wage requirements or risk being disqualified. The amounts regarded as basic wage requirements are in several cases too high for small businesses (Piek and Fintel 2018: 1). Small businesses, most especially those in the survivalist category, cannot afford to pay what could be termed as basic; they, therefore, pay way below the required amounts (DTC 2014: 41). The DTC (2014: 41) noted that many of the

estimated 500 000 employees within the informal sector are employed at below the minimum wage.

b. Complexity in the design

The DTC (2014: 41) identified that: “The general reaction to the ETI Act has been that it is too complicated to be of much use to the SME sector”. The DTC adds that ETI administration is very complex and that stringent controls would have to exist to prevent the abuse of any tax incentive schemes. In the true sense of a small business being ‘small, micro or less’, these businesses truly do not have the personnel to read, interpret, and internalise the specifications and requirements in the ETI Act or any other legislation for that matter. The main aspect of these businesses is to survive and for the business owner to put food on the table.

4.4.5 Concession on advance tax rulings

The advance tax ruling system promotes clarity, consistency, and certainty regarding the interpretation and application of a tax Act. An advance tax ruling may consist of a binding private ruling, binding class ruling, or a binding general ruling. Binding private rulings are written statements issued by SARS to provide feedback to a single taxpayer while binding class rulings are issued to provide feedback to a class of persons regarding a proposed transaction. The class of persons may include shareholders, trusts, or beneficiaries of companies. A binding general ruling may be issued by a commissioner while exercising his/her discretion in relation to general issues (Aucamp 2010: 26). A binding ruling provides clarity and certainty on how tax authorities would interpret and apply the tax laws to a proposed transaction (SARS 2013: 1).

The tax incentive embedded in advance tax rulings with regard to small businesses is within the application fee paid to file for a binding ruling. The application fee for all applications is R14000 except for small businesses. The application fee for small businesses is R2500 in respect of a binding private ruling and a binding class ruling (SARS 2013: 10). Small businesses, therefore, make a saving when applying for

binding rulings. The ease of access to the advance tax ruling system allows small businesses to seek clarity and certainty on the interpretation of tax law hence the possibility of achieving compliance.

4.4.5.1 Possible pitfalls and concerns regarding the relief on advance tax rulings

Not many small businesses would have the capacity to go as far as applying for an advance tax ruling. Having the potential to engage in such applications calls for a small business to have personnel who truly understand the tax system and what it entails to a greater degree. Some small businesses would be more concerned about whether they survive the next day (DTC 2014: 6) than to know when, how, and where to apply for an advance tax ruling. This simply means that all those businesses that would never make this application, would never even recognise the difference in application fees of R2500 and R14000. The difference in these application fees does not really seem to be able to make a significant contribution to the multitudes of small businesses out there.

4.4.6 Relief in relation to accounting for VAT on the payment basis

The South African VAT system is invoice-based, which means that vendors are generally required to account for VAT on the basis of invoices being issued or received. This method of accounting is referred to as the “invoice basis” or “accrual basis” (SARS 2017b: 26). Small businesses, however, can account for VAT on a payment basis if their supplies do not exceed R2.5 million per annum. This means that they account for VAT on actual payments made and actual payments received in respect of taxable supplies during the period (SARS 2017b: 27).

Under the payment basis, the date to account for VAT is delayed until payment has been made, whereas, under the invoice basis, vendors must generally account for the full amount of VAT included in the price of the goods or services supplied. According to the invoice basis, the vendor must account and pay for VAT whether the cash for the supplies is received/paid or not. SARS (2017b: 27) explains that vendors who account for VAT on a payment basis are only required to account for

and pay any output tax due to SARS to the extent that payment has been received from the recipient. Similarly, any VAT charged to a vendor on goods or services acquired for taxable purposes will only be deductible to the extent that payment has been made by the vendor in respect of the taxable supply.

The tax relief with regard to accounting for VAT on a payment basis is that those small businesses do not have to pay output tax for supplies made until cash for those supplies is actually received. Small businesses in the true nature of being small, very small, or micro size may not have the funds to pay to SARS until they receive payment for any supplies made.

4.4.6.1 Possible pitfalls and concerns regarding accounting for VAT on the payment basis

Many small businesses do not keep proper records of daily transactions whether they involve cash receipts and payments or debtors and creditors. For these businesses to succeed in keeping records, they would normally have to recruit a bookkeeper who could actually increase their operational costs and indeed their costs of compliance with the VAT system. The DTC (2014: 35) notes that the accrual basis increases the compliance burden for small businesses yet many tax payers in the SME sector do not maintain proper accounting records related to debtors and creditors. The DTC indicates that instead only cash transactions are recorded. This could be true in most cases; however, small businesses would still not find it easy to prepare a tax invoice for the cash sales made. In the end, it all points to recruiting a bookkeeper, which has to be paid, hence an added cost to the small business.

4.4.7 The venture capital incentive of Section 12J – indirect tax incentive to small businesses

VCCs are vehicles that attract potential investors and then gradually pull away and hand over control to the small business (Maritz 2013: 35). An approved VCC is a company that is designed to provide investors with access to a range of trading companies which have the potential for growth. To meet the challenge of access to

venture capital for SMEs, the government introduced a tax incentive in 2009 for individual and corporate investors as well as venture capital funds in qualifying small businesses (Parker 2014: par 2). An upfront income tax relief equal to a 100 per cent deduction of the amount invested is available immediately to an investor who subscribes for VCC shares. There is no annual limit on this deduction and it is available provided that the investor subscribes for equity shares as opposed to buying them from other investors (Section 12J(2)).

This is an indirect tax incentive to small businesses in South Africa. The tax incentive offered to VCCs is intended to have a positive impact on small businesses in terms of having access to funds being invested in them for growth and expansion. This incentive is meant to lead to an increase in the potential availability of investors in small businesses and therefore an increase in the number of small businesses could be expected (BER 2016: 16). In a 2016 study commissioned by the Small Enterprise Development Agency, the number of small businesses (both formal and informal) in South Africa grew by 3 per cent from 2008 to 2015. There were 2 182 823 small businesses in 2008 as compared to 2 251 821 in 2015 (BER 2016: 16). Considering the 7 year period between 2008 and 2015, the growth rate of small businesses is very low. There are a number of factors that could be responsible for the low growth in the number of small businesses. If questions were to be raised towards the contribution of the VCC tax regime to the above numbers, it could be important to note that the regime was only introduced in 2009. Since then, the regime has also undergone several amendments by SARS in the name of making it possibly more attractive to VCCs and investors to get on board. There are approximately 157 approved companies under the VCC tax regime that are actively raising and investing funds into small businesses (SARS 2019: par 3).

4.4.7.1 Possible pitfalls and gaps with the venture capital incentive

a. The requirements of Section 12J are complicated

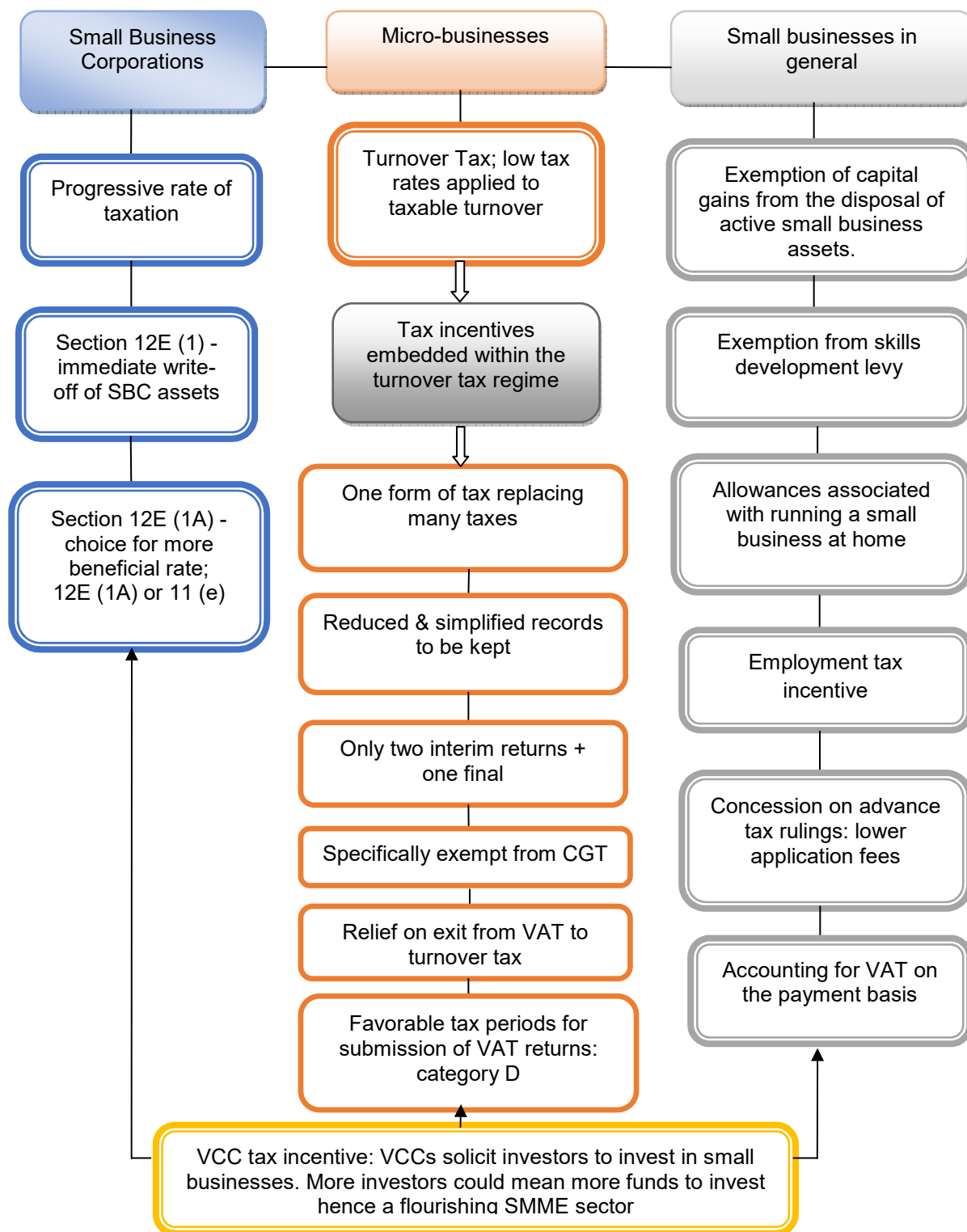
Since the introduction of the incentive in 2009, there were only three VCCs registered under Section 12J of the Act by 2014 (DTC 2014: 22) and approximately 157 towards the end of May 2019 (SARS 2019: par 3). These figures are indicative of the complex nature of the requirements of Section 12J. For example, the trades listed as impermissible trades are limiting for qualifying investees. The requirements of Section 12J(5) and 12J(6A) are not flexible. According to Section 12J(5), a company can only be approved as a VCC if it is a resident with a sole objective of managing investments in qualifying companies, if its tax affairs are in order and it must have been licensed under the Financial Advisory and Intermediary Services Act, 2002 (Act No. 37 of 2002). Section 12J(6A) specifies the conditions under which the approval status may be withdrawn from a VCC.

b. The problem of high costs involved and failure to meet expectations

The DTC (2014: 23) noted that the costs of a VCC investment ranging from due diligence to legal fees on sale and shareholder agreements are not less than R1 million. To compound this problem, VCCs invest in qualifying investees to earn dividends on the shares but the challenge is that most qualifying investees are too small to yield dividend returns that can match the expectations of the VCCs. Given the high costs incurred by VCCs as noted above, buying shares in these small companies may easily be considered worthless. Figure 4.5 below presents a summary of all tax incentives for small businesses in South Africa.

4.5 SUMMARY OF TAX INCENTIVES FOR SMALL BUSINESSES IN SOUTH AFRICA

Figure 4.1 Summary of tax incentives for small businesses in South Africa



Source: Author

4.6 CONCLUSION

The South African government has implemented several tax incentives for small businesses as discussed in this chapter. These tax incentives range from progressive tax rates to accelerated capital allowances for small business corporations, turnover tax for micro-businesses and others including those related to CGT, SDL, and VAT. There are specific requirements to be met by a small business in order to qualify for these tax incentives. The requirements are set by the Income Tax Act and other respective Acts and tax guides from SARS that govern the use of those particular tax incentives.

As a result of the lower progressive rates of taxation, the amount of tax paid by small business corporations that qualify under Section 12E of the Act depends on their respective taxable income (the higher the taxable income, the higher the tax to be paid) as the rates are progressive in nature. In addition, a small business corporation does not pay income tax on the first R78 150 of taxable income. Micro-businesses are taxed under the turnover tax system which is more simplified and it replaces income tax, VAT, provisional tax, CGT, and dividends tax. The turnover tax system has several benefits for micro-businesses, such as submitting only three tax returns in a year, not the nine or more which exist in the normal income tax system. Micro-businesses pay tax at a much lower tax rate and also keep a limited set of records – this allows these businesses to concentrate on profit generation.

Generally, small businesses whose annual payroll does not exceed R500 000 are exempt from paying the SDL. Small businesses, whose market value of assets does not exceed R10 million on the date of disposal of an asset, are allowed to disregard a capital gain or loss from the disposal of active business assets. The exemption is limited to R1.8 million in a lifetime. Small businesses also benefit from the deduction of home business expenditure, relief on advance tax rulings application fees, as well as accounting for VAT on a payment basis. The venture capital incentive regime provides an indirect incentive to small businesses because VCCs solicit investors to invest in small businesses.

South Africa's small business tax incentives have also been closely scrutinised and in this process, the respective possible pitfalls pointing to the gaps left and areas of concern within these tax incentives have been highlighted. This has the potential to provide policy-makers with a prospective starting point for review and amendment of the current tax incentives for small business. After having looked at South Africa's small business tax incentives, the next chapter in the study turns its attention to the tax dispensations offered to similar businesses in Australia, India, and the United Kingdom.

CHAPTER 5

SMALL BUSINESS TAX INCENTIVES OFFERED IN OTHER COUNTRIES

5.1 INTRODUCTION

This chapter presents the small business tax incentives offered by Australia, India, and the United Kingdom. The tax incentives that small businesses in these countries can utilise are identified and briefly discussed. Li (2015: 3) noted that governments continuously introduce new tax incentive policies and therefore a comprehensive list of tax incentives may not exist. Whilst this study attempts to cover every small business tax incentive (and its underlying benefits to the small businesses) available in Australia, India, and the United Kingdom, the list may not be exhaustive, although, it provides the essential background upon which comparisons can be based. The study presents the common small business tax incentives available in the above mentioned countries. These tax incentives were identified based on information from the official government and tax-related websites of the respective countries, and only the concessions that were deemed applicable to this study were included. The tax incentives discussed in this chapter may, therefore, in certain instances, also be applicable to other qualifying businesses. However, the study focuses more on the elements that are beneficial to small businesses within these tax relief measures.

A discussion of the possible pitfalls within these tax incentives from the other countries falls outside the scope of this study, and therefore it is not presented. The tax incentives identified in these countries were also limited to Income Tax, Value Added Tax, and Capital Gains Tax, as in the case with South Africa in chapter 4. In Australia, the Goods and Services Tax (GST) could be considered similar to VAT (Tax Foundation 2017: par 3), while in India, GST has recently replaced 20 consumption indirect taxes including VAT (Asquith 2017: par 1). Therefore, the GST tax incentives for small businesses in Australia and India were included as part of the study.

In the United Kingdom, all companies are liable to pay corporation tax on profits from doing business (Bromley 2019: 2), thus the small business tax reliefs associated with this type of levy were included as part of the study. Unlike in South Africa, in the United Kingdom, income tax is mainly personal tax whereas business tax is generally referred to as corporate tax. Because this study deals with businesses and not personal tax, income tax in the United Kingdom was not discussed but rather corporation tax.

5.2 AUSTRALIA'S SMALL BUSINESSES

This sub-section presents tax incentives for small business entities in Australia. Gilfillan (2015: 1) notes that the Australian Bureau of Statistics (ABS) defines a small business as one that employs fewer than 20 people. However, from a taxation perspective, the focus in the definition of a small business is on annual turnover rather than employment. Section 328-C of the Income Tax Assessment Act (Act No. 38 of 1997) of Australia indicates that a business is regarded as a small business entity if it carries on or previously carried on business and its aggregated turnover is likely to be less than or was less than \$2 million. The aggregated annual turnover threshold has since been increased from \$2 million to \$10 million in the 2016 -17 tax year.

In Australia, similar to South Africa, India, and the United Kingdom, Income Tax treatment depends on the residency status of an entity. Residents of Australia are

generally taxed on their worldwide income while non-residents are only taxed on Australian-sourced income (ATO 2017a: par1). The standard Australian income year is from 1 July of any given year to 30 June of the following year. Entities which may successfully demonstrate that their particular circumstances warrant a different income year period could be allowed to adopt a substituted accounting period with authority from the Australian Commissioner of Taxation (ATO 2018: par 1).

The following should be taken note of in the discussion below:

- 1) The dollars (\$) referred to in this Section are Australian dollars (A\$ or AUD).
- 2) At the time this study was conducted, the exchange rate between the Australian Dollar and the South African Rand, was: A\$1.00= R10.00
- 3) The Income Tax Assessment Act (ITAA) referred to in relation to Australia is the Income Tax Assessment Act 1997 (Act No. 38 of 1997), Compilation No. 158, compiled on 1 July 2016, registered on 8 July 2016, and includes amendments up to Act No. 54 of 2016.
- 4) ITAA 1997 (Act No. 38 of 1997) is a rewrite of ITAA 1936; however, ITAA 1936 has not yet been repealed (Treasury 2009: 4). Certain provisions of ITAA 1936 have been repealed but the Act is still recognised tax law in Australia because the rewriting process leading to the creation of ITAA 1997 is not yet fully finalised (BDO 2017: 5). Therefore, in cases where reference is made to ITAA 1936, the study shall clearly indicate such.

5.2.1 Tax incentives for small business entities in Australia

5.2.1.1 Immediate deduction of small business start-up expenditure

Section 328-10, sub-section 40-880 (2A) of the Income Tax Assessment Act (ITAA) of Australia allows immediate deductibility for certain small business start-up expenses, with effect from 1 July 2015. Examples of such expenditure include legal or accounting advice on best business structure and services in setting up legal arrangements. Immediate deduction is also allowed for professional advice on the

viability of a proposed business, costs associated with raising capital for the proposed operations, as well as payment of fees and taxes to an Australian government agency. A small business entity can deduct its start-up expenditure if it is incurred in relation to a business that was carried on, proposed to be carried on, or incurred to liquidate or deregister a company (Section 40.880 (2A) of the ITAA of Australia).

5.2.1.2 Capital Gains Tax: 15 year asset exemption

According to Section 152.110, subdivision 152-B of the ITAA, an entity that is a company or trust can disregard any capital gain arising from a CGT event if certain conditions are met. The gain must meet the basic conditions of subdivision 152-A which specify that a CGT event must have happened in relation to an asset of a small business entity in an income year. Subdivision 152-A also requires that the net asset value test of Section 152-15 (the sum of the asset does not exceed \$6,000,000 before the CGT event) must be met. The entity must have continuously owned the CGT asset for the 15-year period ending just before the CGT event. Section 152.110 adds that the entity must have had a significant individual (as defined in Section 152.55 of the ITAA) for a total of at least 15 years during which the entity owned the CGT asset.

5.2.1.3 50 per cent active asset reduction in terms of Capital Gains Tax

Section 152.205, subdivision 152-C of the ITAA allows small business entities to reduce the amount of a capital gain by 50 per cent. There are 5 steps to be followed in working out the net capital gain according to Section 102-5 (1) of the ITAA. Step four is of more relevance to this discussion because it relates directly to the small business tax incentive embedded within the Section. The amount to be reduced should be the remaining portion of the capital gain after deducting the unused capital losses of the current and previous year, as well as the discount percentage. However, this reduction can only be done if the basic conditions in subdivision 152-A (refer to 5.2.1.2 above for the basic conditions) are satisfied for the gain.

