

# A discussion of the tax burden on SMEs in South Africa

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## DECLARATION

I declare that "***A discussion of the tax burden on SMEs in South Africa***" is my own work; that all sources used or quoted have been indicated and acknowledged by means of complete references and that this mini-dissertation was not previously submitted by me or any person for degree purposes at this or any other university.

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**SIGNATURE**

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**DATE**

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## **ABSTRACT**

Small and medium-sized enterprises (SMEs) contribute to the GDP and aid in job creation and are thus vital to the economy as well as being a key factor in the business sector with regard to the high rate of unemployment. Despite its importance, the SME business sector has a high failure rate; most previous research studies have, inter alia, identified tax-related issues as a reason for this. The significance of SMEs to the South African economy suggests that they should be able to function in the simplest way possible, with minimal obstacles to growth. The South African Revenue Service (SARS) has attempted to simplify the tax requirements of smaller businesses, but many SMEs still fall outside of this net, requiring them to conduct their tax affairs in a manner similar to larger entities, making tax compliance a burden to SMEs. This study attempts to provide insight as to why tax compliance is seen as more of a burden to SMEs than larger or listed entities.

**Key words:** Small and Medium-sized enterprise, taxation, compliance burden, South African Revenue Services

## ABBREVIATIONS

DTC	Davis Tax Committee
GDP	Gross Domestic Product
PAYE	Pay-as-you-earn
SARS	South African Revenue Services
SBC	Small Business Corporation
SME	Small and Medium-Sized Entity
VAT	Value-added Tax

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# CHAPTER 1: INTRODUCTION

## 1.1 Background

“SMMEs contribute nearly a third of the national GDP and make up 91% of formal businesses in South Africa (*MWeb*, 2015).” SMEs are the lifeblood of our economy (Transnet, 2013) and are crucial for the purposes of job creation (*IOL*, 2014). These statements create the impression that SMEs are important to the growth of our economy and that they aid in creating employment opportunities. The *MWeb* article goes on to indicate that South Africa reports the highest business failure rate amongst the major emerging economies in the world, with one of the reasons for this being a difficult tax regulatory environment. The Department of Trade and Industry (dti) in South Africa stated that SMMEs are defined as small, medium and micro-sized enterprises. For the purposes of this research, SMEs and SMMEs are regarded as the same type of entity in terms of size and sector of the economy, and the terms are used interchangeably.

Since “[t]he government has prioritised entrepreneurship and the advancement of SMMEs as the catalyst to achieving economic growth and development in South Africa” (dti, 2013), SMEs should be able to function in the simplest way possible, with any unnecessary obstacles being reduced to the bare minimum. However, according to Abrie and Doussy (2006:1), tax compliance requirements are a stumbling block for SMEs. The reasons for this are discussed in Chapter three of this research. In an article published in 2014, Standard Bank listed the lack of financial or tax expertise as one of the top ten reasons why small businesses fail. The tax burden in South Africa is often criticised as being too heavy for small businesses in particular (Simply Biz, 2012). It is evident from the above, that tax compliance is one of the obstacles SMEs are specifically burdened with, more than other taxpayers are, which raises two pertinent questions. The first queries why the tax burden on SMEs is regarded as a greater one when compared to that on larger entities, while the second question concerns the reasons behind this

perceived tax burden on SMEs. A detailed discussion, addressing both of these questions, will be provided further on in this dissertation.

It is important to note the measures that the South African government has taken to support the growth of SMEs in the economy. In 1996, the South African government introduced the National Small Business Act (102 of 1996). According to the introductory section on page one of this act, the Act was introduced to promote small business in South Africa. With tax compliance being identified as burdensome on SMEs, the Davis Tax Committee (DTC) was established in 2013 “to assess our tax policy framework and its role in supporting the objectives of inclusive growth, employment, development and fiscal sustainability”. The DTC SME interim report, published in 2014, states that the DTC seeks to “prioritise the examination of the tax system and its impact upon the promotion of small and medium-sized businesses, including an analysis of tax compliance costs, a possible streamlining of tax administration, the simplification of tax legislation and the role of incentives”. The report goes on to state that the costs of tax compliance should not hinder growth in this key sector. The detail in this report further suggests that SMEs as a sector should be provided with as simplified a tax system as possible, in order to encourage the growth of this important sector. This provides further evidence that small businesses, and therefore SMEs, are important to the South African economy and that as a result any obstacle to the success of SMEs, such as tax compliance, should be examined further.

According to Schüssler (2012:24) most business owners have not completed high school, suggesting that anyone can operate a business. Smulders (2013) contends that the level of education and accounting knowledge of a taxpayer has a significant influence on income tax compliance. The taxpayer’s knowledge of the tax system may affect the obstacles faced by SMEs, as those with little or no knowledge of tax may face difficulty in understanding the tax system. These obstacles could impact SMEs negatively and result in late payment, under-payment or non-payment of tax, any of which may result in interest or penalties levied by SARS. In addition, non-compliance could result in SMEs not obtaining tax clearance certificates due to their tax affairs not

being in order. These are only a few of the implications of non-compliance from a tax perspective. This puts the SME in a dire financial position, resulting from lack of funds or lack of business opportunities due to failure in obtaining a tax clearance certificate. Having a basic understanding of the tax system could result in these issues being better understood and the negative financial consequences being avoided.

This research focuses on the tax burden as perceived by SMEs. An important factor, to consider as identified in the questions arising, is why this is specifically regarded a burden to SMEs as opposed to other businesses and taxpayers. A crucial point to begin the discussion is the amount of research that has been conducted in the past on the tax burden on small businesses. Some of this research focused on SMEs, some on small businesses. From an overview perspective, little research has been conducted on the tax burden, as perceived by other entities and taxpayers. According to a study by the International Finance Corporation (IFC) in 2007, compliance risks and attitudes differ greatly between small businesses and larger taxpayers since larger businesses have, as a core aim, to avoid paying tax where possible. The study also stated that larger businesses enjoy access to tax advice that assists them in developing tax strategies to reduce tax liability. According to Sieberhagen (2008), taxes are important to SMEs from a cost point of view because they do not have the financial and human capacity to engage in effective tax-avoidance strategies. There is no doubt that small businesses face a wide range of problems, compared to big businesses. A small business is required to complete the same tax returns as a large company and comply with the same legislation even although, in most cases, the small business has much less expertise and funding to do so (FIAS, 2007).

The possible reasons for the lack of research into the tax burden on large entities are, firstly, that it is a topic that does not have enough depth to be researched; implying that entities, other than SMEs, do not specifically consider tax to be a burden. It is considered purely as an administrative and compliance issue, as opposed to the financial burden experienced by SMEs. Any entity having to bear the cost of taxes would naturally consider that to be

a burden from a financial point of view. The scope of this research does not consider the tax burden from a financial perspective. A second possible reason for this lack of research is that it has simply not been undertaken yet. This being said, the tax burden on SMEs is clearly more topical from a research point of view, based on the amount of literature available. This is evident from the extent of past research that has been identified in the literature review in section 1.2 of this study.

There has been previous research conducted into the tax burden on SMEs, as discussed above. In contrast to this research on SMEs, in 2007, PriceWaterHouseCoopers (PWC) conducted a survey entitled *Total Tax Contribution*. The participants were large businesses, including members of business leadership. This report is relevant to this research as it provides a view on tax compliance from the perspective of larger entities. The participants of the survey were listed on page 33 of the report but did not include any SMEs (PWC, 2007:33). The report on this survey went on to claim that “the participating companies represented a wide range of industries and a very significant representation of large business in South Africa” (PWC, 2007). In the report, the section concerning the cost of tax compliance detailed that the participants reported an average of 4.4 full time employees dealing solely with tax compliance. The report went on to suggest that these large corporations pay high fees to tax experts to find ways around paying tax, therefore minimising the amount of tax that they pay. This provides evidence, that in addition to full-time employees dedicated to tax compliance, such entities also outsource tax experts and professionals to provide tax advice.

This report raises the important question, from the perspective of SMEs, as to how SMEs deal with tax compliance. SMEs have the option of outsourcing to tax experts or alternatively, employing full-time employees dedicated to the tax function. They may also choose to use both options as the larger entities in the PWC report do. This research aims to explore the possible ways SMEs deal with tax compliance issues and whether or not this is seen as burdensome. As mentioned earlier, larger entities are not the focus of this research because they are regarded as commanding a sufficient amount of

time, funds, expertise and resources to engage in tax compliance; this was evident from the PWC survey referred to above.