5.2.1.4 Exemption of capital gains due to business owner's retirement

Section 152.300, subdivision 152-D of the ITAA allows small business entities to disregard capital gains of a small business if the capital proceeds from the sale of an asset are used in connection with the business owner's retirement. For the capital gains to be disregarded under this Section, the basic conditions in Section 152-A (refer to 5.2.1.2) must be satisfied and the entity must satisfy the significant individual test (as laid down in Section 152.55 of the ITAA). As a matter of choice, a small business entity may disregard all or part of each capital gain which falls within the ambit of this subdivision. However, in the case of companies, care must be taken not to exceed the CGT retirement exemption limit of each individual for whom the choice is made. A lifetime limit of \$500,000 exists for all choices that can be made in respect of an individual under this subdivision.

5.2.1.5 Capital Gains Tax roll-over

According to Section 152.400, subdivision 152-E of the ITAA, a small business roll-over allows small business entities to defer the making of a capital gain from a CGT event happening in relation to one or more small business assets. For example, if a small business entity disposes of an active business asset and buys a replacement asset or improves an existing one, the business can choose to defer the capital gain until a later year. According to Section 152-410 of the ITAA, the replacement asset can be acquired one year before or up to two years after the last CGT event in the income year for which the business chooses the roll-over. The gain must satisfy the basic conditions for relief in subdivision 152-A of the ITAA. Section 152.400 of the ITAA clarifies that if a small business chooses the roll-over relief, it may opt to disregard all or part of each capital gain to which subdivision 152-E (CGT roll-over) applies.

5.2.1.6 Simplified depreciation rules

Section 328.170, subdivision 328-D of the ITAA allows small business entities to deduct amounts for most of their depreciating assets on a diminishing value basis

using a pool of assets that are treated as a single depreciating asset. According to Section 328.170 of the ITAA, this simplifies depreciation calculations because a group of assets allocated to one pool is treated as one single asset. The pool rate is 30 per cent and it is made up of the costs or proportion of costs of the depreciating assets that are allocated to it. Small business entities can also immediately write-off most depreciating assets costing less than \$20,000 (the instant asset write-off threshold).

5.2.1.7 Simplified trading stock rules

Small business entities may choose not to account for changes in the value of their trading stock for every year. According to Section 328.280 of the ITAA, this is allowed if the difference between the value of all the entity's trading stock on hand at the start of that year and the value that the entity has reasonably estimated as the trading stock on hand at the end of that year to be, is not more than \$5,000. This concession, therefore, allows small business entities to estimate the value of their trading stock at the end of the financial year to report in their tax return. Section 328.280 of the ITAA clarifies that small businesses only need to record how they estimated the value of their stock without having to notify the ATO that they chose to use an estimate. Entities that may opt not to use an estimate would need to do stock-taking and account for the changes in the value of the stock. In addition, Section 328.285 of the ITAA states that special valuation rules may be used (such as obsolete stock and natural increase of live stock) when making an estimate of the value of the stock on hand.

5.2.1.8 Small business income tax offset

Section 328.355, subdivision 328-F of the ITAA provides a tax offset to a small business that is not a corporate tax entity. Small businesses that qualify are entitled to a tax offset on the tax payable on the portion of their income that is from sole trading activities, partnerships, or a trust. Section 328.355 of the ITAA indicates that in the calculation of net assessable income of an individual's business activities, capital gains and any income from personal services (which are not business

related) should be excluded. This tax incentive is mainly for individual taxpayers with business income from an unincorporated business that has an aggregated annual turnover of less than \$5 million. The income tax offset would reduce the tax payable that relates to the individual's small business income by 8 per cent capped at an annual maximum of \$1,000. This income tax offset is non-refundable and therefore if an individual incurs a loss or has no taxable income, then no offset may be claimed.

5.2.1.9 Small business restructures roll-over relief

Section 328.420, subdivision 328-G of the ITAA allows owners of small business entities to restructure their businesses, including the way in which their business assets are held while disregarding tax gains and losses that may arise. Small businesses in Australia are able to change their legal structures without incurring any income tax liability when active assets are transferred from one entity to another. Small business restructures may occur because of a change in the structure of a partnership or relationship change and/or company incorporations. According to Section 328.420 of the ITAA, this roll-over applies to active CGT assets, trading stock, revenue, and depreciating assets used for business purposes. This Section stipulates a number of conditions under which a roll-over may be allowed on an asset that has been transferred and most significantly it includes the fact that the transaction must involve a genuine restructuring of an ongoing business.

5.2.1.10 Reduced income tax rate for small businesses

For income years commencing on or after 1 July 2015, the income tax rate for small business entities in Australia was reduced from 30 per cent to 28.5 per cent. In the years that follow from 2016, the tax rate for qualifying small businesses would continue reducing accordingly until it reaches 25.0 per cent in 2027 (ATO 2017b: par 1). The corporate income tax rate remains at 30 per cent for all other companies that are not small business entities. Table 5.1 below shows the different lower rates of taxation for small businesses in Australia between 2015 and 2027.

Table: 5.1: Lower taxation rates for Australia’s small business entities between 2015 - 2027

Year	Aggregated annual turnover threshold	Income tax rate for entities under the threshold	Income tax rate for other corporate entities
2015 - 16	\$2m	28.5%	30.0%
2016 - 17	\$10m	27.5%	30.0%
2017 - 18	\$25m	27.5%	30.0%
2018 - 19	\$50m	27.5%	30.0%
2019 –24	\$50m	27.5%	30.0%
2024 – 25	\$50m	27.0%	30.0%
2025 - 26	\$50m	26.0%	30.0%
2026 - 27	\$50m	25.0%	30.0%

Source: ATO 2017b: par 2

5.2.1.11 Tax incentive related to running a small business from home

In Australia, a taxpayer could deduct certain expenses if they are incurred in carrying out income-producing work which is done from home. Deductions are allowed for such expenditure if the taxpayer’s business is run from home and a room is set aside and prepared exclusively for business purposes (ATO 2016: par 1). Examples may include a small business whose main office is at home, a craftsman whose workshop is at home or a doctor with a surgery or consulting room at home (ATO 2016: par 1). Expenditure that could qualify to be deducted under these circumstances may include the following:

- The cost related to the business in terms of using utilities such as electricity and gas – the total usage should be apportioned between private and business use;
- A deduction is allowed for business phone costs which include telephone rental and calls (if the phone is exclusively used for business purposes) but excludes installation expenses, if the phone is used for a dual purpose, a claim is allowed for business calls only;
- Depreciation of office plant and equipment is deductible but if used for a dual purpose, it must be apportioned between private and business use;

- The business-related portion of occupancy expenditure (such as rent, mortgage interest, rates, and insurance) can be claimed - apportioned between private and business usage based on floor area occupied (ATO 2016: par 2).

5.2.1.12 Tax concession in relation to accounting for Goods and Services Tax on a cash basis

The GST in Australia would be the equivalent of VAT in South Africa. GST is levied at 10 per cent on most goods, services, and other items sold or consumed in Australia. Section 29-40 of the GST Act 1999 of Australia allows small business entities to choose to account for GST on a cash basis. The cash accounting turnover threshold is \$2 million or such a higher amount as the regulations may specify. The benefit of accounting for GST on a cash basis is that GST does not have to be paid to the tax authorities on amounts not yet received. For income tax purposes, the entity must be accounting for income using the receipts method or the entity must be an enterprise for which the commissioner determines in writing, whether it can make a choice to account for GST on a cash basis or not.

5.2.1.13 Venture Capital funds tax relief – indirect tax incentive for small businesses

In Australia, there are two Venture Capital Programs: the Venture Capital Limited Partnership (VCLP) program and the Early Stage Venture Capital Limited Partnership (ESVCLP) program. According to Section 118.400 of the ITAA, the two venture capital programs are designed to encourage investment by providing various tax incentives to eligible investors. These tax incentives attract venture capitalists to invest funds in venture capital companies, who in the end invest these funds in small businesses. Through this process, small business entities are able to access the much needed funds for growth and expansion. The venture capital tax relief therefore indirectly benefits small business entities a great deal.

According to Section 118.405 of the ITAA, VCLPs are exempted from income tax on profits from the disposal of eligible investments. Section 118.407 of the ITAA

indicates that the limited partners of an ESVCLP are exempt from income tax on disposals of venture capital investments and they also receive a non-refundable carry forward tax offset of up to 10 per cent of their eligible contributions. Also, the interests of general partners of an ESVCLP are held on a capital account rather than revenue account.

5.3 INDIA'S SMALL BUSINESSES

In accordance with the provisions of the Micro, Small, and Medium Enterprises Development (MSMED) Act, 2006 of India, Micro, Small, and Medium Enterprises (MSME) are classified in two groups, namely; manufacturing enterprises and service enterprises which can consist of individuals, partnerships, or trusts. India (2006: 5) defines manufacturing enterprises in terms of investment in plant and machinery while service enterprises are defined in terms of the size of their investment in equipment. The limits for investment in plant and machinery or equipment for manufacturing and service enterprises are shown in Table 5.2 below in accordance with the definitions of MSMEs in the MSMED Act 2006 of India.

Table 5.2: The limit of investment for India's MSMEs per category

Manufacturing Sector - Investment in plant & machinery	
Micro Enterprises	Does not exceed Rs. 25 lakh
Small Enterprises	More than Rs. 25 lakh up to Rs. 5 crore
Medium Enterprises	More than Rs. 5 crore but does not exceed Rs. 10 crore
Service Sector - Investment in equipment	
Micro Enterprises	Does not exceed Rs. 10 lakh
Small Enterprises	More than Rs. 10 lakh but does not exceed Rs. 2 crore
Medium Enterprises	More than Rs. 2 crore but does not exceed Rs. 5 crore

Source: India (MSMED Act): 2006: 7

The following should be noted:

- 1 Indian Rupee (INR) or Rupees (Rs) is the currency of India.
- 2 A lakh is a unit in the Indian numbering system equal to 100 000 (one hundred thousand).

- 3 A crore is a unit in the Indian numbering system equal to 10 million.
- 4 1 South African Rand = 4.85 Indian Rupees (at the time of conducting this study)
- 5 The Income Tax Act referred to in Section 5.3 and its corresponding sub-sections is the Income Tax Act (ITA) 1961 of India, Act No. 43 of 1961 as amended by the Finance Act, 2017. Therefore, all the income tax Sections quoted hereunder in 5.3 relate to this Act.
- 6 The financial year in India starts on 1 April of a given year and ends on 31 March of the following year.

5.3.1 Tax incentives available to India's MSMEs

This section presents the small business income tax incentives provided by the Department of Revenue (DOR) of India to the MSMEs of India.

5.3.1.1 Presumptive Taxation Scheme

According to the Income Tax Act No. 43 of 1961 of India (ITA-India), a person engaged in a business or profession is required to maintain regular books of accounts and has to get his/her accounts audited. The ITA-India, however, provides a presumptive taxation scheme under Sections 44AD, 44ADA, and 44AE of the ITA-India which provides relief for small business taxpayers in this regard. Under the presumptive taxation scheme, income can be declared at a prescribed rate of 8 per cent of gross receipts of the eligible business. The taxpayer does not have to maintain books of accounts or have them audited, unless if involved in the rendering of professional services (as listed in Section 44AA of the ITA-India: legal, medical, engineering, architectural, accountancy, etc.). This, therefore, means that for a person adopting Section 44AD of the ITA-India, taxable income is not computed in a normal manner (namely receipts less business expenses = taxable income). The presumptive income computed at 8 per cent is considered the final taxable income and no further expenses are taken into account. As a measure of promoting digital payments and creation of a less-cash economy, the rate reduces to 6 per cent in respect of the amount of total turnover received through digital means or a banking

system. The receipts of an eligible business must not exceed Rs. 2 crore. The scheme is designed to give relief to resident small business taxpayers including individuals, partnerships, and Hindu Undivided Families engaged in any business except those involved in plying, hiring, or leasing goods carriages.

5.3.1.2 Depreciation allowance

Section 32(1)(i) of the ITA-India allows small businesses to deduct depreciation at 10 per cent on furniture and buildings as well as 15 per cent on plant and machinery used for business purposes. The Section allows a 25 per cent depreciation allowance on intangible assets such as trademarks, copyrights, know-how, licenses, patents, franchises, and any other business rights. The depreciation may be calculated by either using the straight line or written down value basis. In case the asset was used for less than 180 days of the year, the depreciation allowance is restricted to 50 per cent of the calculated amount. Section 32(1)(iia) of the ITA-India allows a deduction of additional depreciation at 20 per cent of the actual cost of new plant and machinery (excluding aircrafts, ships, and office appliances) used in manufacturing. A proviso to Section 32(1)(iia) of the ITA-India also provides for an allowance of additional depreciation at 35 per cent of new plant and machinery acquired by taxpayers involved in a manufacturing business in the backward areas in the states of Pradesh, Bihar, Andhra, Telangana, or West Bengal.

5.3.1.3 Investment allowance

Section 32A(2)(b)(ii) of the ITA-India provides for an investment allowance deducted at 25 per cent of the actual cost any new plant or machinery acquired and installed by a small business after 31 March 1976. The allowance is available to small businesses involved in a business of manufacturing or production of any article or thing such as beer and alcoholic spirits, tobacco products, cosmetics, toilet paper, toothpaste, confectionery and chocolates, and other items as listed in the Eleventh Schedule of the ITA-India. Section 32AD of the ITA-India provides for a deduction of 15 per cent of actual cost incurred in new plant and machinery intended for setting up a factory in the backward states of Pradesh, Bihar, Andhra, Telangana, and West

Bengal. The new plant and machinery referred to in Section 32AD of the ITA-India exclude ships, aircraft, vehicle, office appliances, and any second-hand plant or machinery. This allowance is available for new assets that were acquired and installed on or after 1 April 2015 but before 1 April 2020.

5.3.1.4 Concession regarding the maintenance of books of accounts and their audit

According to Section 44AA of the ITA-India, persons carrying on legal, medical, engineering, architectural, accountancy, technical accountancy, and interior decoration are mandatorily required to maintain books of accounts for income tax purposes. The persons who are carrying on businesses in other professions which are not included in those mentioned are mandatorily required to maintain books of accounts only if:

- The income from the business or profession exceeds Rs. 2,50,000 or the total turnover exceeds Rs. 25,00,000 in any of the previous three years; or
- The business or profession is newly set up and the income or turnover is likely to exceed the above limits.

The above explanations mean that, other than in those particular circumstances identified, small businesses that are not addressed are not mandated to maintain books of accounts and therefore are exempted from the tedious work that comes with record keeping.

In terms of Section 44AB of the ITA-India, a mandatory audit of books of accounts should be done if the person is carrying on a business and his/her total turnover exceeds 1 Crore or if the gross receipts exceed Rs. 50 Lakh in case of a profession. An audit is also mandatory for a business or a profession which is covered by the presumptive tax scheme of Sections 44AD and 44AE of the ITA-India. This happens when it is claimed that the income from the business is lower than the deemed profits and gains from those respective Sections. Other than in those circumstances, small businesses are not mandated to conduct an audit of their books of accounts.

This is a saving in terms of the finances that would be utilised to pay for the services of a chartered accountant who would have been required to conduct the audit.

5.3.1.5 Deduction of amounts received by an individual member from a Hindu Undivided Family or a partnership

Section 10(2) of the ITA-India allows the deduction of any amounts received by an individual as a member of a Hindu Undivided Family if the amount paid was taken from either the family's income or the estate belonging to the family in case of an impartible estate. Section 28(ii) of the Income Tax Act 2011 of India indicates that an impartible estate refers to property which is indivisible and held by the eldest family member to the exclusion of other family members. In the case of a partnership, Section 10(2A) of the ITA-India exempts the entire amount of the share of profit received by a partner. This means that in the determination of the total income of the partnership, the share of profit apportioned to the partners is deducted from the gross income of the firm. This deduction would reduce the gross income of the partnership business (in other words, also those that are classified as a small business) and ultimately lower the taxable income on which the 30 per cent tax is to be paid. It should be noted that although partnership firms do not have separate legal capacity from the partners, they are treated differently from the partners in terms of tax in India. Partnerships are required to register with the income tax department and pay tax at a rate of 30 per cent. Therefore, this tax incentive of Section 10(2A) of the ITA-India benefits the partnership firm through the deduction of any share of profits apportioned to the partners thus reducing the taxable income of the firm. Interest and remuneration paid to the partners is also an allowable deduction limited by the conditions in Section 40(b) of the ITA-India. However, it should be noted that the above allowances apply to the partnership business but not to the individual partners. The partners have to pay tax on their own income.

5.3.1.6 Allowance due to the employment of new employees

A deduction is allowed to Indian small businesses whose gross income includes any profits derived from the manufacturing of goods. According to Section 80JJAA of the

ITA-India, the deduction is equal to 30 per cent of additional wages paid to new regular workmen employed in the taxpayer's factory in the previous year. The deduction is allowed for three years of assessment, however, no deduction is allowed if the factory is acquired by the business as a result of amalgamation with another company.

5.3.1.7 Deduction in terms of eligible start-up businesses

New small businesses can benefit from Section 80-IAC of the ITA-India which allows all qualifying start-up businesses to deduct 100 per cent of the profits derived from innovation, development, deployment, or commercialisation of new products. The deduction is also allowed to newly-established small businesses involved in technology-driven services or intellectual property rights. The deduction is allowed for three consecutive years out of seven starting from the year in which the business was incorporated. The start-up chooses three consecutive profitable years within the first seven years of incorporation. According to Section 80-IAC of the ITA-India, an eligible start-up means a company or a limited liability partnership incorporated on or after 1 April 2016 but before 31 March 2021. The total turnover of the entity should not exceed Rs. 25 crore and the business should possess a certificate from the Inter-Ministerial Board of Certification.

5.3.1.8 Concessional income tax rate for domestic companies

Section 115BA of the ITA-India was inserted into the ITA-India with effect from 1 April 2017 and it provides for a low tax rate of 25 per cent for certain domestic companies starting from the assessment year 2017 – 2018. According to Section 115BA of the ITA-India, Indian small businesses that meet the requirements have an option to pay income tax at a lower rate of 25 per cent instead of the usual 30 per cent for corporates. This, however, only applies to Indian domestic companies that were registered on or after 1 March 2016 and are not involved in any business other than manufacturing or production. The annual turnover of the company should not exceed Rs. 50 crore.

5.3.1.9 Capital gains tax exemption for small businesses

Section 54GB of the ITA-India exempts long term capital gains arising from the transfer of residential property if the gains are re-invested in the subscription of shares of a small or medium enterprise. The re-investment of the capital gains from the sale of a residential unit could also be in a technology-driven start-up such as investing in computers or computer software. This exemption is granted to individuals or Hindu Undivided Families on property transferred on or before 31 March 2019. This tax incentive is beneficial to small businesses because it promotes re-investment of proceeds into new assets that would ultimately enable the business to increase its capital employed, thus ensuring sustained growth and expansion of business operations.

5.3.1.10 The Goods and Service Tax composition scheme

The Goods and Service Tax regime in India came into effect on 1 July 2017 and replaced over 20 overlapping indirect taxes including VAT and service tax (Asquith 2017: par 1). The government of India introduced the composition scheme under the Goods and Service Tax to simplify the compliance problems particularly for the small businesses (Jain 2017: par 1). Section 10 of the Central Goods and Service Tax Act, No.12 of 2017, indicates that an eligible supplier can opt to pay composition levy which has much lower rates as compared to the standard four-tier Goods and Service Tax rates which are 5, 12, 18, and 28 per cent. The GST scheme is available to small suppliers of goods with aggregate turnover not exceeding Rs.75 lakh (Rs.50 lakh in special category states) in the preceding financial year. Eligible small businesses supplying food or beverages can opt to pay the composition levy at 2.5 per cent of turnover while qualifying manufacturers pay their levy at a rate of 1 per cent and other suppliers pay 0.5 per cent (Jain 2017: par 1).

The scheme is also beneficial to the qualifying small businesses because they are not required to maintain detailed books of accounts, are exempted from filing the three monthly returns and there is no need to issue tax invoices. However, it is

important to note that businesses opting for the GST composition scheme are not allowed to collect tax from customers and are not eligible to take an input tax credit on purchases (Jain 2017: par 4).