## **1.2 Literature Review**

There is a large amount of literature on the tax burden on SMEs, much of which focuses on tax compliance costs. A survey of tax practitioners in South Africa and the annual compliance costs for small businesses was covered in a study by Smulders and Stiglingh in 2008. The survey provided insight as to how many hours it takes for small businesses to conduct tax affairs in accordance with legislative requirements, as well as putting a rand value on the time taken. In addition to studies on the tax compliance burden due to a lack of knowledge and the administrative limitations of the SME owner, research has also been conducted into the concept that SMEs make use of tax practitioners to assist in conducting their tax affairs. This raises the question of the affordability of SMEs doing so. As discussed in section 1.1, this research considers whether SMEs actually make use of these practitioners or use their own internal employees for the tax compliance functions. According to a study done by Upstart Business Strategies CC in 2004, 60% of SMEs were hiring tax practitioners. Approximately 51% of SMEs hiring them were doing so because their own staff were unskilled in tax matters (FIAS, 2007:20). According to Lubbe and Nienaber (2012:1), small businesses rely on tax practitioners as they may lack skilled tax staff. For those that do not make use of these practitioners, it is assumed that these tax compliance activities will be carried out internally. This consequently raises the question of whether or not SMEs possess the necessary tax knowledge to conduct their tax affairs. If they are not making use of tax practitioners and their own staff are unskilled in tax matters, how is tax legislation being effectively complied with?

Smulders and Naidoo (2011) provide a detailed study on the tax compliance costs that small businesses are faced with. Part of their research is focused on the compliance burden while the other section focuses on SARS' initiatives

to address this. The DTC has compiled a report on ways to lower the tax burden on SMEs, as referred to in section 1.1. In recent years, tax legislation has been introduced to allow tax relief in certain areas to those businesses that meet certain requirements. Section 12E relates to small business corporations (SBCs) which are allowed preferential tax rates and capital write-off periods. Micro businesses are allowed to pay tax on turnover, thereby reducing administrative record keeping for tax purposes. The concluding remarks of the study by Smulders and Naidoo (2011) list those burdens that have been addressed and those that require further attention from SARS. These are discussed in detail in Chapter three of this research.

Abrie and Doussy (2006:1) detail the reasons why tax compliance costs are regarded as a stumbling block for SMEs and identified complexity of legislation as well as high compliance costs as some of the reasons for this. Olawale and Garwe (2010) conducted a more general analysis of the obstacles to the growth of new SMEs in South Africa. They (2010:6) ranked high taxes and other tariffs fifteenth out of thirty when grading the perceived obstacles to the growth of new SMEs. Although this factor may not rank high on the list of obstacles, it does feature on the list; therefore tax has been identified as a factor that hampers the growth of SMEs.

The above literature review has raised possible reasons for the tax burden on SMEs such as the lack of tax knowledge by SME owners and staff, the lack of funds to dedicate administrative hours to tax compliance and the necessity and expense of using tax practitioners for skills which are not available within an SME's organisation.

### **1.3 Review of Applicable Legislation**

In order to conduct a literature review which focuses on SMEs, it was necessary to first determine what an SME is, as opposed to other tax-paying entities. The National Small Business Act (102 of 1996) and The National Small Business Amendment Act (26 of 2003) clearly define the requirements

to qualify as an SME. In addition, the Income Tax Act (No. 58 of 1962) clearly states those needed to qualify as a micro business or small business corporation. From a tax point of view and for the purposes of this study, an entity will be viewed as a small business or micro business if it meets the requirements of the Income Tax Act (No. 58 of 1962) and qualifies for those tax concessions. The Income Tax Act (No. 58 of 1962) also details all legislation applicable to tax paying entities, whether they are large companies, SBCs or micro businesses. In addition to the Income Tax Act (No. 58 of 1962), the Tax Administration Act (No. 28 of 2011) needs to be considered alongside it as this Act spells out in detail administrative requirements for tax paying entities. SMEs, like all other taxpayers, are required to comply with the requirements of both the Income Tax Act (No. 58 of 1962) and the Tax Administration Act (No. 28 of 2011). These Acts were used to summarise the legislative requirements applicable to SMEs, thereby indicating the extent and complexity of the tax burden.

#### **1.4 Research Question**

As explained above, tax compliance is perceived as a stumbling block for SMEs (Abrie & Doussy, 2006:1). This is discussed in further detail with regard to the possible reasons why it exists. As indicated, Abrie & Doussy (2001:1) identified complexity of legislation, in addition to high compliance costs, as reasons for the existence of this “stumbling block”. The question that arises is: why are SMEs specifically worse off from a tax burden point of view than larger or listed entities? The research aims to explore the reasons raised by Abrie & Doussy (2006:1) and other reasons behind this perceived tax compliance burden specifically as this applies to SMEs. The reasons why SMEs are worse off from a tax burden point of view than larger or listed entities are also explored. Based on the amount of literature available regarding the tax burden as it is perceived by SMEs, as well as the Total Tax Contribution survey (PWC, 2013), it is evident that there is a specific tax burden imposed on SMEs to conduct their tax affairs in accordance with the legislation imposed on them under the Income Tax Act (No. 58 of 1962) which

is not perceived as a burden by other entities who need to comply with the same regulations.

### **1.5 Research Objectives**

As stated, this research aims to acquire a better understanding of why there is a distinct burden on SMEs when it comes to tax. In addition to this, the burden on SMEs is investigated and compared to larger entities. This includes a summary of all the different reasons tax compliance is perceived to be a burden to SMEs. In order to determine what these could be, past research studies on the topic were reviewed in detail and summarised. The objective of this research was to consolidate past research and provide an overall view for the above issues. In order to gather data to conduct this literature review, online sources were consulted in detail as were relevant print publications. Research was conducted using previous theses and dissertations, newspaper, magazine and journal articles. Tax and administrative legislation imposed on SMEs was summarised. To do this, a detailed review of both the Income Tax Act (No. 58 of 1962) and the Tax Administration Act (No. 28 of 2011) was conducted. An overview of the legislation applicable to SMEs was carried out, with focus placed on areas that are regarded as more of a tax burden. This was identified during the initial literature review. In addition to this, reasons for the tax burden were summarised and concessions to alleviate this burden were considered. Further recommendations to decrease the tax burden even further were researched in detail.

### **1.6 Research Design**

The meaning of the term 'Ontology' concerns one's view of the world (within which, in this case, one conducts one's research) (Coetzee, van der Zwan & Schutte, 2014:27). Two of the views that exist are the realist and relativist world views (Coetzee *et al*, 2014:27). According to Coetzee, van der Zwan and Schutte (2014:27), a relativist's view of the world depends on many circumstances and factors. This research will be influenced by various factors

relating to legislation and past research. Epistemology is defined as the meaning of knowledge, i.e. what one considers to be knowledge (Coetzee *et al*, 2014:27). The initial part of the research includes a summary of all tax legislation imposed on SMEs, covering a broad spectrum of requirements from the Income Tax Act (No. 58 of 1962) and the Tax Administration Act (No. 28 of 2011). These acts are constantly being altered: each year, changes to tax rates and rules are announced during the budget speech by the Minister of Finance. Changes are also put into effect through the Taxation Law Amendment Acts each year.

The next part of the current study presents a literature review of antecedent research conducted on the subject. Due to the various factors that influence the research and the different resources from which knowledge on the topic can be gained, this dissertation squares with the relativist view of knowledge. A qualitative type of approach was followed as the study deals with taxpayers' perceptions. Existing research as well as tax legislation applicable to SMEs was analysed and summarised. In 2006, Smulders conducted research entitled "Tax compliance burden for small business on South Africa". Smulder's research was conducted using a qualitative approach by analysing existing literature. Such a technique is applicable to this study which uses a descriptive method, as Smulders did in 2006

The research was conducted within the interpretivist paradigm. It does not prove or disprove a stated hypothesis but rather delves into a discussion of the tax burden on SMEs; i.e. it does not attempt to achieve a stated requirement but simply obtains more information on this topic. Research under the interpretivist paradigm does not aim to prove a single truth but rather to gain a wider understanding of a phenomenon (Coetzee *et al*, 2014:27).

A descriptive research methodology was followed. This study will provide more information on a topic that has been researched and explored in detail in the past. Inductive logic starts with making an observation and subsequently uses further information to draw conclusions (Coetzee *et al*, 2014:27). This

research will further examine the reason for this observation in relation to other research carried out as well as to legislation.