5.3.1.11 Venture capital funds tax relief – indirect tax incentive for small businesses

The Central Board of Direct Taxes of India ruled at the start of 2017 that profits made by investors in certain venture capital funds from the sale of stakes in qualifying start-ups would be treated as capital gains rather than revenue gains for income tax purposes (BusinessLine 2017: par 3). The underlying tax incentive, in this case, lies on the side of the investor, in that the gains would not be considered for income tax purposes which will attract investors to commit their funds in qualifying start-ups. This will ultimately provide the much needed investment resources for these small businesses. The gains must have been made as a result of an Alternate Investment Fund registered as category I or II on the Securities and Exchange Board of India. The gains would still be treated as capital in nature even if the sale were to result in the transfer of control and management of the underlying business (BusinessLine 2017: par 3).

5.4 THE UNITED KINGDOM'S SMALL BUSINESSES

The United Kingdom consists of Great Britain (England, Wales, and Scotland) and Northern Ireland (Deloitte 2015: 1). The currency in the United Kingdom is the pound sterling (GBP) also symbolised as £. By the time this research study was conducted, 1GBP was equivalent to R17.58. In terms of taxation, the tax year for businesses is different from that of individuals. Companies can either follow the financial year (a 12 month period which runs from 1 April of every year and ends on 31 March of the following year) or the calendar year. The tax year for individuals runs from 6 April of every year to 5 April of the following year. United Kingdom companies pay corporation tax (current rate is 19 per cent and the main rate is 30 per cent – for companies with profits over £300,000) which is regulated by the Corporation Tax Act of 2010 and other Acts. Sole-traders, partnerships, and individuals pay income tax

(as determined in the tax tables with different tax brackets) regulated by the Income Tax Act 2007. All taxes are paid to Her Majesty's Revenue and Customs (HMRC) apart from business rates from businesses and council tax from households which are paid to local councils.

The United Kingdom, like South Africa, has different definitions applicable to Small and Medium-sized Enterprises. Crawford and Freedman (2008: 2) explain that the term small business in the United Kingdom is relative and it may depend on the purpose of the definition. For the purpose of collecting statistics, the Department for Business defines small businesses as companies with less than 250 employees (Rhodes 2017: 5). For accounting purposes, the Companies House defines a small business as an entity employing less than 50 people and with a turnover of under £6.5 million, and a medium business as an entity with less than 250 employees and an annual turnover of less than £25.9 million (The Company Warehouse 2012: par 3). For the purpose of R&D tax relief, HMRC defines an SME as a business with not more than 500 employees and an annual turnover not exceeding €100 million or a balance sheet total of less than €86 million (HMRC 2018: par 2). The HMRC definition is of more relevance to this study because of its link to tax-related matters.

5.4.1 Tax incentives for small businesses in the United Kingdom

This Section presents the small business tax incentives provided by Her Majesty's Revenue and Customs to small businesses in the United Kingdom.

5.4.1.1 Business rates relief

As indicated in paragraph 5.4 above, businesses in the United Kingdom pay business rates (taxes paid on non-residential properties) to local councils. Based on eligibility, some properties may get different kinds of discounts on these rates. These discounts are referred to as 'business rates relief' (GOV.UK 2017a: par 1). The underlying tax incentive may be claimed in different circumstances as follows:

a. Small business rate relief

Small business rate relief is available if the property's rateable value is less than £15,000 and the business uses only one property. The rateable value is the open market rental value on 1 April 2015 based on the estimates by the Valuation Office Agency (GOV.UK 2017a: par 1). No business rates are paid if the property's rateable value is £12,000 or less, while from £12,001 to £15,000, the rate of relief gradually goes up from 0 to 100 per cent. On acquisition of a second property, the existing relief on the first property continues for the next 12 months with a possibility of the relief continuing even afterwards if none of the other properties exceeds £2,899 in value and the total value of all the properties is less than £20,000 (£28,000 in London).

b. Rural rate relief

Rural rate relief is available to businesses operating in rural areas with a population of less than 3 000 people (GOV.UK 2017a: par 1). This might be useful to small businesses. No business rates are paid if the business is located in an eligible area and it meets the following conditions:

- For a village shop (general store) or post office, the rateable value of the property must not exceed £8,500 and such shop or post office must be the only one in the rural settlement.
- For a public house or a petrol station, the rateable value of the property must not exceed £12,500 and such property must be the only public house or petrol filling station in the rural settlement.

c. Hardship relief

Local councils provide hardship relief as a means of reducing business rates for businesses that satisfy the council that it would be in difficulty without this relief and that the hardship relief given to the entity would be in the interest of the local people

(GOV.UK 2017a: par 1). This form of relief is intended to help a business to recover from a temporary crisis (financial or otherwise) of an exceptional nature and a recovery plan would be required by the council before considering a business's application. Relief may be given for a full year, or part thereof, depending on the nature and likely duration of the hardship (Winchester City Council 2017: 5).

5.4.1.2 Employment allowance

The employment allowance is available to eligible employers who are paying class 1 National insurance. The insurance amount is deducted by the employer and paid to the authorities (GOV.UK 2017b: par 2). The employer also makes a contribution towards each employee's National insurance (13.8 per cent for the current tax year) and it is on this amount that the employment allowance can be claimed. The allowance for the employer can be up to an aggregate amount of £3,000 a year and it reduces the employer's National insurance bill each time the payroll is run until the total amount (£3,000) is exhausted or the tax year comes to an end. The employment allowance can be claimed at any time during the tax year. An employer may also claim the allowance if he/she employs a care or support worker, however, employers with more than one PAYE reference number can only make a claim against one (GOV.UK 2017b: par 2).

5.4.1.3 Capital allowances

In the United Kingdom, the Capital Allowances Act of 2001 provides for allowances in respect of capital expenditure incurred by the taxpayer. Capital allowances can be claimed when a taxpayer acquires plant or machinery to be used for business purposes (GOV.UK 2017c: par 1). Besides claiming capital allowances on plant and machinery, taxpayers in the United Kingdom can also make a claim as a result of renovating business premises, extracting minerals, performing research and development, acquiring intellectual property and patents, as well as dredging. Capital allowances in the United Kingdom are not limited to small businesses only; they apply to all the different sizes of businesses ranging from small to large.

a. Annual Investment Allowance

The full value of an item that qualifies for an Annual Investment Allowance (AIA) may be deducted from the taxpayer's profits before tax (GOV.UK 2017c: par 1). The AIA is £200,000 for a 12-months period from 1 January 2016 and can be claimed on most plant and machinery. Plant and machinery include items used in the business (including motor vehicles), costs of demolishing plant and machinery, integral features of building, alterations to a building to install other plant and machinery, as well as some fixtures such as kitchen and bathroom units. The following items are excluded from plant and machinery: leased items, land and structures such as bridges and roads, items used only for business entertainment as well as buildings including doors, gates, shutters, mains water, and gas systems. Similarly, AIA claims cannot be made on any items owned for another reason before being used in the business (GOV. UK 2017c: par 2).

b. Writing down allowances

Writing down allowances may be used to claim capital allowances on items if their value were in excess of the AIA claimed by the taxpayer already or if the items do not qualify for the AIA (such as items used for another purpose before bringing them into use in the business). Writing down allowances relates to the deduction of a percentage of the value of an item from the profits on an annual basis. The percentage deducted depends on the type of item, for example, the rate of deduction on business motor vehicles is determined based on their carbon dioxide emissions. Taxpayers are required to group items into pools depending on the rates that they would qualify for (GOV.UK 2017c: par 3.1).

There are three types of pools into which items could be grouped and these include; the main pool, the special rate pool, and the single asset pools. The main pool with a rate of 18 per cent includes all plant and machinery (not qualifying for AIA – unless categorised in such a way that puts them in either the special rate pool or the single asset pools) (GOV.UK 2017c: par 3.2). The special rate pool with a lower claim rate of 8 per cent includes all long life items (items with a useful life of at least 25 years),

integral features of buildings (such as lifts, escalators, water heating systems, electrical systems, air conditioning systems, etc.), thermal insulation of buildings as well as motor vehicles with carbon dioxide emissions of more than 130g/km. Otherwise, items could be brought into single asset pools with a claim rate of 18 per cent or 8 per cent (depending on the item). The pool ends when the asset is sold, otherwise, the balance is moved into the main pool if the asset is still being used after eight years (GOV.UK 2017c: par 3.2).

c. First-year allowances

A taxpayer that buys an asset which qualifies for first-year allowances may deduct the full cost of the qualifying asset (specific energy and water efficient equipment listed below) from profits before tax (GOV.UK 2017c: par 4). Deducting the full cost means that 100 per cent of the expenditure incurred in acquiring the qualifying asset (see examples below) is deducted from trading profits for that particular period. Hence, the underlying tax incentive is that the business would have been permitted to treat the capital expenditure as if it were revenue expenditure. The 100 per cent deduction of first-year allowances is only available if the assets listed below are acquired new and unused. Taxpayers can claim first-year allowances on energy and water efficient equipment such as motor vehicles with low carbon dioxide emissions and energy saving equipment (listed on the energy technology product list) (GOV.UK 2017c: par 4). Such allowances could also be claimed on water saving equipment (listed on the water efficient technologies product list), plant and machinery for gas refuelling stations, new zero-emissions goods vehicles, as well as gas, biogas, and hydrogen refuelling equipment. First-year allowances may be claimed in addition to the Annual Investment Allowance (GOV.UK 2017c: par 4).

5.4.1.4 Capital Gains Tax relief

Tax relief on CGT in the United Kingdom is available under the following categories:

a. Entrepreneurs' relief

Entrepreneurs' relief is available to sole traders or business partners, who dispose of all or part of their business. The relief allows qualifying taxpayers to pay only 10 per cent on qualifying profits from the disposal of a business instead of 20 or 28 per cent that would be paid by other taxpayers (GOV.UK 2017d: par 1). It also applies in the case of the disposal of shares or securities in a personal company where the taxpayer held at least 5 per cent shares and voting rights (GOV.UK 2017d: par 7).

b. Business asset rollover relief

The business asset rollover relief allows taxpayers to delay paying capital gains tax after the disposal of some types of business assets if all or part of the proceeds is used to replace the disposed of assets. As a result of this relief, the taxpayer pays no CGT on the gains from the original asset until the new asset is sold (GOV.UK 2017d: par 1; Section 754 – 763 of CTA 2009). This relief could also be claimed if the taxpayer uses the proceeds to improve on already existing assets. To qualify for business asset rollover relief, the new assets must be bought within three years of selling the old ones and the business must be trading during the time of the disposing and buying of assets (GOV.UK 2017d: par 2; Section 754 – 763 of CTA 2009).

c. Incorporation relief

Incorporation relief allows taxpayers to delay paying CGT when they transfer their business to a company in return for shares in the corporation. No CGT is paid until the shares are sold (GOV.UK 2017d: par 1). To qualify for incorporation relief, the taxpayer must be a sole trader or in a business partnership and the transfer should include the business and all its assets (except cash) in return for shares in the company.

d. Gift hold-over relief

A taxpayer may be able to claim gift hold-over relief if he/she gives away business assets (including certain shares) or sells them for less than their value (GOV.UK 2017d: par 1). The person giving away the assets does not pay CGT but the receiver of the assets pays CGT (if any is due) whenever he/she decides to sell or dispose of those assets. Otherwise, no CGT is paid in case the assets are given away as gifts to a husband, wife, civil partner, or a charity. To be eligible for this relief, in case of business assets, the taxpayer must be a sole trader, business partner, or a person with at least 5 per cent shares and voting rights in a personal company. If the give-away involves shares, they must be held in either a company that is not listed on any recognised stock exchange or in a personal company (GOV. UK 2017d: par 2).

e. Disincorporation relief

As a result of this relief, companies are allowed to transfer certain types of assets to their shareholders who may continue to operate the business in an unincorporated form without the company having to pay corporation tax on the disposal of the assets (HMRC 2013: par 1). The qualifying assets are transferred below their market value (other than transferring assets at a market value which would attract tax) and as such, no corporation tax liability arises to the company. The shareholders, in this case, continue to accept the reduced transfer value for all future capital gains computations. The business must be transferred as a going concern (to individual shareholders) with all its assets except cash, and the total market value of the assets must not be more than £100,000 (HMRC 2013: par 3).

5.4.1.5 Research and Development tax relief

A tax relief of 230 per cent is available to small businesses for R&D. The qualifying small business must be a going concern and should not be under administration or liquidation (HMRC 2015: par 1). If a small business makes a loss in its business operations, it may choose to carry forward the loss or to receive R&D tax credits (worth up to 14.5 per cent of the surrenderable loss) instead of carrying the loss

forward. Small businesses are also entitled to additional R&D corporation tax relief if they meet the R&D threshold of £10,000 in the period (Section 1064 of CTA 2009), and they have qualifying expenditure (Section 1065 of CTA 2009). The additional relief according to Section 1063 of CTA 2009 is 30 per cent of qualifying expenditure. Costs that qualify for R&D tax relief may include: employee costs (employees directly involved in carrying out R&D), staff providers, materials, utilities, payments to clinical trial volunteers, software, and subcontracted R&D expenditure.

5.4.1.6 Lower rate of tax for small profits of ring-fenced companies

In the United Kingdom, different rates of corporation tax exist for companies that profit from oil extraction or oil rights, otherwise known as ring-fenced companies (GOV. UK 2018a: par 1& 2). For such companies, there are two rates (the small profits rate and the main rate) at which tax could be paid depending on the amount of profits made in a given accounting year. For the accounting year 2018 – 2019, the small profits rate is 19 per cent and this is for all ring-fenced companies whose profits do not exceed £300, 000. The main rate of 30 per cent applies to all ring-fenced companies whose profits exceed £300,000 (GOV. UK 2018a: par 2). It is possible for large ring-fenced corporates to make low/small profits depending on their nature of operations, expenditure incurred in a given accounting year and time spent in the business.

5.4.1.7 Tax incentive related to running a small business from home

The business proportion of the cost of council tax, lighting, heating, broadband, and phone calls can be claimed by a taxpayer who runs a small business from home. Business expenditure incurred while running a small business from home can be calculated using simplified expenses (through the use of flat rates instead of working out the actual business costs) (GOV.UK. 2018b: par 4). Simplified expenses can be used by sole traders and business partnerships (excluding partnerships that have companies as partners). Tax payers, who work from home for 25 hours or more in a month, can apply the pre-determined flat rate to determine their business expenditure. In the 2018 financial year, the monthly flat rate for 25 – 50 hours of

work from home in a month is £10, for 51 – 100 hours, is £18, and £26 for 101 and more hours (GOV.UK. 2018b: par 4).

5.4.1.8 VAT optimised flat rate scheme

The flat rate scheme simplifies sales and purchases records and allows small business taxpayers to apply a lower fixed flat rate percentage (lower than the standard 20 per cent VAT rate) to gross turnover in calculating the amount of VAT payable to authorities (HMRC 2017: par 2). This means that the scheme allows small businesses to pay a percentage of turnover rather than working out the VAT on all individual purchases. The lower flat rate scheme can be applied by eligible small businesses that are not associated with any other business and their taxable turnover in the following year is not expected to exceed £150,000. Limited cost businesses (businesses whose goods cost less than 2 per cent of turnover or £1,000 a year) pay VAT at a flat rate of 16.5 per cent (HMRC 2017: par 4.4).

Entities that do not fall in the category of limited cost businesses use their business type or industry sector to identify the rate at which they should pay VAT. The rates are pre-determined by HMRC according to business types and for the 2018 tax year, the lowest flat rate is 4 per cent which applies to retailing food, confectionery, tobacco, newspapers, or children's clothing businesses. The highest flat rate is 14.5 per cent for accountancy, civil, legal and construction services (HMRC 2017: par 4.3).

5.4.1.8.1 Advantages/benefits embedded within the VAT optimised flat rate scheme

The VAT optimised flat rate scheme has several advantages embedded within the system itself and on their own, and they could be seen to present tax incentives to small businesses as seen below:

a. Reduction of 1 per cent for new VAT registrations

In the first year of the business being registered for VAT under the optimised flat rate scheme, the new taxpayer is allowed a 1 per cent reduction from the flat rate. Businesses that are transferred as going concerns are also entitled to deduct the 1 per cent from their flat rates from the date of transfer. This rule allows businesses to reduce the flat rate applied to the turnover by 1 per cent until the day before their first anniversary of becoming VAT registered (HMRC 2017: par 4.7).

b. Reduced records to be kept

HMRC (2017: par 2.2) notes that the VAT optimised flat rate scheme provides simplified record keeping as businesses do not have to keep detailed records of sales and invoices. The business must, however, continue to keep records of the flat rate calculation showing how the VAT payable was calculated and the amount spent on relevant goods. The business should also keep VAT invoices issued to VAT registered customers.

c. Cash basis accounting allowed

Small businesses that expect their taxable supplies in the next year to be £1,350,000 or less are allowed to use cash basis accounting in the United Kingdom to determine their income and expenditure. With regard to the VAT optimised flat rate scheme, taxpayers using the cash based turnover method are required to apply the flat rate percentage to only the VAT inclusive supplies for which payments have already been received in the accounting period. In this way, taxpayers do not pay VAT that is still being owed to them by their customers (HMRC 2017: par 9).

5.4.1.9 Venture capital schemes: indirect tax relief for small businesses

In the United Kingdom, HMRC offers tax relief to individuals who make investments in small companies to encourage more investments through venture capital schemes. Tax relief is particularly offered for investments made in United Kingdom

small companies and social enterprises that qualify for venture capital schemes (HMRC 2016: par 1). The relief is directly offered to the investor and it indirectly passes on to the small business because when tax relief is provided to investors, it becomes more attractive for potential investors to commit funds into qualifying investments. This process, in the end, benefits the small businesses because they would have access to the much needed funds for growth and expansion. The following venture capital schemes shown in Table 5.3 below are available in the United Kingdom:

Table 5.3: The different venture capital schemes available in the United Kingdom with their respective income tax relief particulars

Schemes	Annual investment limit on which relief can be claimed	Income tax relief	Minimum qualifying period for share relief	Tax payable on dividends
Enterprise Investment Scheme (EIS)	£1 million	30%	3 years	Yes
Seed Enterprise Investment Scheme (SEIS)	£100,000	50%	3 years	Yes
Social Investment Tax Relief (SITR)	£1 million	30%	3 years	Yes
Venture Capital Trusts (VCT)	£200,000	30%	5 years	No

Source: HMRC 2016: par 2

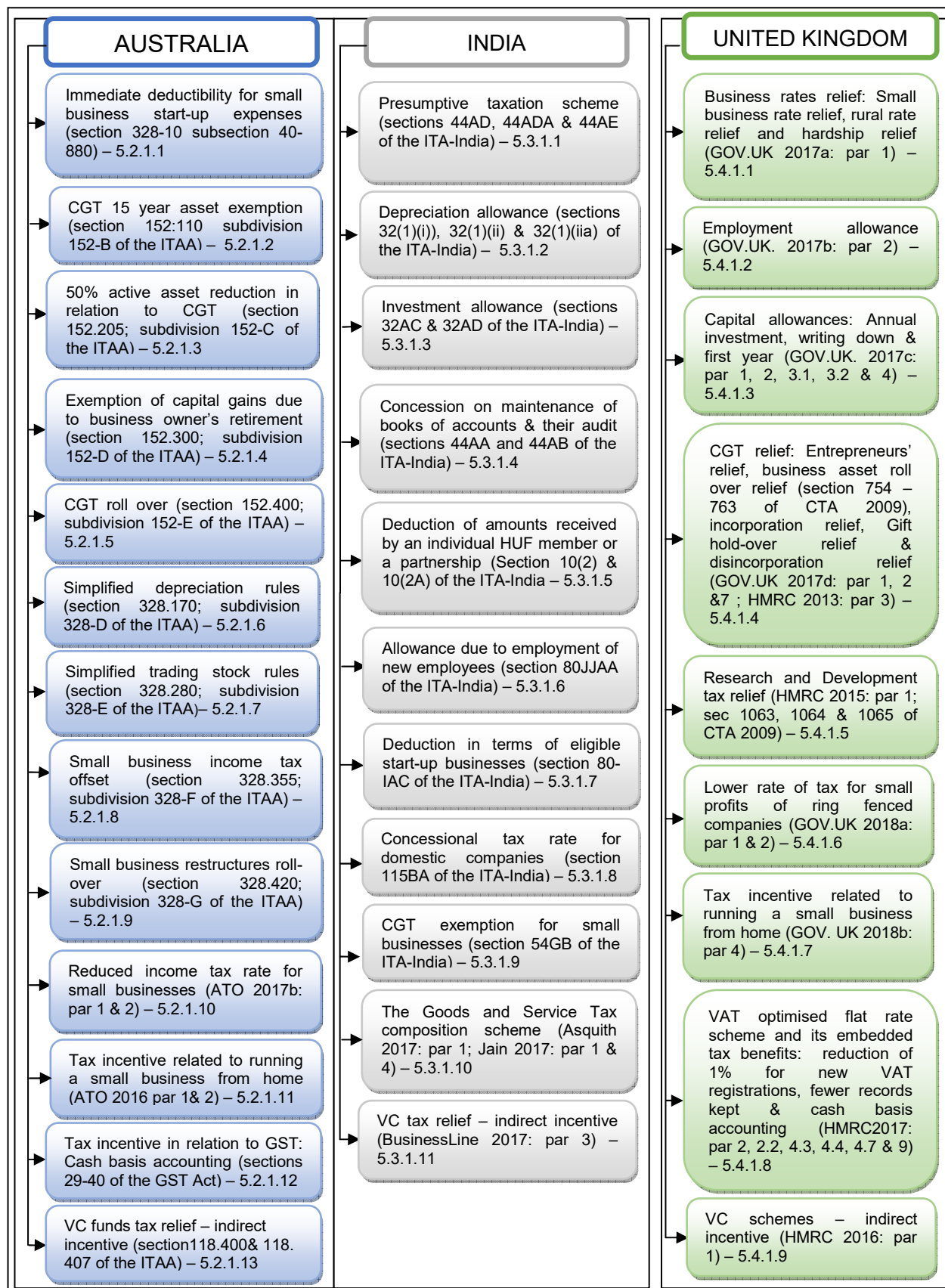
5.5 SUMMARY AND CONCLUSION

This sub-section presents a summary and conclusion of chapter 5.

5.5.1 Summary

Figure 5.1 below summarises the small business tax incentives offered by Australia, India, and the United Kingdom. As indicated at the beginning of this chapter, the tax incentives included in this study were limited to Income Tax, VAT (GST in Australia and India), and CGT.

Figure 5.1: Summary of small business tax incentives offered by Australia, India and the United Kingdom



Source: Author

5.5.2 Conclusion

There are many tax incentives for small businesses in Australia, India, and the United Kingdom. For purposes of this study, the small business tax incentives that have been focused on include those in line with income tax, VAT/GST, CGT, and corporation tax. The availability of many tax incentives for small businesses in each of the three countries is indicative of the importance attached to the respective small business sectors with regard to economic development. The three countries all have highly advanced economies and this study has noted that they all have a solid foundation and good support for their small business sectors through the tax incentives that they provide. Australia, India, and the United Kingdom seem to be aware that structured support provided in nurturing small businesses may develop them into large corporations.

It is worth noting that all three countries whose small business tax incentives have been presented in this chapter have lower corporate rates of tax for small businesses as compared to the normal rates for all other corporates. Australia has its own company tax cut for small businesses which currently provides a lower rate of 28.5 per cent and will continue to reduce annually until it will reach 25 per cent in the assessment year 2026 – 2027. The real tax incentive in this is that the standard rate of taxation in Australia is 30 per cent; hence the small business entities are incentivised in this regard by paying the lower tax rates. India provides a concessional tax rate for domestic small businesses which is 25 per cent as compared to the 30 per cent standard tax rate. The United Kingdom has a much lower standard rate of corporation tax which stands at 19 per cent (for ring-fenced companies which make profits not exceeding £300,000) in comparison to the 30 per cent company tax paid in Australia and India.

Small businesses, most especially those entities that are still in the start-up phases, need much support from their respective governments for them to survive and have a hope of growth and expansion. The governments must carefully use tools and instruments available to them in supporting these small businesses and tax incentives are among those tools through which much needed support could be

given. Among others, Australia offers small business tax incentives such as the immediate deduction of start-up expenditure, CGT exemptions, simplified depreciation, and trading stock rules, income tax offset, etc. India offers to its small businesses, tax incentives including the presumptive taxation scheme, depreciation and investment allowances, deduction in terms of eligible start-ups, allowance due to the employment of new employees, CGT exemptions, the GST composition scheme, etc. The United Kingdom offers business rates relief, employment, and capital allowances, CGT relief, R&D relief, etc. However, for tax incentives to yield the desired results, care must be taken to ensure that they are well implemented and monitored to avoid abuse.

Indeed, direct, and indirect tax takes away so much from the little profits made by a small business and therefore any mechanism that attempts to reduce what the tax authorities detract from the small entity could be a welcome boost. The profits of a small business are vital to its survival and the manner in which they are handled could well be one of the determinants of whether the business would continue to exist or not.

Chapter 5 has looked at the small business tax incentives offered by Australia, India, and the United Kingdom, while chapter 4 presented a detailed discussion of South Africa's tax dispensations in the SME sector. In chapter 6, the study compares South Africa's small business tax incentives with those offered in the other three countries.

CHAPTER 6

COMPARISON OF SOUTH AFRICA'S SMALL BUSINESS TAX INCENTIVES WITH THOSE OFFERED IN AUSTRALIA, INDIA, AND THE UNITED KINGDOM

6.1 INTRODUCTION

This chapter presents the comparison of the small business tax incentives offered by South Africa with those that are offered by Australia, India, and the United Kingdom. South Africa's tax incentives for small businesses were discussed in chapter 4 while those for the other three countries were presented in chapter 5. Even though some of South Africa's small business tax incentives are specifically attached to small business corporations and others to micro-businesses, for purposes of comparison in this chapter all tax incentives are generally considered to apply to small businesses. No categories of small businesses are thus considered in this chapter. Comparative Tables 6.1 – 6.18 are used to summarise and compare all the small business tax incentives that were identified from the four countries. The tables include a brief comparative comment and a key identified by the letters A – G which is used to indicate the availability of particular small business tax incentives in each set of countries. Letters A – D identify the small business tax incentives that are available in South Africa only or which are also offered in any one, two, or all three of the other countries. Letters E, F and G are used to identify small business tax incentives that are available in Australia, India, and the United Kingdom but are not offered in South Africa.

6.2 COMPARATIVE TABLES

The study uses these tables to summarise all the small business tax incentives identified in the four countries as well as to draw a comparison between those incentives. The tables include a brief comparative comment after each set of similar (or closely linked) small business tax incentives from the different countries. Added

to the tables is a key, formed by the letters A – G, which is used to indicate the small business tax incentives that exist in the different countries and also to show those tax incentives that are not available in South Africa. The key to the tables is explained as follows:

Key

A – Available in all four countries

B – Available in South Africa and any two of the other three countries

C – Available in South Africa and any one of the other three countries

D – Available in South Africa only

E – Available in all the other three countries but not in South Africa

F – Available in any two of the other three countries but not in South Africa

G – Available in any one of the other three countries but not offered in South Africa

The above key, denoted by the letters A – G, is to be used in tables 6.1 – 6.18 and used as part of the reference points in the discussion in paragraphs 6.3 – 6.9. The presentation of the tables below followed the same order in which South Africa's small business tax incentives were presented in chapter 4. After listing South Africa's small business tax dispensation (in summary format in each table), a similar or closely matching tax incentive from the SME sector of Australia, India, or the United Kingdom (or from any two or all countries) is identified and also listed in the same table. In the case where there is no matching incentive to that of South Africa or one with similar features among those tax incentives presented in chapter 5, then it shall be considered that a particular incentive is a category D. This means that according to this study, such tax incentive shall be considered to exist in South Africa only. After exhausting South Africa's small business tax incentives, the tax concessions from either or all the other three countries denoted by the letters E, F, and G will also be presented in the tables that follow thereafter. The tables below, starting with 6.1, present a summary and comparison of small business tax incentives available in South Africa, Australia, India, and the United Kingdom.

Table 6.1: South Africa's progressive rate of taxation for Small Business Corporations compared with other countries' SME sector tax incentives

No.	South Africa	Australia	India	United Kingdom	Key
1.	Progressive rate of taxation for SBCs: Rate of tax to be paid depends on the amount of taxable income. A tax threshold also exists (set at R78 150 for the year ending 31 March 2019) (par 4.2.1).	-	-	-	D
<p>Comparative comment:</p> <p>The Progressive rate of taxation incentive for small businesses (summarised above) is only available in South Africa compared to the other three countries used in the study. In terms of tax rate, Australia implemented a company tax cut for small businesses in 2015 from 30 – 28.5 per cent (par 5.2.1.10) and it will continue reducing until it reaches 25 per cent in the tax year 2026 – 2027. India's small companies that are domestic pay a concessional tax rate of 25 per cent (par 5.3.1.8) starting from assessment year 2017 – 2018. In the United Kingdom, ring-fenced companies that make profits lower than £300,000 are taxed at a small profits rate of 19 per cent (par 5.4.1.6) compared to the 30 per cent main rate of corporation tax paid by companies whose profits exceed the same amount. In all three of the countries (Australia, India & the United Kingdom), there is an element of a lower/concessional rate for small businesses but not exactly similar to the progressive rate of taxation offered by South Africa. Refer to paragraph 6.6 for a detailed discussion of findings. The study now turns its attention to the comparison of capital allowances presented in table 6.2 below.</p>					

Source: Author

Table 6.2: Comparison of South Africa's capital allowances for small businesses with Australia, India and the United Kingdom's SME tax incentives

No.	South Africa	Australia	India	United Kingdom	Key
2.	<p>Capital allowance:</p> <p>Immediate write off of all plant or machinery used in the process of manufacture or a process of a similar nature. 100 per cent of the cost of the qualifying plant or machinery can be claimed in the first year of bringing the asset into use for the first time (par 4.2.2.1).</p>	-	<p>Investment allowance:</p> <p>Deduction of 25 per cent of the actual cost of new plant or machinery acquired by a small business involved in the manufacturing or production of any article or thing (par 5.3.1.3).</p>	<p>Annual Investment Allowance (AIA):</p> <p>The full value of plant or machinery can be claimed through the AIA (£200,000 per annum) (par 5.4.1.3 a).</p> <p>Can also deduct first-year allowances for the full cost of plant and machinery used in gas refuelling stations (par 5.4.1.3 c).</p>	B
<p>Comparative comment:</p> <p>There are similarities between South Africa's capital allowance, India's investment allowance, and the United Kingdom's AIA presented in Table 6.2 above. In South Africa, 100 per cent of the qualifying plant or machinery can be claimed in the first year of bringing the new asset into use. Similarly, the United Kingdom's AIA allows the deduction of the full value of plant or machinery, although the cost of the qualifying assets is capped at £200,000 per annum. Only 25 per cent of the full cost of a similar asset can be claimed in India. Refer to paragraph 6.4 for the discussion of tax incentives identified by key B. The next table (Table 6.3) looks at how small businesses deal with the depreciation allowance in the different countries used in the study.</p>					

Source: Author

Table 6.3: Dealing with the depreciation allowance among small businesses in the different countries

No.	South Africa	Australia	India	United Kingdom	Key
3.	<p>Choosing to apply the more beneficial rate to claim on company assets (Choice between wear and tear and accelerated depreciation):</p> <p>Being able to make a choice between applying the wear and tear allowance (20 per cent for five years) or the accelerated depreciation (50; 30; 20 per cent). This is applicable to all the other assets of the SBC besides plant and machinery used in manufacturing or a process of a similar nature. Companies choose the option which allows them to pay less tax (par 4.2.2.2).</p>	<p>Simplified depreciation rules:</p> <p>Small businesses are allowed to allocate depreciating assets to a single pool and deduct amounts for them at 30 per cent on the diminishing balance as if they were one single asset.</p> <p>The most newly acquired assets drawn into the pool are depreciated at 15 per cent (diminishing balance) regardless of when they were acquired during the year while an immediate write off is allowed for assets costing less than \$20,000 (par 5.2.1.6).</p>	<p>Depreciation allowance:</p> <p>10 per cent is allowed on both furniture and building, and 15 per cent on plant and machinery used in the business. 25 per cent is allowed on intangible assets while an additional 20 per cent to be deducted on new plant and machinery used in manufacturing. 35 per cent is allowed on new plant and machinery acquired for manufacturing in the backward states (par 5.3.1.2).</p>	<p>Writing down allowances:</p> <p>In the United Kingdom, this incentive is used to claim capital allowances on items if their value were in excess of the AIA which would have been claimed already or if the items do not qualify for the AIA. The percentage to be deducted depends on the item. Items are grouped into pools depending on the rates of deduction they qualify for. The main pool (18 per cent rate) takes all plant and machinery not qualifying for the AIA and the special rate pool (8 per cent) includes all items with a useful life of at least 25 years (par 5.4.1.3 b).</p>	A
<p>Comparative comment:</p> <p>As indicated in number 3 above, South African qualifying small businesses have a choice to opt for the more beneficial rate when claiming on company assets. The choice is made between the wear and tear allowance of Section 11(e) – 20 per cent for five years and the 50; 30; 20 per cent allowance of Section 12E (1A) of the ITA. The case with the other countries does not include a choice between different alternatives to identify a more beneficial rate, but they all have ways of providing for a depreciation allowance to give an incentive to small businesses. Australia offers simplified depreciation rules which are somewhat similar to the United Kingdom's writing down allowance because they both allow small businesses to allocate assets to a single pool and deduct amounts for them as if they were one single</p>					

asset. The pool rate is 30 and 15 per cent for the newly acquired assets in Australia, while in the United Kingdom the main pool rate is 18 and 8 per cent for all items drawn into the special rate pool. In the United Kingdom, the allowance is only effected after the deduction of the AIA for items whose value is in excess of the investment allowance (meaning that it is an additional allowance on top of the AIA) or for those that do not qualify for the AIA.

India's depreciation allowance is not specific to small businesses only, but it cuts across all sizes of businesses including small, medium, and large. In India, 25 per cent is allowed on intangible assets and 20 per cent on new plant and machinery. India, unlike any of the other three countries, has a specific provision for new assets acquired for manufacturing in the backward areas (deducted at 35 per cent). Refer to paragraph 6.3 for a detailed discussion of small business tax incentives identified by key A. In the following table (Table 6.4), the study compares South Africa's Turnover tax with the small business tax incentives offered by Australia, India, and the United Kingdom.

Source: Author

Table 6.4: Comparing South Africa's Turnover tax incentive with Australia, India and the United Kingdom's SME sector tax concessions

No.	South Africa	Australia	India	United Kingdom	Key
4.	<p>Turnover tax:</p> <p>A simplified tax system for South Africa's micro-businesses under which tax is calculated on the annual turnover of the business. Deductions are not considered. Small businesses that are taxed under the turnover tax system do not pay income tax, VAT, provisional tax, capital gains tax and neither do they pay dividends tax. Annual qualifying turnover must not exceed R1million. Turnover tax is optional; a business could still apply the general income tax</p>	–	<p>Presumptive taxation scheme:</p> <p>Presumptive income is computed at 8 per cent of gross turnover and it is considered the final taxable income. Expenses are not taken into account. The rate reduces to 6 per cent in respect of total turnover received through digital means; intended for the creation of a less-cash economy. The normal approach of computing taxable income, which is turnover less business expenses = taxable income,</p>	–	C

	system. A business may choose to be registered for VAT while also registered under the turnover tax regime. No tax is paid on the first R335 000 of taxable income for the year of assessment ending 28 February 2019 (par 4.3.1).		is disregarded. The maintenance of books of accounts and having them audited is not required (par 5.3.1.1).		
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Comparative comment:

The summarised presentation in Table 6.4 above shows that there are notable similarities between South Africa's turnover tax regime and India's presumptive taxation scheme for small businesses although the two systems are not exactly carbon copies of each other. South Africa's turnover tax is calculated on annual turnover whereby deductions are not considered. Similarly, the presumptive tax scheme of India disregards business expenses (deductions) in the determination of a certain presumptive income (now considered the final taxable income). It should be noted that India's presumptive tax scheme is used to determine the taxable income of a small business while in South Africa's turnover tax system tax liability is determined by applying the rates of turnover tax directly on the annual turnover of the micro-business. Refer to paragraph 6.5 for details.

Source: Author

Table 6.5: Comparison of the benefits of South Africa's Turnover tax system with SME tax incentives offered by Australia, India and the United Kingdom

No.	South Africa	Australia	India	United Kingdom	Key
5.	<p>The benefits and advantages embedded within the turnover tax system:</p> <p>One form of tax instead of many different taxes reduced and simplified records kept, reduced number of returns submitted to tax authority (only two interim returns and one final return), exit VAT relief and</p>	<p>SME tax incentives that could be matched with the advantages of the turnover tax system:</p> <p>A small business entity can disregard a capital gain arising from an event which would have happened in relation to an asset owned for 15 years or more (par 5.2.1.2).</p> <p>50 per cent active asset reduction with</p>	<p>SME tax incentives that could be matched with the advantages of the turnover tax system:</p> <p>In the presumptive tax system, a small business does not have to maintain books of accounts or have them audited unless it is involved in the provision of specific professional services (par 5.3.1.1)</p>	<p>SME tax incentives that could be matched with the advantages of the turnover tax system:</p> <p>The business asset roll-over relief allows taxpayers to delay paying capital gains tax after the disposal of certain business assets if all or part of the proceeds is used to replace the disposed of assets. No capital gains tax</p>	A

	<p>favourable tax periods for the submission of VAT returns (par 4.3.2 a – f).</p> <p>In terms of capital gains tax, micro-businesses in South Africa are specifically exempt from CGT. The turnover of a micro-business excludes proceeds from the disposal of an asset that has not been used mainly for business purposes. Only 50 per cent of all receipts of a capital nature is required to be added into the taxable turnover of the micro-business (par 4.3.2 d).</p>	<p>regard to capital gains tax (par 5.2.1.3).</p> <p>Small businesses can disregard capital gains if the proceeds from the sale of an asset are in connection with the small business owner's retirement (par 5.2.1.4).</p> <p>The capital gains tax roll-over relief allows small businesses to defer capital gains until a later year (par 5.2.1.5).</p>	<p>Goods and Service Tax replaced over 20 overlapping indirect taxes in India. Under the Goods and Service Tax composition scheme, small businesses are exempted from maintaining books of accounts, they are not required to file returns and neither do they need to issue invoices (par 5.3.1.10).</p> <p>Capital gains deduction either if the proceeds are re-invested in subscription for an SME's company shares or in a specified long term asset within six months (par 5.3.1.9).</p>	<p>is paid on the gains from the disposal of the original asset until the new asset is sold (par 5.4.1.4 b).</p> <p>Entrepreneurs relief, Incorporation relief, Gift hold-over relief, and disincorporation relief are also available to small businesses in the UK (par 5.4.1.4 a, c, d and e)</p> <p>Reduced records are kept under the VAT optimised flat rate scheme which allows small businesses to pay VAT at a lower flat rate percentage (par 5.4.1.8 & 5.4.1.8.1 b).</p>	
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Comparative comment:

As summarised in Table 6.5 above, South Africa's turnover tax regime is a package with several underlying benefits to the small business's tax affairs. Some of the benefits in the package are comparable with certain small business tax incentives offered in Australia, India, and the United Kingdom. In close similarity to South Africa's reduced and simplified records required under the turnover tax regime, India's presumptive tax scheme does not require a small business to maintain books of accounts unless involved in the provision of professional services. India's Goods and Service Tax composition scheme also does not require maintenance of books of accounts or the filing of returns or issuing of tax invoices. This slightly differs from South Africa's system because a micro-business would still be required to submit at least two interim returns and a final return. Reduced records are also kept under the VAT optimised flat rate scheme of the United Kingdom, similar to South Africa's turnover tax regime. The United Kingdom system, however, allows small businesses to pay VAT at a lower flat rate percentage while micro South African businesses that could opt to remain registered for VAT would pay VAT at the ongoing standard rate.