## 1.7 Overview of Chapters

Chapter One offers an introduction and background to the topic in order to introduce the reader to the topic and spark an interest in this specific facet of tax. Chapter Two provides a summary of the tax and administrative legislation applicable to SMEs, which offers a clear indication of the amount of legislation SMEs need to comply with. The summary of legislation goes into detail about the requirements for SMEs, in order to explain not just simple tax rates but also certain qualifying criteria to qualify as an SBC or micro business. The terms SBC, SME, SMME, small business and micro business are frequently used in the reviewed material and in the chapters that follow. A distinction is drawn between each of these terms in Chapter Two. There, summaries on the different types of taxes to be considered, such as income tax, provisional tax, employees' tax, VAT and so forth, are provided. The chapter also offers a brief description of each type of tax as well as the deadlines and administrative requirements. Thus, Chapter Two provides an indication of the tax burden on SMEs purely from a legislative point of view. This study subsequently needs to consider whether tax legislation has in fact created a specific burden on SMEs from a compliance point of view and if so, what the reasons are for tax being seen as a burden. While legislation is dealt with in Chapter Two, compliance is discussed in Chapter Three. The latter provides a detailed summary of past research conducted into this topic. It includes a summary of conclusions reached as to why these burdens exist and the different types of problems encountered by SME owners within the South African tax system. It further provides a summary of the tax concessions that have been made available to SMEs and considers the effectiveness of the different concessions as drawn from tax legislation as well as past research. Chapter Four provides a discussion on recommendations presented in past research studies to further alleviate the tax burden on SMEs. Concluding remarks are made in Chapter Five. The legislation that has been identified in Chapter Two extends to the compliance burden in Chapter Three, which cannot be considered until the basis of the burden i.e. tax legislation has been considered in Chapter Two. Chapter Four provides further solutions to the tax

burden. Chapter Five offers a conclusion drawing together Chapters Two and Three and Four.

## **CHAPTER 2: SUMMARY OF TAX LEGISLATION APPLICABLE TO SMEs AND THE ADMINISTRATIVE BURDEN**

### **2.1 Introduction**

The DTC interim report (2014) stated that, amongst other objectives, the Committee seeks to streamline tax administration and simplify tax legislation. The report also suggested that certain areas of legislation needed to be examined with the purpose of simplifying the provisions of the relevant sections of tax legislation to make these more understandable for SMEs. Research by Abrie and Doussy (2006:01) into tax compliance, mentioned above, identified the complexity of tax legislation. Not all SMEs are aware of the extent of the legislation with which they are required to comply (FIAS, 2007). In this study by the FIAS, it was noted that tax practitioners regard tax legislation as being too complex for most taxpayers to understand. The study by Smulders and Naidoo in 2011 reported that SARS needs to address the burden for SMEs that has resulted as they cannot afford to spend excessive amounts of time trying to understand complex tax legislation (Smulders, 2014). The 2014 report by Smulders likewise stated that the definitions contained in tax legislation should be simplified. Many SMEs do not have time to absorb changes to tax; for instance, in the UK tax system, SMEs feel at a loss compared to their bigger competitors who can employ specialists to keep abreast of the constant changes in legislation (Steed, 2011). It is evident from the above information that the complexity of tax legislation adds to the tax compliance burden for SMEs in particular. The remainder of this chapter explores the different taxes to which SMEs are subject as well as those provisions that are regarded as complex and difficult for SMEs to understand and comply with, and attempts to provide reasons for the above. This legislation is considered from the perspective of detailed tax calculation provisions as well as tax administrative provisions, thereby encompassing both the Income Tax Act (No. 58 of 1962) and the Tax Administration Act (No. 28 of 2011).

The former Act (No. 58 of 1962) was introduced into law 53 years ago and since then has been amended by at least 97 instances of legislation, resulting in an income tax act that is now complex and fragmented (Mandy, 2013). In other words, each of these 97 pieces of legislation would have to be interpreted and understood by an SME whose staff, as discussed in Chapter One, may not have the required skills and knowledge to achieve this. The Act has become a jumble of provisions thrown together in an illogical manner (Mandy, 2013). The sections contain multiple subsections, paragraphs and sub-paragraphs using overly legalistic language (Mandy, 2013). The article by Mandy (2013) sums up the extent of the complexity of the Income Tax Act (No. 58 of 1962). Not only are the onerous provisions of these pieces of legislation not fully understood by SMEs but the administrative provisions, as discussed below, have also created a huge compliance burden on SMEs from an administrative point of view.