South Africa's specific CGT exemption of micro-businesses could be compared to Australia's allowances of disregarding capital gains tax under the various ITAA Sections listed. India's capital gains

allowance as well as the United Kingdom's business asset roll-over relief also has similarities with South Africa's specific CGT exemption for micro-businesses. Australia allows its small business entities to disregard capital gains if the proceeds from the sale of an asset are in connection with the small business owner's retirement while the capital gains roll-over relief allows deferring of capital gains until a later year. Australia's capital gains tax roll-over relief and South Africa's roll-over in Part IX of the Eighth Schedule of the Act (not included in the above table but highlighted in paragraph 4.4.1) have similarities with the United Kingdom's business asset roll-over relief which allows taxpayers to delay paying capital gains tax after the disposal of certain business assets if all or part of the proceeds is used to replace the disposed assets. However, South Africa's CGT roll-over does not specifically apply to small businesses only but applies generally to all businesses, unlike the roll-overs identified in the other countries in the above table. The United Kingdom's requirement of allowing a deduction of proceeds from business assets if they are used in replacing of the asset (par 5.4.1.4 b) has similarities with India's approach which involves re-investing proceeds in a specified long term asset (par 5.3.1.9). However, the two approaches are different from South Africa's specific exemption of micro-businesses under the turnover tax regime.

Australia's and the United Kingdom's roll-over reliefs are also both different from the capital gains tax specific exemption of South Africa, which allows a qualifying micro-business to add only 50 per cent of all receipts of a capital nature to its taxable turnover (par 4.3.2.d). However, Australia's 50 per cent active asset reduction (par 5.2.1.3) has certain similarities with South Africa's requirement which compels micro-businesses to add 50 per cent of all receipts of a capital nature to their taxable income as a substitute to capital gains tax. South Africa's CGT exemption has similarities with Australia's capital gains allowance. Refer to paragraph 6.3 for details regarding all the tax incentives identified by the letter A. The following table (Table 6.6) compares South Africa's skills development levy with SME tax incentives offered by Australia, India, and the United Kingdom.

Source: Author

Table 6.6: South Africa's exemption from skills development levy compared to SME tax incentives from the other three countries

No.	South Africa	Australia	India	United Kingdom	Key
6.	Exemption from skills development levy: In South Africa, all employers whose total annual salaries are less than R500 000 are exempt from registering and paying skills	-	-	-	D

	development levy (par 4.4.2).				
Comparative comment:					
This tax incentive is available in South Africa only in reference to the above summary in number 6. Refer to paragraph 6.6. In the following table (Table 6.7), the study compares the SME tax incentives which are related to running a small business from home.					

Source: Author

Table 6.7: Comparison of the small business tax incentives that are linked to running a small business from home

No.	South Africa	Australia	India	United Kingdom	Key
7.	<p>Tax incentive related to running a small business from home:</p> <p>For home office expenditure to be deducted it must not be of a capital nature. The taxpayer who receives remuneration from employment or uses part of his home as an office can claim rental, repairs, and expenses incurred as well as wear and tear allowance (par 4.4.3).</p>	<p>Tax incentive related to running a small business from home:</p> <p>Expenditure is deductible by a small business if it is incurred in running a business from home in a room that is exclusively set aside for such purpose. Examples of such expenditure may include; business utilities such as gas and electricity, business phone costs, depreciation of plant and office equipment and occupancy expenditure such as rent, insurance, rates, etc. (par 5.2.1.11).</p>	-	<p>Tax incentive in relation to running a small business from home:</p> <p>The business proportion of the cost of council tax, lighting, heating, broadband, and phone calls can be claimed. A taxpayer who runs a small business from home can use the flat rates of simplified expenses to determine the actual business expenditure incurred and hence claim it (par 5.4.1.7).</p>	B

Comparative comment:

In relation to Table 6.7 above, South Africa's tax incentive that is related to running a small business from home has similarities with the tax dispensation offered to small businesses in Australia and the United Kingdom. For this reason, this tax incentive is categorised as a category B in the comparative table. In South Africa, Australia, and the United Kingdom, business expenditure that is incurred in

running a small business from home (excluding capital expenditure) is deductible for tax purposes. South Africa allows a taxpayer who receives remuneration from running a small business at home, to deduct rent, repairs, wear and tear, and other expenses incurred specifically for business purposes. The United Kingdom allows a deduction of the proportion of council tax, heating, lighting, phone calls, as well as broadband expenditure that is business related (par 5.4.1.7). Similarly, Australia allows a deduction of apportioned amounts for electricity, telephone, rent, and depreciation in relation to a room that is set up exclusively for business purposes at home (par 5.2.1.11). Refer to paragraph 6.4 for a detailed discussion. In the next table (Table 6.8), the study compares South Africa's Employment Tax Incentive with employment-related tax concessions available to the SME sector in Australia, India, and the United Kingdom.

Source: Author

Table 6.8: Comparison of South Africa's Employment Tax Incentive with employment related tax incentives available to SMEs in Australia, India and the United Kingdom

No.	South Africa	Australia	India	United Kingdom	Key
8.	<p>Employment Tax Incentive:</p> <p>This incentive reduces an employer's cost of hiring young people (between the ages of 18 – 29) through a cost-sharing mechanism with the government while leaving the employee's wage unaffected. It is aimed at encouraging employers to hire young and in-experienced job seekers (par 4.4.4).</p>	-	<p>Allowance due to the employment of new employees:</p> <p>Available to businesses that derive income from the manufacturing of goods. The deduction is equal to 30 per cent of additional wages paid to new regular employees recruited in the previous year in the taxpayer's factory (par 5.3.1.6).</p>	<p>Employment allowance:</p> <p>This incentive is available to eligible employers paying class 1 National insurance of employees. The allowance can be claimed on the employer's contribution (13.8 per cent for the current year) and it can be up to £3,000 a year (par 5.4.1.2).</p>	B

Comparative comment:

As indicated in Table 6.8 above, a tax incentive related to the employment of workers is available in South Africa, India, and the United Kingdom although the approach and intentions are different in each

case. In South Africa, the Employment Tax Incentive is intended to promote the employment of young in-experienced job seekers while in India, the allowance focuses on promotion and giving support to the manufacturing sector. India's employee tax incentive is based on new employees recruited in the taxpayer's factory. In the United Kingdom, the employment allowance is aimed at reducing the employer's class 1 National insurance bill. Refer to paragraph 6.4 for a discussion of all the tax incentives identified by key B. In the next table (Table 6.9) the study seeks to compare South Africa's concession available to small businesses with regard to advance tax rulings, with tax incentives offered to small businesses in Australia, India, and the United Kingdom.

Source: Author

Table 6.9: South Africa's SME concession on advance tax rulings compared to small business tax incentives offered in Australia, India and the United Kingdom

No.	South Africa	Australia	India	United Kingdom	Key
9.	Concession on advance tax rulings: The standard application fee for advance tax rulings is R14000 while small businesses are charged only R2500 to lodge a similar application (par 4.4.5).	-	-	-	D
Comparative comment: This tax incentive is available in South Africa only as indicated in Table 6.9 above. Refer to paragraph 6.6 for details. The following table (Table 6.10) compares South Africa's VAT related tax incentives for SMEs with tax dispensations for small business in Australia, India, and the United Kingdom.					

Source: Author

Table 6.10: Comparison of South Africa's SME VAT related tax incentives with their equivalent in Australia, India and the United Kingdom

No.	South Africa	Australia	India	United Kingdom	Key
10.	VAT related tax incentive: Small businesses can account for VAT on a payments basis	GST related tax incentives: Small businesses in Australia can choose to account	GST related tax incentives: The Goods and Service Tax composition	VAT related tax incentive: The VAT optimised flat rate scheme allows cash basis	

	<p>if their supplies do not exceed R2.5 million per annum. They, therefore, account for VAT on actual payments made and actual payments received in respect of taxable supplies during the period. This is opposed to the invoice basis where vendors generally account for VAT on the basis of total amounts on invoices received or issued (par 4.4.6).</p>	<p>for Goods and Services Tax on a cash basis.</p> <p>This means that they do not have to pay Goods and Services Tax on amounts that they would not have received (par 5.2.1.12).</p>	<p>scheme.</p> <p>The supplier can opt to pay a composition levy which has much lower rates as compared to the standard Goods and Service tax rates.</p> <p>Maintenance of detailed books of accounts is not required, no need to issue tax invoices and small businesses are exempted from filing the three monthly returns (par 5.3.1.10).</p>	<p>accounting.</p> <p>Taxpayers using the cash based turnover method are required to apply the flat rate percentage to only the VAT inclusive supplies for which payments have already been received in the accounting period. Taxpayers do not pay VAT that is still being owed to them (5.4.1.8.1 c).</p> <p>Detailed records of sales and invoices are not required while a 1 per cent reduction applies on new VAT registrations. Invoices must still be issued to VAT registered customers (par 5.4.1.8.1 b).</p>	<p>A</p>
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Comparative comment:

As indicated in Table 6.10 above, this tax incentive or something with some similar features exists in all four countries. The Value Added Tax system of South Africa allows small businesses to account and pay for VAT on a payments basis and therefore payments are only made on actual receipts. Similarly, small businesses can account for the Goods and Services Tax of Australia on a cash basis, likewise, the VAT optimised flat rate scheme of the United Kingdom. Unlike in the other three countries, India's Goods and Service Tax composition scheme for small businesses has nothing to do with accounting for tax on a cash basis. India's Goods and Service Tax composition scheme provides an option to suppliers of goods and services to pay composition levy at much lower rates as compared to the standard Goods and Service Tax. Refer to paragraph 6.3 for the discussion. Table 6.11 below compares the venture capital tax incentives that are associated with investing in a small business across the four countries.

Source: Author

Table 6.11: Comparison of venture capital tax incentives related to investing in small businesses across the four countries

No.	South Africa	Australia	India	United Kingdom	Key
11.	<p>The Venture capital incentive:</p> <p>The underlying tax incentive under the venture capital scheme is a direct concession to investors and indirect concession to small businesses. The incentive encourages investors to inject more funds into qualifying small businesses and in the long run, the indirect beneficiaries of the concession are the recipients of the funds which are needed for growth and expansion (par 4.4.7).</p>	<p>The venture capital limited partnership programme and the early stage venture capital limited partnership programme:</p> <p>The programmes encourage investment by providing various tax incentives to eligible investors. The end result is that small business entities are the indirect beneficiaries because they are able to get the much needed funds to grow their businesses (par 5.2.1.13).</p>	<p>Venture capital funds tax relief:</p> <p>In India, profits made by investors in certain venture capital funds from the sale of stakes in qualifying start-ups are treated as capital rather than revenue receipts for tax purposes. This indirectly benefits small business entities because the investors are encouraged to invest more funds into the qualifying start-ups for them to grow their businesses (par 5.3.1.11).</p>	<p>Venture capital schemes:</p> <p>The different schemes such as; Enterprise Investment Scheme, Seed Enterprise Investment Scheme, Social Investment Tax Relief, and Venture Capital Trusts, provide relief to investors and indirectly to small businesses as investors are handed an incentive to invest more in small businesses (par 5.4.1.9).</p>	A
<p>Comparative comment:</p> <p>The venture capital funds tax incentive is available in all four countries as indicated in Table 6.11 above. The tax incentive directly benefits the investors and encourages them to invest more funds into qualifying start-ups and small businesses. In the end, the small businesses indirectly benefit from the tax incentive because, as a result, investors are enticed to commit more funds into such businesses and therefore the small business are able to get the much needed funds for investment. In all four countries, the fundamental pillars of this incentive take a somewhat similar approach to giving an incentive to the investors as a way of encouraging them to invest more into the small businesses. Refer to paragraph 6.3 for a detailed discussion. In the next table (Table 6.12), the study compares the tax incentives linked with the deduction of start-up expenditure for small businesses.</p>					

Source: Author

Table 6.12: Comparison of the small business tax incentive linked to start-up expenditure

No.	South Africa	Australia	India	United Kingdom	Key
12.	-	<p>Immediate deduction of small business start-up expenditure:</p> <p>In Australia, small business entities can fully deduct certain start-up expenditure in the year in which they would have been incurred. Start-up expenditure incurred in obtaining legal or accounting advice or services relating to the proposed operations and payment of a fee or tax to an Australian government agency are immediately deductible (par 5.2.1.1).</p>	<p>Deduction in terms of eligible start-up businesses:</p> <p>For three consecutive years, small businesses in the start-up phase can deduct 100 per cent of any profits derived from a business involving innovation, development, commercialisation of new products, process or services driven by technology, or intellectual property rights (par 5.3.1.7).</p>	-	F
<p>Comparative comment:</p> <p>A tax incentive that allows the deduction of small business start-up expenditure is available in Australia and India as indicated in Table 6.12. In Australia, certain start-up expenditure of a small business could be deducted immediately in the income year in which it would have been incurred, while in India the deduction is applicable within three consecutive years out of seven of starting the business. India's tax incentive in this regard is intended to promote small businesses that do something new and unique thus supporting innovation, technological advancements, new products, and intellectual property rights while Australia focuses on ensuring that start-ups get professional advice and the services most needed by new businesses. Refer to paragraph 6.8 for further discussion. In the next table (Table 6.13), the study seeks to compare Australia's simplified trading stock rules for small businesses with tax incentives available to SMEs in South Africa, India, and the United Kingdom.</p>					

Source: Author

Table 6.13: Comparison of Australia's simplified trading stock rules for SMEs with
mall business tax concessions from the other countries

No.	South Africa	Australia	India	United Kingdom	key
13.	-	Simplified trading stock rules: Small business entities in Australia are allowed to estimate the value of their trading stock at the end of the financial year to report in their tax return provided the difference between the actual balance of stock and the estimated amount at the end of the year is not more than \$5,000 (par 5.2.1.7).	-	-	G
Comparative comment: This tax incentive for small businesses is only available in Australia as indicated in Table 6.13 above. Refer to paragraph 6.9 for a discussion of all tax incentives identified by key G. The following table (Table 6.14) compares small business tax incentives which are related to the deduction of a specific kind of income or the offsetting of some portion of income tax.					

Source: Author

Table 6.14: Comparison of SME tax incentives that are linked to the deduction of a
specific kind of income or offsetting of some income tax

No.	South Africa	Australia	India	United Kingdom	Key
14.	-	Small business income tax offset: Qualifying small businesses in Australia are entitled to a tax offset on the tax payable on the portion of their	Deduction of amounts received by an individual member from a Hindu Undivided Family or a partnership: Amounts received by an individual who belongs to a Hindu Undivided Family are allowable	-	F

		income that is from sole trading activities, partnerships, or trusts. The tax offset reduces the tax payable by 8 per cent (par 5.2.1.8).	deductions if they were paid to the member from the family's income. The partners' share of profit, interest, and remuneration to a partner are also exempted in the calculation of the taxable income of a partnership (par 5.3.1.5).		
Comparative comment:					
As indicated in Table 6.14 above, in Australia, small business entities are allowed an income tax offset on the portion of their income that is from sole trading activities, partnerships or trusts. On the other hand, in India, small businesses/partnerships are allowed to deduct a partner's share of profits, interest, and remuneration to a partner, in determining the taxable income of a partnership. Refer to paragraph 6.8 for details. In the next table (Table 6.15), the study compares SME tax incentives related to the restructuring of businesses and the resultant transfer of assets.					

Source: Author

Table 6.15: Comparison of SME tax incentives related to the restructuring of businesses and the resultant transfer and disposal of assets

No.	South Africa	Australia	India	United Kingdom	Key
15.	Exemption of capital gains from the disposal of active small business assets: There is an exemption on capital gains from the disposal of an active business asset of a small business. The disposal could also involve disposing of interest in the active business assets of a partnership or the entire direct interest in a company. The	Small business restructures roll-over relief: Owners of small business entities are allowed to restructure their businesses in terms of legal structures and the manner in which business assets are held while disregarding tax gains and losses that may arise (par 5.2.1.9).	-	Disincorporation relief: Between 1 April 2013 and 31 March 2018, small companies in the UK were allowed to transfer a going concern business with all its qualifying assets to shareholders at a reduced value (for corporation tax and capital gains tax purposes) and the shareholders would continue operating	B

<p>assets or the interest in a partnership or company must have been held for a period of five continuous years. The natural person must be at least 55 years and the amount to be disregarded must not exceed R1.8 million during the lifetime of a natural person (par 4.4.1).</p>			<p>the business in a disincorporated form as a sole trader or partnership. There would be no corporation tax paid or CGT (par 5.4.1.4 e)</p>
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Comparative comment:

As indicated above in Table 6.15, there are notable similarities between Australia's small business restructures roll-over relief and the disincorporation relief of the United Kingdom (although the United Kingdom's relief ended on 31 March 2018). South Africa's exemption of capital gains from the disposal of active small business assets also has somewhat similar features to the incentives from Australia and the United Kingdom. In the three countries, the disposal of some of the original assets of the business has an element of dissolution, restructuring, or disincorporation of the business. In South Africa, the disposal of a partner's interest in a partnership or company eventually leads to the dissolution of the entity because of the withdrawal of one of the partners and possibly formation of another business operated in a different form. The new business could even be a partnership but with fewer members or a new member introduced to replace the one leaving. The capital gains from such disposals are exempt from CGT. In Australia, small business owners are allowed to restructure their businesses including the manner in which business assets are held, without attracting capital gains tax. The United Kingdom's approach was similar, although, it accommodated a situation whereby the company would be disincorporated (transferred) as a going concern to shareholders who would continue operating as sole traders or partnerships. Unlike Australia's restructure roll-over relief, in the United Kingdom assets could be transferred to shareholders at a reduced value. It is worth noting that under normal circumstances, the transfer of a business from one form to another (such as from a company to a sole trader or partnership) would constitute a capital disposal of the business assets and thus attract capital gains tax. However, due to the availability of the three tax incentives under discussion, the respective taxpayers in South Africa, Australia, and the United Kingdom could be given relief in that regard. Refer to paragraph 6.4 for details. The next table (Table 6.16) compares the concessionary tax rates for small businesses across the four countries.

Source: Author

Table 6.16: Comparison of concessionary tax rates for small businesses among the four countries

No.	South Africa	Australia	India	United Kingdom	Key
16.	-	<p>Reduced income tax rate for small businesses:</p> <p>The income tax rate for small business entities was reduced from 30 to 28.5 per cent in 2015 and it would continue reducing until it reaches 25.0 per cent in 2027. For the financial year 2018 – 19, the reduced income tax rate is 27.5 per cent (par 5.2.1.10).</p>	<p>Concessional tax rate for domestic companies:</p> <p>Small businesses in India that were registered on or after 1 March 2016 and are involved in manufacturing could pay tax at a lower income tax rate of 25 per cent instead of the usual 30 per cent for corporates (par 5.3.1.8).</p>	<p>Lower rate of tax for small profits of ring-fenced companies:</p> <p>Ring-fenced companies (companies that profit from oil extraction or oil rights) have a small profits rate at which corporation tax could be paid depending on the amount of profits made during the financial year. The small profits rate is 19 per cent (instead of 30 per cent) and it applies to all ring-fenced companies whose profits do not exceed £300, 000(par 5.4.1.6).</p>	E
<p>Comparative comment:</p> <p>Table 6.16 above, shows that Australia, India, and the United Kingdom, all have lower rates at which income tax is payable by the small businesses. The reduced income tax rate for Australia, for the tax year 2018 – 19 is 27.5 per cent which will continue reducing until reaching 25 per cent in 2026 – 27 while other businesses are taxed at 30 per cent. India's small businesses involved in manufacturing are taxed at 25 per cent while the lower rate of tax for small profits of ring-fenced companies in the United Kingdom is 19 per cent. Similar to Australia, the other companies are all taxed at a standard income tax rate of 30 per cent, in both India and the United Kingdom. South Africa does not have a lower rate of income tax that could be directly compared to the 28 per cent fixed rate which applies to all companies, however, SBCs are taxed at a progressive rate under a system which also has a tax threshold below which no tax is payable. A company paying tax using the progressive rate of tax for small business corporations would generally pay lower tax than a normal corporate entity whose tax is paid at 28 per</p>					

cent flat rate. It could be argued that the progressive rate of taxation in South Africa is the closest comparative to the concessional income tax rates for small businesses in Australia, India, and the United Kingdom. However, the progressiveness of the SBC rate makes it very distinct from the generally flat lower rates of income tax that are available in the other three countries. As a result, in this study, South Africa's progressive rate of taxation for small business corporations was not compared with the lower rates for small businesses in Australia, India, and the United Kingdom. Refer to paragraph 6.7 for further discussion. The following table (Table 6.17) looks at a comparison of the United Kingdom's business rates relief for small businesses with SME tax incentives in the other three countries.

Source: Author

Table 6.17: Comparison of the United Kingdom's business rates relief with SME tax incentives in South Africa, Australia and India

No.	South Africa	Australia	India	United Kingdom	Key
17.	-	-	-	Business rates relief: In the UK, businesses pay rates to local councils on non-residential property owned. Small businesses pay discounted/ concessional business rates which include small business rate relief (on the property with a rateable value of less than £15,000), rural rate relief and hardship relief (par 5.4.1.1 a, b and c).	G
Comparative comment: As shown in Table 6.17 above, this incentive is offered in the United Kingdom only, in comparison to the three other countries included in the study. Refer to paragraph 6.9 for the discussion. In the next table (Table 6.18), the study compares the United Kingdom's R&D tax relief for small businesses with tax incentives available to the SME sector in South Africa, Australia, and India.					

Source: Author

Table 6.18: Comparison of the United Kingdom’s R&D tax incentive for SMEs with tax concessions available to small businesses in the other three countries

No.	South Africa	Australia	India	United Kingdom	Key
18.	-	-	-	<p>Research and Development tax relief:</p> <p>Small businesses, whose projects meet the definition of Research and Development in the UK, are allowed to deduct 230 per cent of their qualifying costs from their annual profits. They are also allowed to deduct a tax credit worth up to 14.5 per cent of the surrenderable loss (par 5.4.1.5).</p>	G

Comparative comment:

With reference to Table 6.18 above, this incentive is specifically offered to small businesses in the United Kingdom only, in comparison to the three other countries included in the study. South Africa offers a R&D tax incentive which allows a 150 per cent deduction of qualifying expenditure (par 3.3). However, South Africa’s R&D tax incentive is generally available to all sizes of businesses with a specific application process and therefore not specifically designed for small businesses as the situation in the United Kingdom. India also offers a R&D tax incentive (150 per cent for an in-house R&D facility) generally to all qualifying businesses particularly manufacturing companies, irrespective of size and therefore not specific to small businesses (Singh 2017: par 1). In Australia, the R&D tax incentive offers a refundable tax offset of 43.5 per cent for qualifying R&D entities with aggregated turnover of less than \$20 million per annum (ATO 2017c: par 5). The amount of annual turnover specified is indicative that the design of the Australian R&D tax incentive is not specific to small businesses because, in Australia, a small business is considered to have an aggregated annual turnover of less than \$10 million (par 5.2). The R&D tax incentives in South Africa, Australia, and India generally apply to all qualifying businesses in those particular countries (including small businesses) but they are not specifically designed for small businesses as in the case in the United Kingdom. Refer to paragraph 6.9 for further discussion. The following paragraphs (6.3 – 6.9) present a detailed discussion of findings from the above comparison which has been done in Tables 6.1 – 6.18.

Source: Author

6.3 SMALL BUSINESS TAX INCENTIVES AVAILABLE IN ALL FOUR COUNTRIES – KEY A

There are four different tax incentives that are available in all four countries involved in this study. The study meticulously found close similarities in these incentives and hence grouped them together in this category despite the minor differences that exist either in their respective designs or implementation. In the comparative tables above, Tables 6.3, 6.5, 6.10, and 6.11 were all identified with key A, symbolising the existence (or the existence of a similar tax incentive perhaps with a different name) in South Africa, Australia, India, and the United Kingdom.

In Table 6.3 of the comparative tables, South Africa's depreciation allowance is shown to have an inherent incentive in it, whereby small businesses could make a choice to apply the more beneficial rate between wear and tear and accelerated depreciation. Australia has simplified depreciation rules which allow small businesses to allocate assets into a single pool and deduct amounts for them (at 30 per cent diminishing balance) as if they were a single asset. In India, the depreciation allowance is 10 per cent on furniture and buildings used in the business and 15 per cent for plant and machinery. An additional depreciation of 20 per cent is available on new plant and machinery, however, the allowance is 35 per cent if the items were acquired for manufacturing in the designated backward areas. In the United Kingdom, similar to Australia, items are grouped into pools depending on the rates of deduction that they qualify for. This allowance is used in the United Kingdom to claim on items if their value were in excess of the AIA or for items that do not qualify for it.

It might be worthwhile for South Africa to introduce the pooling system as applied in Australia or the United Kingdom in which depreciating assets are allocated into a single pool and amounts deducted for them as if they were one item. This could have an element of simplifying depreciation rules as Australia terms it. Small businesses do not put emphasis on maintaining books of accounts and neither do they have the funds to establish a finance function. Therefore, any new developments that could have an element of further simplifying the tedious work of finance and accounting

would be beneficial. South Africa could also borrow a leaf from the United Kingdom's Annual Investment Allowance and determine a certain amount that is an annual allowable deduction for the qualifying investments. Over and above this amount, the depreciation allowance could still be claimed if the Annual Investment Allowance amount is exhausted. Determining one block figure (like the United Kingdom's Annual Investment Allowance) could present a possibility of simplifying the depreciation allowance.

In Table 6.5 a comparison of South Africa's benefits and advantages embedded within the turnover tax system was presented and the different tax incentives from Australia, India, and the United Kingdom that have similarities with the benefits of the turnover tax regime were highlighted. South Africa allows micro-businesses to include only 50 per cent of all receipts of a capital nature into their taxable turnover. Regarding the CGT incentives comparison, all the other three countries have an element of encouraging small businesses to consider re-investing in new assets after the disposal of the ones which they originally had. Australia's capital gains tax roll-over relief of Section 152.400 subdivision 152-E of the ITAA, India's capital gains tax exemption for small businesses as highlighted in Section 54GB and 54EE of the ITA-India, and the United Kingdom's business asset roll-over relief (GOV.UK 2017d: par 1; Section 754 – 763 of CTA 2009) - all these give small business an allowance on capital gains if all or part of the proceeds from the disposal are used in replacing the disposed asset within a certain period. South Africa also allows businesses to disregard capital gains arising from the disposal of an asset if the proceeds are to be invested in acquiring a replacement asset (Part IX of the Eighth Schedule of the ITA). However, unlike Australia, India and the United Kingdom, South Africa's roll-over tax relief does not specifically apply to small businesses only; it is for all businesses irrespective of size.

In Table 6.10 the VAT (GST in Australia and India) incentives or concessions were compared. India offers a composition tax scheme which has much lower rates than the standard GST. The United Kingdom also has the VAT optimised flat rate scheme for small businesses which has lower rates than the standard 20 per cent VAT and offers an avenue for simplifying sales and purchases records. Similar to India and

the United Kingdom, South Africa could consider introducing a lower rate scheme within the main VAT system, which is intended to accommodate micro-businesses that may opt to register voluntarily for VAT. Micro-businesses in South Africa, even though they could be registered for turnover tax, could opt for a voluntary VAT registration to tap into the benefits that being VAT registered offers. Voluntary VAT registration could be necessary if such micro-businesses supply goods and services to VAT registered customers who would have to deduct the VAT charged to them. In these circumstances, South Africa's micro-businesses could benefit from a more simplified scheme within the main VAT system. Such a simplified scheme could be designed to require reduced records and have lower VAT rates (to encourage customers of micro-businesses, hence boost sales). There could be a possibility that making the VAT rate lower might instead complicate VAT for micro-businesses. The reasoning in this regard is that more records could be required from the taxpayers to qualify although they should still be much simpler in nature than those in the standard VAT system. This might require thorough thought and further investigation but introducing a less complicated scheme within the standard VAT system to accommodate micro-businesses seems worthwhile. The design of the simplified VAT scheme could enable small businesses to keep their VAT registered customers as they would be able to deduct the VAT charged from them. Entering into the VAT bracket would also allow these small businesses to tap into the advantages of being able to claim input VAT.

In Table 6.11 the venture capital incentive schemes from the four countries were compared. In all four countries, this incentive is offered to investors and it indirectly benefits the small businesses because the tax incentive attracts investment funds and re-directs them to the qualifying businesses. This incentive truly acts as a vehicle which attracts funds from investors who are enticed to invest. It also makes the funds available to the small businesses that require investing in more resources that could lead to growth and expansion.

6.4 SMALL BUSINESS TAX INCENTIVES AVAILABLE IN SOUTH AFRICA AND ANY TWO OF THE OTHER THREE COUNTRIES – KEY B

The study identified four sets of tax incentives that made this category. The capital and investment allowances identified in Table 6.2, the tax incentive related to running a small business from home in Table 6.7, the employee/employment related tax incentives in Table 6.8, and the exemption of capital gains from the disposal of active small business assets as indicated in Table 6.15. Regarding the capital allowances compared in Table 6.2, the United Kingdom has a pre-determined maximum amount of £200 000 of its Annual Investment Allowance as seen in par 5.4.1.3 a. Taxpayers could still claim a depreciation allowance after the exhaustion of the Annual Investment Allowance (as discussed in paragraph 6.3). The United Kingdom, through its first-year allowances, also allows a deduction of the full cost of plant and machinery used in gas fuelling stations. South Africa's capital allowance seems to be generally favourable (similar to the United Kingdom's Annual Investment Allowance and first-year allowances) with a streamlined focus on promoting investments in manufacturing. A comparison of South Africa's capital allowance of deducting 100 per cent of the cost of the qualifying plant or machinery in the first year, with India's 25 per cent investment allowance under somewhat similar circumstances, shows that the tax incentive in South Africa is much more favourable. South Africa deserves credit in this regard for the support to its SME sector, as allowing businesses to deduct 100 per cent of the entire cost of the qualifying asset in the first year could be a big boost to the finances of a small business hence ensuring survival.

The tax incentive that is related to running a small business from home (Table 6.7) is available in South Africa, Australia, and the United Kingdom. In all the three countries, expenditure is deducted if incurred in running a business from home, in a room that is exclusively set aside for purposes of doing business. In South Africa and Australia, expenditure has to be apportioned between business and private usage using different methods such as floor space is being used to determine and separate business from private rent. In the United Kingdom, business expenditure in the case of home run businesses could be determined using the flat rates of simplified

expenses. It could be argued that businesses that operate from home are generally very small and indeed any form of saving would be very important to their survival. Therefore, such allowable deductions of expenditure in terms of determining tax payable are crucial to the survival of the small business because they reduce the amount of the tax expense to be paid by the entity. This tax incentive is already available in South Africa and in comparison to other countries used in this study; there are no major differences in terms of its administration apart from the United Kingdom using the flat rates of the simplified expenses to determine the allocation of expenditure between private and business usage. In this regard, South Africa, like Australia, uses its own methods to determine the actual amounts of expenditure to be allocated between business and private usage such as floor space occupied in terms of working out rent. Otherwise, South Africa's tax incentive for running a small business from home does not look any less than what is offered elsewhere and therefore could be maintained as it is.

The employment tax incentive compared in Table 6.8 exists in South Africa, India, and the United Kingdom. The focus of this tax incentive differs in the different countries and in this case, South Africa's approach focuses on encouraging businesses to employ young inexperienced job seekers. The focus in India is on employment of new employees in the taxpayer's factory therefore aimed at promoting manufacturing in the country. In the United Kingdom, the aim of the incentive is to minimise the employer's costs with regard to the national insurance bill. Over and above the different intentions embedded in the different designs of this tax incentive in the respective countries, the major aim is to entice employers to employ as many people as possible. Hence, the incentive could be seen as a ploy to create more employment opportunities for the masses. South Africa's ETI may require further simplification of the arguably complex design of the ETI Act. South Africa could also review the requirements for qualification and disqualification for the ETI because some micro-businesses cannot afford paying the minimum wage as indeed identified by Piek and Fintel (2018: 1) (par 4.4.4. 1 a. and b.).

In Table 6.15, South Africa's exemption of capital gains from the disposal of the active business assets of a small business and disposal of interest in a partnership

or company was compared with restructures roll-over relief of Australia and the disincorporation relief of the United Kingdom. It should be noted that South Africa's requirements to be met by a small business to qualify for this tax incentive are very strict and limiting. Examples are requirements such as the amount to be disregarded not exceeding R1.8 million in the lifetime of a natural person. A natural person must have attained 55 years prior to the disposal of the assets or the disposal must have been triggered by ill-health and the asset must have been held by the taxpayer for a period of at least five continuous years. These requirements are very strict and make this tax incentive very difficult to qualify for.

In Australia and the United Kingdom, small business entities are allowed to restructure or transfer their businesses as going concerns with all qualifying assets to shareholders at a reduced value while disregarding the resultant tax liabilities. This tax incentive could play a vital role in that, instead of small businesses being closed with a total shutdown during difficult times, they would consider restructuring/transferring the available resources and continue operating in a new business formation. A sole proprietorship or partnership could be established as a result of a restructure of the original entity while not being bothered by the resultant taxes which should have normally ensued from the transfer of assets. It could be more feasible in difficult times to restructure a bigger business into a much smaller business that could be operated at low costs. In such a case, some assets from the original business could be transferred to one of the former shareholders in the original business and he/she would continue operating as a sole trader from his/her own home. This could indeed prevent a total shut down of the small business's operations and some customers could be maintained with a restructure of this kind, while the tax incentive would allow this transition to be smooth without worrying about tax implications. With South Africa's failure rate of new small businesses estimated to be more than 85 per cent (Rungani and Potgieter 2018: 1), there is a need for a tax incentive of this design that could allow a small business to be restructured and continue operating in a smaller and less complicated form.

6.5 SMALL BUSINESS TAX INCENTIVES AVAILABLE IN SOUTH AFRICA AND ANY ONE OF THE OTHER THREE COUNTRIES – KEY C

The study compared South Africa's turnover tax for micro-businesses with the presumptive taxation scheme of India. Table 6.4 formed the only category of tax incentives identified by key C. South Africa's turnover tax system and India's presumptive taxation scheme both aim at simplifying the taxation of small businesses as much as possible, together with the maintenance of reduced or no books of accounts at all. In both systems, no deductions are considered in the determination of annual turnover onto which tax is calculated (with regard to South Africa) and presumptive income (in terms of India). South Africa's turnover tax is arguably well structured with several underlying benefits (compared in Table 6.5), a progressive element in the rates and a turnover threshold of R335 000 for the financial year ended 28 February 2019. The taxable turnover threshold could enable the survivalist micro-businesses, whose turnover is below R335 000, to continue operating while not taking on any burden of taxation which would be detrimental to any hopes of surviving. The progressive nature of the turnover tax rates is to impose as little a tax burden as possible on micro-businesses with a lower taxable turnover.

6.6 SMALL BUSINESS TAX INCENTIVES AVAILABLE IN SOUTH AFRICA ONLY – KEY D

The key D category tax incentives that were identified by the study included Tables 6.1, 6.6, and 6.9. The study could not find small business tax incentives in Australia, India, and the United Kingdom that are close matches with these tax incentives that are offered in South Africa. In cases where similarities were identified within the different tax incentives from the other three countries, they were considered not close enough to warrant genuine comparisons. As a result, the study categorised this group of tax incentives to be available in South Africa only.

The progressive rate of taxation for Small Business Corporations (presented in Table 6.1) is one of these tax incentives. This tax incentive is distinguished from the others by the progressive rate at which businesses are taxed, which means that the higher

the taxable income of the taxpayer, the higher the tax rate. This progressive rate of tax, along with the tax threshold (R78 150 for the tax year ending 31 March 2019) is more favourable to small business corporations than the 28 per cent income tax flat rate for all companies. However, there are a few concerns surrounding this tax incentive and they may need to be addressed in order for the incentive to be made more user-friendly and beneficial to SBCs. There is also a concern that this tax incentive may not benefit small businesses that do not have taxable income. More to that, it has also been highlighted that there are complications surrounding the definition of a small business corporation and the requirements to be met for one to qualify as a SBC (par 4.2.3.2 and 4.2.3.3). Another concern is the high cost that businesses have to incur in ensuring compliance with regard to this incentive in terms of hiring professionals to manage the books of accounts. These concerns may need to be addressed by the tax authorities for the smooth running of this incentive. Further simplification, as well as giving more clarity to the terminology used in this incentive, could be a good start in making the dispensation better than it is currently.

The study also identified that the exemption of small businesses from paying the skills development levy and the concession on advance tax rulings (denoted in Tables 6.6 and 6.9), were available in South Africa only. These three tax incentives are generally very small and would have a minimal impact on the finances of a small business. For example, the concession on advance tax rulings is in the difference in the application fee; all applications are made at a cost of R14 000, whereas small businesses are only charged R2 500 to apply for either a Binding Private Ruling or a Binding Class Ruling (par 4.4.5). The difference in the application fees is R11 500 which could be considered as relief for the small business. However, the concern is that not many small businesses would have the capacity to go as far as applying for an Advance Tax Ruling. This happens seldom and therefore this tax incentive would generally have no realistic impact on the finances of the business.

It could be a similar scenario with regard to the skills development levy exemption whereby it might be seen to be too small to make a realistic positive impact on the finances of a small business. On the other hand, it could be better to let all businesses register for SDL and increase their chances of being considered for

grants by their respective SETAs (par 4.4.2.1). There is also a possibility of an employer receiving back some funds from the SETA if proof of employee training is provided. It could be a good idea for the small business to be registered for the levy, provide training and make employees better equipped to deliver on the job while at the same time, the entity (employer) claims back certain funds from the SETA. On that note, one could argue that the exemption of small businesses from registering for skills development levy is more of a disincentive to them than an incentive.

6.7 SMALL BUSINESS TAX INCENTIVES AVAILABLE IN ALL THE OTHER THREE COUNTRIES BESIDES SOUTH AFRICA – KEY E

Australia's reduced income tax rate for small businesses, India's concessional tax rate for domestic companies, and the United Kingdom's lower rate of tax for small profits of ring-fenced companies, made this category and they appear in Table 6.16. In each of the three other countries mentioned above, there is a lower rate available to small businesses (in relation to the standard income tax rate in that particular country) at which income tax could be paid. The standard income tax rate in all three countries is 30 per cent, which is 2 per cent more than South Africa's standard rate of 28 per cent. Australia's reduced income tax rate for the year 2018 – 19 is 27.5 per cent (Table 5.1) and it will continue reducing annually until reaching 25 per cent in 2026 – 27. India's concessional tax rate is 25 per cent, while the United Kingdom's lower rate for small profits of ring-fenced companies is 19 per cent. South Africa's lower rates of tax for small businesses (progressive rate of taxation for SBCs and the turnover tax scheme for micro-businesses) were not compared with the lower tax rates from the other three countries because of the distinctive differences that exist between them.

Because of the existence of the progressive rate of taxation for small business corporations and the turnover tax regime for micro-businesses in South Africa, there seems to be no need for any further reduction of the income tax rate for small businesses. There could be possible gaps that may need to be dealt with in the progressive rate of tax and the turnover tax regime, but the two systems are arguably well structured and favourable for South Africa's small businesses. In

Australia, India, and the United Kingdom, the lower rates lack a progressive element which makes South Africa's progressive rate of tax and turnover tax, more favourable because one size cannot fit all. It is, therefore, better to have a system with differing rates that progress with the level of taxable income (or taxable turnover in the case of micro-businesses).