SARS levies many different types of taxes on businesses in South Africa. Corporate Income Tax is the primary form of tax borne by most businesses. The reason is that it is compulsory for every business registered in South Africa to register as a taxpayer in accordance with the Income Tax Act (No. 58 of 1962). This is also illustrated in the abovementioned Total Tax Contribution report by PWC in 2013, which states that corporate income tax is the highest tax borne by companies operating in South Africa. In 2013, this tax equated to 79.1% of total taxes borne by South African companies (PWC, 2013). In addition to the Income Tax Act (No. 58 of 1962), the Tax Administration Act (No. 28 of 2011) also needs to be considered in detail, as SMEs need to fully comply with the latter Act (No. 28 of 2011) from an administrative and tax compliance point of view. One of the main purposes of the said Act (No. 28 of 2011) is to “provide for the effective and efficient collection of tax.” This Act not only determines the duties and responsibilities of SARS but also spells out in detail the administrative requirements for taxpayers. It provides a simplified approach to their obligations, while describing what they are entitled to from SARS. This relates to all types of taxpayers, including corporate entities such as SMEs. In addition to tax legislation governing the different types of taxes,

SMEs are also obliged to comply with the requirements under the Tax Administration Act (No. 28 of 2011).

This Act (No. 28 of 2011) is divided into the following chapters:

**Table 1: Tax Administration Act No. 28 of 2011**

<b>Chapter 1</b>	Definitions	<b>Chapter 11</b>	Recovery
<b>Chapter 2</b>	General Administration	<b>Chapter 12</b>	Interest
<b>Chapter 3</b>	Registration	<b>Chapter 13</b>	Refunds
<b>Chapter 4</b>	Returns and Records	<b>Chapter 14</b>	Write off or Compromise of Tax Debts
<b>Chapter 5</b>	Information Gathering	<b>Chapter 15</b>	Administrative Non-Compliance Penalties
<b>Chapter 6</b>	Confidentiality	<b>Chapter 16</b>	Understatement Penalties
<b>Chapter 7</b>	Advance Tax Rulings	<b>Chapter 17</b>	Criminal Offences
<b>Chapter 8</b>	Assessments	<b>Chapter 18</b>	Reporting of unprofessional conduct
<b>Chapter 9</b>	Dispute Resolution	<b>Chapter 19</b>	General provisions
<b>Chapter 10</b>	Tax Liability & Payment	<b>Chapter 20</b>	Transitional provisions

Source: BDO

SMEs are bound to comply with all of the above items of the given legislation in order for them to operate in a tax-compliant environment. Compliance with tax laws is onerous and time-consuming (Smulders, 2006). As mentioned earlier in this study, SMEs face many challenges in the South African economy and should be allowed to function in the simplest possible way. From an operational point of view, certain chapters of the Tax Administration Act (No. 28 of 2011) are referred to regularly by SMEs during tax compliance activities whilst others contain general definitions and provisions that are relevant only from an overview perspective. The following chapters in the Tax Administration Act (No. 28 of 2011) are discussed later in this chapter to shed light on the complexities that lead to this undue burden on SMEs:

- Chapter three: Registration
- Chapter four: Returns and records
- Chapter fifteen: Administrative non-compliance penalties
- Chapter sixteen: Understatement penalties

In addition to corporate income tax and the administrative section of tax legislation, there are various other taxes that an SME may be liable for if it

meets the relevant requirements or thresholds. For the 2014 tax year, there were 2.7 million corporate taxpayers registered with SARS (Treasury, 2014). This exceeded VAT vendors as well as taxpayers registered to pay import VAT and customs duties, which were recorded at 662 194 and 272 544 taxpayers respectively (Treasury, 2014). Although the number of corporate income taxpayers exceeded VAT vendors, the revenue collected from corporate income tax amounted to R 179.5 billion whereas that collected from VAT amounted to R 237.7 billion. It may appear as if VAT is the main tax borne by SMEs; however, an important consideration is that while not all SMEs are VAT vendors, all SMEs are liable to register for income tax, which effectively means that they are burdened with the administrative requirement of submitting tax returns. Income tax is applicable to most sizes of businesses, ranging from the very small to the largest sized entities. In addition to this basic corporate income tax, entities may be required to register as VAT vendors. They may also be subject to many other types of taxes, for example capital gains tax, dividends tax, pay-as-you-earn (PAYE) and the skills development levy (SDL). Corporate income tax is usually paid via the provisional tax system which as a result brings in the complexities of provisional tax estimates and payments. As noted, this research aims to obtain a better understanding of the tax burden on SMEs. In so doing, it is important to determine to what extent SMEs are burdened with tax legislation. This legislation should be considered in terms of each of the taxes listed above. Once the extent of legislation is considered, a better understanding of the perceived tax burden may be had. This chapter will focus on an explanation of the complexities of the legislation governing the following types of taxes:

- Corporate income tax and provisional tax
- Capital gains tax
- Dividends tax
- Value-added-tax (VAT)
- Pay-as-you-earn (PAYE).