6.8 SMALL BUSINESS TAX INCENTIVES AVAILABLE IN ANY TWO OF THE OTHER THREE COUNTRIES BUT NOT IN SOUTH AFRICA – KEY F

Tax incentives denoted by key F appear in Tables 6.12 and 6.14. As indicated in Table 6.12, Australia's immediate deduction of small business start-up expenditure was compared to India's deduction in terms of eligible start-up businesses. India's tax incentive, in particular, focuses on the promotion of small businesses that do something new and unique thus supporting innovation, technological advancements, development of new products, and having intellectual property rights. South Africa may need a tax incentive with a similar focus and approach as a measure of encouraging small businesses to engage in doing something new and unique. Both India and Australia seem to fully recognise that a small business in the start-up phase requires a lot of support until it is fully established and has some financial buffer and business acumen to rely on. South Africa could be missing exactly this mindset. A tax incentive that allows the deduction of small business start-up expenditure could go a long way in contributing to the survival of the business. This tax incentive could also ensure tax compliance by the small business because the new business would not be scared to register for tax purposes and submit returns as would be required.

Australia's income tax offset and India's deduction of amounts received by an individual member of a Hindu Undivided Family or a partnership (Table 6.14) is also classified in this category. An income tax offset exists for Australia's small businesses on the portion of their income that is from sole trading activities, partnerships or trusts. This tax incentive, therefore, enables small business entities to conduct their main business operations alongside sole trader or partnership engagements and the side income from sole proprietor or partnership activities

would be exempted from tax. This side income could be a huge bonus to the taxpayer and it could be vital in the survival of the small business as it would contribute to more funds to be invested in the main business. South Africa could consider introducing a small business income tax offset that could be implemented in a manner similar to that of Australia or with certain necessary amendments.

6.9 SMALL BUSINESS TAX INCENTIVES AVAILABLE IN ANY ONE OF THE OTHER THREE COUNTRIES BUT NOT OFFERED IN SOUTH AFRICA – KEY G

There are three tax incentives for small businesses that were identified under this category; Table 6.13 – simplified trading stock rules (available in Australia only), Table 6.17 – Business rates relief; and Table 6.18 – Research and Development tax relief (both available in the United Kingdom only). In Australia, qualifying small businesses may opt to take advantage of the simplified trading stock rules and by doing so, they may not have to undertake a detailed annual stock take or to account for changes in trading stock at the end of the financial year. The taxpayer can estimate and determine the value of the trading stock to be included in the tax return at the end of the year.

This tax incentive is not available in South Africa. However, the study does not recommend its introduction because of the weaknesses identified by Australia's tax practitioners in their own piece of legislation. Marsden, Sadiq, and Wilkins (2013: 11 – 12) noted that an annual stock take is a vital internal control mechanism that assists in determining exactly how much stock is on hand at the end of each income year. The annual stock take would help in monitoring inventory losses due to safety, obsolescence, and damage. Marsden et al (2013: 12) also argued that, under the circumstances surrounding this tax incentive in Australia, a closing stock take was still mandatory at the end of the year. In their explanation, they argued that to come up with a 'reasonable estimate', the entity would have to conduct a stock take to determine whether the value of its closing stock was within \$5 000 of its opening stock (par 5.2.1.7). South Africa's small businesses may therefore not benefit if this tax incentive was to be introduced.

The business rates relief indicated in Table 6.17 is a small business tax incentive that is only available in the United Kingdom, with regard to this study. In the United Kingdom, taxpayers who own and use the property for commercial/business purposes, pay business rates to local councils and some properties pay discounted rates based on eligibility. The discounted rates are tax incentives in their own right and most notably they include the small business rate relief, the rural rate relief, and the hardship relief (par 5.4.1.1 a. b. and c). In South Africa, similar to the United Kingdom, there are property rates (both residential and business) paid to local councils in which the particular properties are located, however, there are no discounted rates for any form or size of business (GOV.UK 2017a: par 1). The small business rate relief in particular, if introduced in South Africa, would provide relief to the small businesses as well as encouraging them to acquire their own properties instead of operating in rented premises.

The United Kingdom's Research and Development tax relief which is indicated in Table 6.18 is specifically offered to small businesses unlike the R&D tax incentives in South Africa, Australia, and India which apply generally to all businesses. For that reason, the study recorded only the United Kingdom's R&D tax relief and ignored those of the other three countries because they were not specifically designed for small businesses (refer to the comparative comment on Table 6.18). South Africa's R&D tax incentive, which generally applies to all sizes of companies, has been available for over 10 years but it has not benefited small businesses and this has led to the cry of many. Paluch (2015: par 6) lamented that there was little benefit for small businesses from South Africa's R&D tax incentive because the majority of them were in a tax loss situation. He suggested that the incentive should be made more meaningful to small businesses because they are hugely important to innovation in the economy. Paluch (2015: par 9) added that South Africa should follow the example of other countries which provide for a refund for smaller companies within their R&D tax incentive.

South Africa's R&D tax incentive underwent a review in 2015/16 by a joint Government-Industry task team established by the former Minister of Science and

Technology – Miss Naledi Pandor (Timm 2017: par 8), however, the implementation of some key reforms is still not realised. Timm (2017: par 3) particularly noted that the introduction of a refundable tax credit within South Africa’s R&D tax incentive was one of several recommendations made by the task team and that it would make the incentive significantly more favourable to small businesses. In fact, Timm (2017: par 4) adds that according to the task team, a refundable tax credit for small businesses, which is also in use in the United Kingdom together with a few other countries that were mentioned, would make the incentive more attractive to small businesses. This recommendation of the task team is however not yet implemented to date. Based on the above, South Africa’s R&D tax incentive may need to be re-designed to include a tax credit which would accommodate small businesses, as is the case with the United Kingdom.

6.10 RECOMMENDATIONS

This study investigated the question of whether there were any areas of concern within South Africa’s small business tax incentives. It also investigated whether there were any small business tax incentives available in Australia, India, and the United Kingdom that are not in South Africa which could be introduced to improve South Africa’s small business tax system (par 1.4). South Africa’s small business tax incentives were identified and discussed and the possible gaps and areas of concern were put forward. The small business tax incentives that are offered by Australia, India, and the United Kingdom were identified, discussed, and compared with South Africa’s small business tax incentives. As a result, the study identified a few small business tax incentives that are available in the three countries but not in South Africa and possibly, if introduced, they could contribute to improving the small business tax system. Some of South Africa’s small business tax incentives could also be amended to make them more favourable to the small business sector.

The following recommendations made by the study are hereby documented for consideration with a view that they could possibly contribute towards improving the small business tax incentives available in South Africa:

1. Introduce the asset pooling system to simplify depreciation for small businesses so that taxpayers can allocate a group of assets to a single pool and depreciate them at a certain determined percentage as if they were one item (par 6.3).
2. Introduce an Annual Investment Allowance and determine a certain amount of the annual deduction for qualifying investments. The depreciation allowance should still be claimed over and above this amount in situations where a taxpayer has exhausted the investment allowance for that particular year (par 6.3).
3. Introduce a simplified lower rate scheme within the main VAT system to accommodate micro-businesses which may opt to voluntarily register for VAT (par 6.3).
4. Simplify the ETI Act and review the requirements for qualification and disqualification of taxpayers to make them more favourable to small businesses (par 6.4).
5. Introduce a small business restructures roll-over relief that could allow small businesses to be restructured if the need arises. This shall allow assets to be transferred in the process from the main businesses to a smaller and less complex form of business (which continues to be operated) without incurring capital gains tax on the movement of assets (par 6.4).
6. Introduce an immediate deduction of small business start-up expenditure which would allow new small businesses that are engaged in the production of specific products (such as new and unique products) to deduct their qualifying start-up expenditure in the first year of doing business (par 6.8).
7. Introduce a small business income tax offset that could allow small business taxpayers to conduct their main business operations alongside private sole proprietor or partnership engagements for which the resultant income would be

exempted from income tax in the computation of the taxable income of the main business (par 6.8).

8. Introduce small business rate relief for business properties owned and used/occupied by small businesses so that there are either no business rates paid for properties that do not exceed a certain amount or lower rates are paid to the local municipality than those paid by larger businesses (par 6.9).
9. Amend the Research and Development tax incentive to include a refundable tax credit which would make it more favourable to small businesses (par 6.9).

6.11 FURTHER RESEARCH

The study identified the following areas for further research:

- Implementation of the recommended small business tax incentives

As indicated in par 3.6.1 and 3.6.2, there is a lot that must be considered regarding the choice and eligibility criteria that must be followed before implementing a tax incentive. The government of South Africa cannot simply introduce the recommended small business tax incentives without conducting further research on their suitability to the country's economic environment. A further study could, therefore, investigate whether South Africa's small business tax incentives have a positive contribution to the economy and whether the recommended amendments and new incentives could be of any benefit to small businesses.

- Possible solutions to areas of concern within South Africa's small business tax incentives

A quantitative study which is conducted using actual data from small businesses themselves might be needed to validate the current thesis's findings regarding the weaknesses identified within South Africa's small business tax incentives. This

study, therefore, recommends a quantitative thorough investigation of the possible solutions to the identified pitfalls.

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ANNEXURE A

SECTION 12E: DEDUCTIONS IN RESPECT OF SMALL BUSINESS CORPORATIONS

(1) Where any plant or machinery (hereinafter referred to as an asset) owned by a taxpayer which qualifies as a small business corporation or acquired by such a taxpayer as purchaser in terms of an agreement contemplated in paragraph (a) of

the definition of “instalment credit agreement” in section 1 of the Value-Added Tax Act—

- (a) is brought into use for the first time by that taxpayer on or after 1 April 2001 for the purpose of that taxpayer’s trade (other than mining or farming); and
- (b) is used by that taxpayer directly in a process of manufacture (or any other process which is of a similar nature) carried on by that taxpayer,

[Para. (b) substituted by s. 21 of Act No. 25 of 2015.]

a deduction equal to the cost of such asset shall be allowed in the year that such asset is so brought into use.

[Sub-s. (1) amended by s. 21 (a) of Act No. 31 of 2005 and by s. 35 (a) of Act No. 31 of 2013.]

(1A) Subject to subsection (1), where any machinery, plant, implement, utensil, article, aircraft or ship in respect of which a deduction is allowable under section 11 (e) (“the asset”) is acquired by a small business corporation under an agreement formally and finally signed by every party to the agreement on or after 1 April 2005, the amount allowed to be deducted in respect of the asset must, at the election of the small business corporation and subject to the provisions of that section, be either—

- (a) the amount allowable in terms of and subject to that section; or
- (b) an amount equal to 50 per cent of the cost of the asset in the year of assessment during which it was first brought into use, 30 per cent in the first succeeding year and 20 per cent in the second succeeding year.

[Sub-s. (1A) inserted by s. 9 (1) (a) of Act No. 9 of 2005 and substituted by s. 13 of Act No. 3 of 2008.]

(2) For purposes of this section the cost to a taxpayer of any asset shall be deemed to be the lesser of the actual cost to the taxpayer to acquire that asset or the cost which a person would, if he had acquired the said asset under a cash transaction concluded at arm’s length on the date on which the transaction for the acquisition of the asset was in fact concluded, have incurred in respect of the direct cost of acquisition of the asset, including the direct cost of the installation or erection thereof.

[Sub-s. (2) substituted by s. 21 (b) of Act No. 31 of 2005 and by s. 26 (a) of Act No. 17 of 2017.]

(3) Any expenditure (other than expenditure referred to in section 11 (a)) incurred by a taxpayer during any year of assessment in moving an asset in respect

of which a deduction was allowed or is allowable under this section from one location to another must—

- (a) where the taxpayer is or was entitled to a deduction in respect of that asset under subsection (1A) in that year and one or more succeeding years, be allowed to be deducted from his or her income in equal instalments in that year and each succeeding year in which that deduction is allowable; or
- (b) in any other case, be allowed to be deducted from that taxpayer's income in that year.

[Sub-s. (3) substituted by s. 9 (1) (b) of Act No. 9 of 2005 deemed to have come into operation on 1 April, 2005 and applicable in respect of any asset acquired by a small business corporation under an agreement formally and finally signed by every party to the agreement on or after that date.]

(3A)

[Sub-s. (3A) inserted by s. 31 (1) (d) of Act No. 45 of 2003 and deleted by s. 9 (1) (c) of Act No. 9 of 2005 deemed to have come into operation on 1 April, 2005 and applicable in respect of any year of assessment which ends on or after that date.]

(4) For the purposes of this section—

- (a) “**small business corporation**” means any close corporation or co-operative or any private company as defined in section 1 of the Companies Act or a personal liability company as contemplated in section 8 (2) (c) of the Companies Act if at all times during the year of assessment all the holders of shares in that company, co-operative, close corporation or personal liability company are natural persons, where—

(i) the gross income for the year of assessment does not exceed an amount equal to R20 million: Provided that where the close corporation, co-operative or company during the relevant year of assessment carries on any trade, for a period 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 a part of a month shall be reckoned as a full month), during which that company, co-operative or close corporation carried on that trade bears to 12 months;

[Sub-para. (i) amended by s. 17 (1) of Act No. 30 of 2002, by s. 37 (1) of Act No. 12 of 2003, by s. 9 (1) (d) of Act No. 9 of 2005, by s. 24 of Act No. 9 of 2006, substituted by s. 15 (1) of Act No. 8 of 2007,

by s. 23 (1) (b) of Act No. 7 of 2010, amended by s. 7 (1) of Act No. 23 of 2013 and by s. 26 (b) of Act No. 17 of 2017.]

(ii)

at any time during the year of assessment, no holder of shares in the company or member of the 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—

(aa)

a company contemplated in paragraph (a) of the definition of “listed company”;

(bb)

any portfolio in a collective investment scheme contemplated in paragraph (e) of the definition of “company”;

[Item (bb) amended by s. 23 (1) (a) of Act No. 60 of 2008.]

(cc)

a company contemplated in section 10 (1) (e) (i) (aa), (bb) or (cc);

[Item (cc) amended by s. 23 (1) (b) of Act No. 60 of 2008 and substituted by s. 23 (1) (c) of Act No. 7 of 2010 deemed to have come into operation as from the commencement of years of assessment ending on or after 1 January, 2009.]

(dd)

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 of the income derived from the trade of that co-operative during any year of assessment is solely derived from its members;

[Item (dd) inserted by s. 14 (b) of Act No. 20 of 2006 and substituted by s. 25 (b) of Act No. 35 of 2007.]

(ee)

any friendly society as defined in section 1 of the Friendly Societies Act, 1956 (Act No. 25 of 1956);

[Item (ee) inserted by s. 14 (b) of Act No. 20 of 2006 and amended by s. 25 (c) of Act No. 35 of 2007 and by s. 23 (1) (c) of Act No. 60 of 2008 with effect from 1 July, 2009.]

(ff)

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-operative Banks Act, 2007, that may provide, participate in or undertake only the following—

(A)

in the case of a primary savings co-operative bank, banking services contemplated in section 14 (1) (a) to (d) of that Act; and

(B)

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;

[Item (ff) added by s. 25 (d) of Act No. 35 of 2007 and amended by s. 23 (1) (d) of Act No. 60 of 2008 and by s. 23 (1) (d) of Act No. 7 of 2010 with effect from the commencement of years of assessment commencing on or after 1 January, 2011.]

(gg)

a venture capital company as defined in section 12J;

[Item (gg) added by s. 23 (1) (e) of Act No. 60 of 2008 with effect from 1 July, 2009.]

(hh)

any company, close corporation or co-operative if the company, close corporation or co-operative—

(A)

has not during any year of assessment carried on any trade; and

(B)

has not during any year of assessment owned assets, the total market value of which exceeds R5 000; or

[Item (hh) added by s. 21 of Act No. 17 of 2009 and amended by s. 23 (1) (e) of Act No. 7 of 2010 with effect from the commencement of years of assessment commencing on or after 1 January, 2011.]

(ii)

any company, co-operative or close corporation if the company, co-operative or close corporation has taken the steps contemplated in section 41 (4) to liquidate, wind up or deregister: Provided that this item ceases to apply if the company, co-operative or close corporation has at any stage withdrawn any step so taken or does anything to invalidate any step so taken, with the result that the company, co-operative or close corporation will not be liquidated, wound up or deregistered;

[Sub-para. (ii) substituted by s. 21 of Act No. 74 of 2002, by s. 31 (1) (b) of Act No. 45 of 2003 and amended by s. 25 (a) of Act No. 35 of 2007 and by s. 20 of Act No. 43 of 2014. Item (ii) added by s. 23 (1) (f) of Act No. 7 of 2010 and substituted by s. 25 of Act No. 22 of 2012.]

(iii)

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

[Sub-para. (iii) substituted by s. 31 (1) (c) of Act No. 45 of 2003 and by s. 25 (e) of Act No. 35 of 2007.]

(iv)
such company is not a personal service provider as defined in the Fourth Schedule;

[Para. (a) amended by s. 14 (a) of Act No. 20 of 2006, by s. 23 (1) (a) of Act No. 7 of 2010, by s. 35 (b) of Act No. 31 of 2013 and by s. 29 (1) of Act No. 15 of 2016 deemed to have come into operation on 1 May, 2011 and applicable in respect of years of assessment ending on or after that date. Sub-para. (iv) substituted by s. 23 (1) (f) of Act No. 60 of 2008 with effect from 1 March, 2009 and applicable in respect of a year of assessment commencing on or after that date.]

(b)

.....
[Para. (b) deleted by s. 23 (1) (g) of Act No. 60 of 2008 with effect from 1 March, 2009 and applicable in respect of a year of assessment commencing on or after that date.]

(c)

“investment income” means—

(i)
any income in the form of dividends, foreign dividends, royalties, rental derived in respect of immovable property, annuities or income of a similar nature;

[Sub-para. (i) substituted by s. 14 (c) of Act No. 20 of 2006 and by s. 34 (1) (a) of Act No. 24 of 2011 with effect from 1 April, 2012.]

(ii)
any interest as contemplated in section 24J (other than any interest received by or accrued to any co-operative bank as contemplated in paragraph (a) (ii) (ff)), any amount contemplated in section 24K and any other income which, by the laws of the Republic administered by the Commissioner, is subject to the same treatment as income from money lent; and

[Sub-para. (ii) substituted by s. 25 (f) of Act No. 35 of 2007.]

(iii)
any proceeds derived from investment or trading in financial instruments (including futures, options and other derivatives), marketable securities or immovable property;

(d)

“personal service”, in relation to a company, co-operative or close corporation, means any service in the field of accounting, actuarial science, architecture, auctioneering, auditing, broadcasting, consulting, draftsmanship, education, engineering, financial service broking, health, information technology, journalism, law, management, real estate broking, research, sport, surveying, translation, valuation or veterinary science, if—

(i)

that service is performed personally by any person who holds an interest in that company, co-operative or close corporation or by any person that is a connected person in relation to any person holding such an interest; and

[Sub-para. (i) substituted by s. 26 (c) of Act No. 17 of 2017.]

(ii)

that company, co-operative or close corporation does not throughout the year of assessment employ three or more full-time employees (other than any employee who is a holder of a share in the company or a member of the co-operative or close corporation, as the case may be, or who is a connected person in relation to a holder of a share in the company or a member), who are on a full-time basis engaged in the business of that company, co-operative or close corporation of rendering that service.

[S. 12E inserted by s. 12 of Act No. 19 of 2001 and amended by s. 31 (1) (a) of Act No. 45 of 2003 with effect from the date of promulgation of that Act, 22 December, 2003 and applicable in respect of any year of assessment ending on or after that date. Para. (d) substituted by s. 9 (1) (e) of Act No. 9 of 2005, amended by s. 14 (d) of Act No. 20 of 2006 and by s. 23 (1) (g) of Act No. 7 of 2010 and substituted by s. 34 (1) (b) of Act No. 24 of 2011. Sub-para. (ii) substituted by s. 35 (c) of Act No. 31 of 2013.]

ANNEXURE B

SIXTH SCHEDULE

[Sixth Schedule added by s. 28 (1) of Act No. 90 of 1972, amended by ss. 27 to 41 inclusive of Act No. 65 of 1973, by ss. 63 to 68 inclusive of Act No. 85 of 1974, by s. 37 of Act No. 69 of 1975, by s. 19 of Act No. 101 of 1978, by s. 29 of Act No. 96 of 1981, by ss. 58 and 59 of Act No. 94 of 1983, by s. 45 of Act No. 121 of 1984, by ss. 21 to 25 inclusive of Act No. 96 of 1985, by ss. 31 and 32 of Act No. 65 of 1986 and by ss. 26 (b) and 27 of Act No. 85 of 1987, repealed by s. 51 (1) of Act No. 113 of 1993 and inserted by s. 71 (1) of Act No. 60 of 2008 with effect from 1 March, 2009 and applicable in respect of a year of assessment commencing on or after that date.]

DETERMINATION OF TURNOVER TAX PAYABLE BY MICRO BUSINESSES (Part IV of Chapter II)

<u>Part I:</u>	Interpretation
<u>Part II:</u>	Application of Schedule

<u>Part III:</u>	Taxable turnover
<u>Part IV:</u>	Registration
<u>Part V:</u>	Administration
<u>Part VI:</u>	Miscellaneous

PART I
INTERPRETATION
DEFINITIONS

1. In this Schedule, unless the context indicates otherwise, any meaning ascribed to a word or expression in this Act must bear the meaning so ascribed and—

“investment income” means—

(i)

any income in the form of annuities, dividends, foreign dividends, interest, rental derived in respect of immovable property, royalties, or income of a similar nature; and

[Para. (i) substituted by s. 68 of Act No. 23 of 2018.]

(ii)

any proceeds derived from the disposal of financial instruments;

[Definition of “investment income” inserted by s. 85 (1) (a) of Act No. 7 of 2010 with effect from the commencement of years of assessment commencing on or after 1 March, 2011.]

“micro business” means a person that meets the requirements set out in Part II of this Schedule;

“professional service” means a service in the field of accounting, actuarial science, architecture, auctioneering, auditing, broadcasting, consulting, draftsmanship, education, engineering, financial service broking, health, information technology, journalism, law, management, real estate broking, research, sport, surveying, translation, valuation or veterinary science;

[Definition of “professional service” substituted by s. 85 (1) (b) of Act No. 7 of 2010 with effect from the commencement of years of assessment commencing on or after 1 March, 2011.]

“qualifying turnover” means the total receipts from carrying on business activities, excluding any—

(a) amount of a capital nature; and

(b) amount exempt from normal tax in terms of section 10 (1) (zK) or 12P;

[Para. (b) substituted by s. 88 of Act No. 25 of 2015 and by s. 64 of Act No. 15 of 2016.]

“**registered micro business**” means a micro business that is registered in terms of paragraph 8;

“**taxable turnover**” means the amount determined in terms of paragraph 5 of this Schedule.

PART II

APPLICATION OF SCHEDULE

PERSONS THAT QUALIFY AS MICRO BUSINESSES

2. (1) A person qualifies as a micro business if that person is a—

- (a) natural person (or the deceased or insolvent estate of a natural person that was a registered micro business at the time of death or insolvency); or
- (b) company,

where the qualifying turnover of that person for the year of assessment does not exceed an amount of R1 million.

(2) If a person described in subparagraph (1) carries on a business during the relevant year of assessment for a period which is less than 12 months, the amount described in subparagraph (1) is reduced proportionally taking into account the number of full months that it did not carry on business during that year.

PERSONS THAT DO NOT QUALIFY AS MICRO BUSINESSES

3. A person does not qualify as a micro business for a year of assessment where—

- (a) that person at any time during that year of assessment holds any shares or has any interest in the equity of a company other than a share or interest described in paragraph 4;
- (b) more than 20 per cent of that person’s total receipts during that year of assessment consists of—

(i)

where that person is a natural person (or the deceased or insolvent estate of a natural person that was a registered micro business at the time of death or insolvency), income from the rendering of a professional service; and

(ii)
where that person is a company, investment income and income from the rendering of a professional service;

[Sub-para. (b) substituted by s. 86 (1) (a) of Act No. 7 of 2010 with effect from the commencement of years of assessment commencing on or after 1 March, 2011.]

(c)
at any time during that year of assessment that person is a “personal service provider” or a “labour broker”, as defined in the Fourth Schedule, other than a labour broker in respect of which a certificate of exemption has been issued in terms of paragraph 2 (5) of that Schedule;

(d)

.....
[Sub-para. (d) deleted by s. 86 (1) (b) of Act No. 7 of 2010 with effect from the commencement of years of assessment commencing on or after 1 March, 2011.]

(e)

the total of all amounts received by that person from the disposal of—

(i)
immovable property used mainly for business purposes; and
[Item (i) substituted by s. 86 (1) (c) of Act No. 7 of 2010 with effect from the commencement of years of assessment commencing on or after 1 March, 2011.]

(ii)
any other asset of a capital nature used mainly for business purposes, other than any financial instrument,

[Item (ii) substituted by s. 86 (1) (c) of Act No. 7 of 2010 with effect from the commencement of years of assessment commencing on or after 1 March, 2011.]

exceeds R1,5 million over a period of three years comprising the current year of assessment and the immediately preceding two years of assessment, or such shorter period during which that person was a registered micro business;

(f)

in the case of a company—

(i)
its year of assessment ends on a date other than the last day of February;

(ii)

at any time during its year of assessment, any holder of shares in that micro business is a person other than a natural person (or the deceased or insolvent estate of a natural person);

[Item (ii) substituted by s. 114 (a) of Act No. 31 of 2013.]

(iii)

at any time during its year of assessment, any holder of shares in that micro business holds any shares or has any interest in the equity of any other company other than a share or interest described in paragraph 4: Provided that the provisions of this item do not apply to the holding of any shares in or interest in the equity of a company, if the company—

(aa)

has not during any year of assessment—

(A)

carried on any trade; and

(B)

owned assets, the total market value of which exceeds R5 000;
or

[Para. (aa) substituted by s. 86 (1) (d) of Act No. 7 of 2010 with effect from the commencement of years of assessment commencing on or after 1 March, 2011.]

(bb)

has taken the steps contemplated in section 41 (4) to liquidate, wind up or deregister: Provided further that this paragraph ceases to apply if the company has at any stage withdrawn any step so taken or does anything to invalidate any step so taken, with the result that the company will not be liquidated, wound up or deregistered;

[Item (iii) amended by s. 63 of Act No. 17 of 2009 and by s. 114 (b) of Act No. 31 of 2013. Para. (bb) substituted by s. 86 (1) (d) of Act No. 7 of 2010 with effect from the commencement of years of assessment commencing on or after 1 March, 2011.]

(iv)

it is a public benefit organisation approved by the Commissioner in terms of section 30;

[Item (iv) amended by s. 89 (a) of Act No. 25 of 2015.]

(v)

it is a recreational club approved by the Commissioner in terms of section 30A;

(vi)

it is an association approved by the Commissioner in terms of section 30B; or
[Item (vi) added by s. 89 (b) of Act No. 25 of 2015.]

(vii)
it is a small business funding entity approved by the Commissioner in terms of section 30C;
[Item (vii) added by s. 89 (b) of Act No. 25 of 2015.]

(g) in the case of a person that is a partner in a partnership during that year of assessment—

(i)
any of the partners in that partnership is not a natural person;

(ii)
that person is a partner in more than one partnership at any time during that year of assessment; or

[Item (ii) amended by s. 86 (1) (e) of Act No. 7 of 2010 and by s. 97 (1) (a) of Act No. 24 of 2011 with effect from the commencement of years of assessment commencing on or after 1 March, 2012.]

(iii)
the qualifying turnover of that partnership for that year of assessment exceeds the amount described in paragraph 2.

[Item (iii) amended by s. 86 (1) (f) of Act No. 7 of 2010 and by s. 97 (1) (b) of Act No. 24 of 2011 with effect from the commencement of years of assessment commencing on or after 1 March, 2012.]

(iv)

.....
[Item (iv) added by s. 86 (1) (g) of Act No. 7 of 2010 and deleted by s. 97 (1) (c) of Act No. 24 of 2011 with effect from the commencement of years of assessment commencing on or after 1 March, 2012.]

(h)

.....
[Sub-para. (h) added by s. 86 (1) (h) of Act No. 7 of 2010 and deleted by s. 97 (1) (d) of Act No. 24 of 2011 with effect from the commencement of years of assessment commencing on or after 1 March, 2012.]

PERMISSIBLE SHARES AND INTERESTS

4. The disqualification in terms of paragraph 3 (a) or 3 (f) (iii) does not apply to a share or interest—

(a) in a company as described in paragraph (a) of the definition of a “listed company”;

(b)

in a portfolio in a collective investment scheme as described in paragraph (e) of the definition of a company;

- (c) in a company as described in section 10 (1) (e);
- (d) in a venture capital company as defined in section 12J;
- (e) that constitutes 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 of the income derived from the trade of that co-operative during any year of assessment is solely derived from its members;
- (f) that constitutes 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-operative Banks Act, 2007 (Act No. 40 of 2007), that may provide, participate in or undertake only banking services as described in section 14 (2) (a) or (b) of that Act; or
- (g) in any friendly society as defined in section 1 of the Friendly Societies Act, 1956 (Act No. 25 of 1956).

PART III

TAXABLE TURNOVER

TAXABLE TURNOVER

5. The taxable turnover of a registered micro business in relation to any year of assessment consists of all amounts not of a capital nature received by that registered micro business during that year of assessment from carrying on business activities in the Republic, including amounts described in paragraph 6 and excluding amounts described in paragraph 7, less any amounts refunded to any person by that registered micro business in respect of goods or services supplied by that registered micro business to that person during that year of assessment or any previous year of assessment.

[Para. 5 substituted by s. 87 (1) of Act No. 7 of 2010 with effect from the commencement of years of assessment commencing on or after 1 March, 2011.]

INCLUSIONS IN TAXABLE TURNOVER

6. The taxable turnover of a registered micro business includes—

- (a) 50 per cent of all receipts of a capital nature from the disposal of—

(i)
immovable property mainly used for business purposes, other than trading stock; and

[Item (i) substituted by s. 88 (1) (a) of Act No. 7 of 2010 with effect from the commencement of years of assessment commencing on or after 1 March, 2011.]

(ii)
any other asset used mainly for business purposes, other than any financial instrument; and

[Item (ii) substituted by s. 88 (1) (a) of Act No. 7 of 2010 with effect from the commencement of years of assessment commencing on or after 1 March, 2011.]

(b)
in the case of a company, investment income (other than dividends and foreign dividends).

[Sub-para. (b) substituted by s. 88 (1) (b) of Act No. 7 of 2010 and by s. 98 (1) of Act No. 24 of 2011 with effect from 1 April, 2012.]

(c)

.....
[Sub-para. (c) deleted by s. 88 (1) (c) of Act No. 7 of 2010 with effect from the commencement of years of assessment commencing on or after 1 March, 2011.]

EXCLUSIONS FROM TAXABLE TURNOVER

7. The taxable turnover of a registered micro business does not include—

(a)
in the case of a natural person, investment income;

[Sub-para. (a) substituted by s. 89 (1) (a) of Act No. 7 of 2010 with effect from the commencement of years of assessment commencing on or after 1 March, 2011.]

(b)
any amount exempt from normal tax in terms of section 10 (1) (zK) or 12P;

[Sub-para. (b) substituted by s. 115 (1) of Act No. 31 of 2013 and by s. 65 of Act No. 15 of 2016.]

(c)
any amount received by that registered micro business where that amount accrued to it prior to its registration as a micro business and that amount accrued was subject to tax in terms of this Act; and

[Sub-para. (c) amended by s. 89 (1) (b) of Act No. 7 of 2010 with effect from the commencement of years of assessment commencing on or after 1 March, 2011.]

(d)

any amount received by that registered micro business from any person by way of a refund in respect of goods or services supplied by that person to that registered micro business.

[Sub-para. (d) added by s. 89 (1) (c) of Act No. 7 of 2010 with effect from the commencement of years of assessment commencing on or after 1 March, 2011.]

PART IV

REGISTRATION

REGISTRATION

8. (1) A person that meets the requirements set out in Part II may elect to be registered as a micro business—

(a)

before the beginning of a year of assessment or such later date during that year of assessment as the Commissioner may prescribe by notice in the *Gazette*; or

(b)

in the case of a person that commenced business activities during a year of assessment, within two months from the date of commencement of business activities.

(2) A person that elected to be registered in terms of subparagraph (1) must be registered by the Commissioner with effect from the beginning of that year of assessment.

(3) A person that is deregistered in terms of paragraph 9 or 10 may not again be registered as a micro business.

[Sub-para. (3) substituted by s. 99 (1) of Act No. 24 of 2011 with effect from the commencement of years of assessment commencing on or after 1 March, 2012.]

VOLUNTARY DEREGISTRATION

9. (1) A registered micro business may elect to be deregistered before the beginning of a year of assessment or such later date during that year of assessment as the Commissioner may prescribe by notice in the *Gazette*.

(2) A registered micro business that elects to be deregistered under subparagraph (1) must be deregistered by the Commissioner with effect from the beginning of that year of assessment.

(3)

[Sub-para. (3) deleted by s. 72 (1) of Act No. 43 of 2014 with effect from 1 January, 2016 and applicable in respect of years of assessment commencing on or after that date.]

COMPULSORY DEREGISTRATION

10. (1) A registered micro business must notify the Commissioner within 21 days from the date on which—

- (a) the qualifying turnover of that registered micro business for a year of assessment exceeds the amount described in paragraph 2, or there are reasonable grounds for believing that the qualifying turnover will exceed that amount; or
- (b) that registered micro business is disqualified in terms of paragraph 3.

(2) The Commissioner must, subject to subparagraph (3), deregister a registered micro business with effect from the beginning of the month following the month during which the event as described in subparagraph (1) (a) or (1) (b) occurred.

[Sub-para. (2) substituted by s. 116 of Act No. 31 of 2013.]

(3) If the increase in the qualifying turnover of that person to an amount greater than the amount described in paragraph 2 is of a nominal and temporary nature, the person must apply to the Commissioner for a decision whether the person must remain a registered micro business or not.

[Sub-para. (3) substituted by s. 90 of Act No. 25 of 2015.]

(4)

[Sub-para. (4) deleted by s. 100 (1) of Act No. 24 of 2011 with effect from the commencement of years of assessment commencing on or after 1 March, 2012.]

PART V

ADMINISTRATION

INTERIM PAYMENTS

11. (1) A registered micro business must, within six calendar months from the first day of the year of assessment—

- (a) estimate the taxable turnover for the year of assessment;
- (b) calculate the amount of tax payable on the estimated taxable turnover; and
- (c) pay an amount equal to 50 per cent of the amount of tax so calculated.

(2) The estimate described in paragraph (1) (a) may not be less than the taxable turnover of the previous year of assessment unless the Commissioner, on application by the taxpayer and having regard to the circumstances, approves a lower estimate.

[Sub-para. (2) substituted by s. 91 of Act No. 25 of 2015.]

(3) Where full payment of the amount described in subparagraph (1) (c) is not received by the Commissioner within six calendar months from the first day of the year of assessment, interest at the prescribed rate is payable from the first day after the six calendar months to the earlier of the date on which the shortfall is received and the last day of the year of assessment.

(3)

(Pending amendment: Sub-para. (3) to be deleted by s. 271 read with para. 99 (a) of Sch. 1 of Act No. 28 of 2011 with effect from a date to be determined by the President by proclamation in the *Gazette* – date not determined to the extent that Sch. 1 amends or repeals a provision relating to interest: Proclamation No. 51 in *Government Gazette* 35687 of 14 September, 2012.)

(4) A registered micro business must, by the last day of the year of assessment—

- (a) estimate the taxable turnover for the year of assessment;
- (b) calculate the amount of tax payable on the estimated taxable turnover; and
- (c) pay an amount equal to the amount of tax so calculated less the amount paid in terms of subparagraph (1).

(4A) For the purposes of paragraph 2 (1) of the Fourth Schedule, section 89bis (2), section 6 of the Skills Development Levies Act, 1999 (Act No. 9 of 1999), and section 8 of the Unemployment Insurance Contributions Act, 2002 (Act No. 4 of 2002), a registered micro business may elect to pay the amounts deducted or withheld in terms of that paragraph or those sections to the Commissioner—

(i) with regard to amounts deducted or withheld during the first six calendar months from the first day of the year of assessment, within seven days after the end of such period; and

(ii) with regard to amounts deducted or withheld within the next six calendar months following the period in item (i), within seven days after the end of such period.

[Sub-para. (4A) inserted by s. 26 (1) (a) of Act No. 21 of 2012 and substituted by s. 15 (1) (a) of Act No. 39 of 2013 with effect from 1 March, 2014 and applicable in respect of tax periods commencing on or after that date.]

(4B) If a registered micro business has made an election in terms of subparagraph (4A), the election must apply to all amounts deducted or withheld in terms of the applicable provisions referred to in that subparagraph.

[Sub-para. (4B) inserted by s. 15 (1) (b) of Act No. 39 of 2013 with effect from 1 March, 2014 and applicable in respect of tax periods commencing on or after that date.]

(5) Where full payment of the amount described in subparagraph (4) (c) is not received by the Commissioner by the last day of the year of assessment, interest at the prescribed rate is payable from the day following the last day of the year of assessment to the earlier of the date on which the shortfall is received and the due date of the assessment for that year of assessment.

(6) Where the estimate described in subparagraph 4 (a) is less than 80 per cent of the taxable turnover for the year of assessment, a penalty, which is deemed to be a percentage based penalty imposed under Chapter 15 of the Tax Administration Act, equal to 20 per cent of the difference between the tax payable on 80 per cent of the taxable turnover for the year of assessment and the tax payable on that estimate must be charged.

[Sub-para. (6) substituted by s. 271 read with para. 99 (b) of Sch. 1 of Act No. 28 of 2011 and by s. 26 (1) (b) of Act No. 21 of 2012 (Editorial Note: effective date in s. 26 (2) of Act No. 21 of 2012 substituted by s. 67 of Act No. 44 of 2014).]

(7) Where the Commissioner is satisfied that the estimate described in subparagraph (4) (a) was not deliberately or negligently understated and was seriously made based on the information available, or is partly so satisfied, the Commissioner must waive the penalty charged in terms of subparagraph (6) in full or in part.

[Sub-para. (7) substituted by s. 26 (1) (c) of Act No. 21 of 2012 (Editorial Note: effective date in s. 26 (2) of Act No. 21 of 2012 substituted by s. 67 of Act No. 44 of 2014).]

(8) Where the Commissioner has issued an assessment in respect of the payment required in terms of subparagraph (4), a penalty must not be imposed in terms of subparagraph (6).

[Sub-para. (8) substituted by s. 271 read with para. 99 (c) of Sch. 1 of Act No. 28 of 2011.]

12.

[Para. 12 repealed by s. 271 read with para. 100 of Sch. 1 of Act No. 28 of 2011.]

PART VI

MISCELLANEOUS

AMOUNTS RECEIVED BY A CONNECTED PERSON MAY BE INCLUDED IN QUALIFYING TURNOVER

13. The total amount received from carrying on business activities by a connected person in relation to a person described in paragraph 2 (1) (a) or (b) must be included in the qualifying turnover of that person for purposes of applying paragraph 2, where—

- (a) the connected person carries on business activities that should properly be regarded as forming part of the business activities carried on by that person; and
- (b) the main reason or one of the main reasons for the connected person carrying on business activities in the way that the connected person does is to ensure that the qualifying turnover of that person does not exceed the amount as described in that paragraph.

[Para. 13 amended by s. 92 of Act No. 25 of 2015.]

RECORD KEEPING

14. Notwithstanding the provisions of Part A of Chapter 4 of the Tax Administration Act, a registered micro business must only retain a record of—

- (a) amounts received by that registered micro business during a year of assessment;
- (b) dividends declared by that registered micro business during a year of assessment;
- (c) each asset of that registered micro business as at the end of a year of assessment with a cost price of more than R10 000; and
- (d) each liability of that registered micro business as at the end of a year of assessment that exceeded R10 000.

[Para. 14 amended by s. 271 read with para. 101 of Sch. 1 of Act No. 28 of 2011.]

15.

[Para. 15 repealed by s. 271 read with para. 102 of Sch. 1 of Act No. 28 of 2011.]