As this research focuses on a discussion relating to SMEs, it is imperative to determine what entity qualifies as an SME. Since there are many terms used in this study and research in general that make reference to the size and type of entity being discussed, it is crucial to differentiate between the terms used. The following are employed in the course of this research:

- SME
- SMME
- SBC
- Small business
- Micro business.

As previously explained, an SME is a small and medium-sized enterprise. According to a study by Cloete, Courtney and Fintz (2002:1), the SME definition differs in literature and no conclusive definition has been established. SMMEs differ from SMEs and include small, medium and micro-sized enterprises. The National Small Business Act (102 of 1996) was promulgated with the aim of “providing guidelines to organs of state in order to promote small business in the Republic”. This affords evidence that the Government has placed emphasis on the promotion of small businesses in South Africa. The Act details the classification requirements for an SMME. This schedule can be found in Appendix 1 at the end of this research. It determines the requirement on an industry specific basis: turnover requirements range from R 200 000 for a micro business to R 51 million for a medium-sized entity. The SMME classification includes micro enterprises as per the National Small Business Act (102 of 1996). The definition of micro enterprises from a taxation point of view is discussed later in this chapter and includes those entities whose turnover does not exceed R 1 million per annum, amongst other requirements.

In research by Kruger in 2011, the following was noted in respect of entity size from the perspective of black economic empowerment (BEE) in South Africa:

- Small and micro enterprises are those earning less than R 5 million per annum
- Medium enterprises are those earning between R 5 million and R 35 million per annum.

It is to be noted that from a BEE perspective, SMMEs are those entities with a turnover of up to R 35 million per annum. This differs from the SMME classification as per the National Small Business Act (102 of 1996), discussed above. This indicates that SMMEs can be classified differently based on different perspectives. For the purpose of this research, an SME will be viewed from a tax perspective in terms of section 12E of the Income Tax Act (No. 58 of 1962) as an entity with a gross income not exceeding R 20 million per annum, also referred to as a small business corporation (SBC). This is since the research is tax-based; the classification of an SME in this study is therefore made from a tax perspective. The Income Tax Act (No. 58 of 1962) provides detailed guidance as to specific requirements that must be met for an entity to qualify as an SBC. In order for an entity to qualify as an SBC and utilise the SBC tax concessions, section 12E must be understood and effectively applied.

An extract from section 12E of the Income Tax Act (No. 58 of 1962) defines an SBC as follows (Income Tax Act No. 58 of 1962):

“Any close corporation or co-operative or any private company as defined in section 1 of the Companies Act if at all times during the year of assessment all the holders of shares in that company, co-operative or close corporation are natural persons, where –

- (i) the gross income for the year of assessment does not exceed an amount equal to R 20 million: Provided that where the close corporation, co-operative or company during the relevant year of assessment carries on any trade, for purposes of which any asset contemplated in this section is used, for a period 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, during which that company, co-operative or close corporation carried on that trade bears to 12 months,

- (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...
- (iii) not more than 20 percent 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
- (iv) such company is not a personal service provider as defined in the Fourth Schedule..." (Income Tax Act No. 58 of 1962).

In applying these requirements to determine whether an entity qualifies as an SBC, Timm (2015:3) pointed out that the onerous criteria relating to these tax concessions have resulted in entities choosing not to adopt them. The article goes on to state that SARS' tax break has not proved to be as effective as SARS had hoped. It is evident from the above that the provisions of section 12E are complex and may not be understood or adopted by those SMEs who qualify for them.

As may be perceived from the above information, there is a varied amount of tax legislation that an SME would need to comply with in order to function in a tax-compliance environment. The issue of SMEs view that tax legislation is a burden has been addressed, based on the argument that it is not readily comprehensible for the reasons mentioned. The remainder of the chapter delves into a discussion as to the different types of taxes and administrative legislation and provides evidence for the difficulties SMEs experience in this regard.

## **2.2 The Attributes of an SME and the Unique Challenges Faced by Them**

As mentioned at the beginning of this research study, SMEs have proven to be valuable to the South African and other world economies since they aid in job creation and economic growth. This is expanded on in Chapter Three. This section aims to explore the specific attributes of an SME that distinguish them from larger entities as well as those unique challenges faced by SMEs as opposed to larger firms.

SMEs possess many traits that stem from entrepreneurship, resulting in flexibility, speed, risk-taking and innovation (Chen, Lee & Mintz, 2002). SMEs are more flexible than larger companies as the decisional process is faster since the entrepreneur is permanently present and accessible in the business. The creativity and entrepreneurial involvement of SMEs constitute the fuel of their growth and success. The given involvement in an SME makes it distinctive when compared to a larger entity (Savlovschi & Robu, 2011). Key features of an SME are flexibility and their quick adaptability to change which distinguishes them from larger entities (Okpara & Kabongo, 2009). McKiernan and Morris (1994) identified similar features of an SME such as the role of the entrepreneur, the flexibility and the relationship between ownership and control. Formal regulations pose a risk of restricting the flair of the entrepreneur and may hamper the growth and success of the SME (McKiernan & Morris, 1994). As a result, SMEs make a unique contribution to the economic development of a country (Savlovschi & Robu, 2011).

There are however, many negative aspects to the establishment and running of an SME. SMEs may suffer from poor management skills resulting from a lack of training and education. In addition to this, they may have low levels of financial literacy which results in a lack of business planning. This in turn results in their inability to obtain financing (NCR, 2011). Okpara and Kabongo (2009) asserted that SMEs in African countries operate in an adverse policy and regulatory environment due to difficulties in accessing credit, using out-dated technology and lacking sufficient working capital.

The dti White Paper (2005) identified the following common problems faced by SMEs:

- An unfavourable legal environment
- Lack of access to markets and procurement
- Lack of access to funding and credit
- Low levels of skilled labour
- Lack of access to information
- Shortage of support institutions.

The strategy outlines in this dti White Paper formed the basis of the National Small Business Act (102 of 1996) which was introduced into legislation in order to promote small business in South Africa.

One of the obstacles identified, as mentioned earlier, is the regulatory burden of legislation (Abrie & Doussy, 2006). Surveys and Govender (2008) identified the complexity of tax legislation as a significant challenge for SMEs. This chapter further examines certain complex areas of tax legislation that an SME may find difficult to interpret and understand, putting them at a disadvantage when compared to larger entities. The reason for this difficulty in understanding is once again due to the lack of resources and knowledge from the perspective of the SME (Rametse, 2010). SMEs often need to dedicate internal resources to tax compliance, therefore adding to the regulatory burden as these resources could well be used elsewhere in the business (Abrie & Doussy, 2006).

## **2.3 Tax Legislation and the SME**

### **2.3.1 Corporate income tax**

As indicated, the Total Tax Contribution report by PWC (2013) states that corporate income tax is the highest tax borne by companies operating in South Africa. As pointed out, an important consideration is that not all SMEs

are VAT vendors; however, all SMEs are obliged to register for income tax, and therefore, as discussed in the introduction to this chapter, corporate income tax applies to all of them and is an administrative burden for all because they are required to submit income tax returns regardless of whether or not they have an income tax liability for the year of assessment (Anon, 2009). Income tax legislation governs the rules and requirements in calculating taxable income and therefore corporate income tax (Income Tax Act No. 58 of 1962). These comprise elements of income and deductions as per section 1 and sections 10 to 24 of the Income Tax Act (No. 58 of 1962). As with other areas of the tax legislation, the laws relating to taxable income alter often and the deductions enjoyed in past tax years may not apply today (Buck, 2015). An example would be the taxation of interest in recent years. There are numerous provisions in the Income Tax Act (No. 58 of 1962) relating to interest income and expenditure; since these are increasing, taxpayers are forced to be up to date with all these changes. At the very least, an SME will be required to consider the additional interest provisions of section 24J, 24M and 24N when determining the taxability of interest income and expenditure (Reifarth, 2015). The urban development zone as well as research and development incentives were highlighted during the 2015 budget speech; as was section 12P relating to government grants. It should be noted that in addition to understanding the existing extensive and onerous rules of tax legislation, SMEs also need to utilise their limited resources and knowledge to keep up to date with the numerous changes (Smulders, 2006). SMEs find the tax process to be stressful, and the complex nature of income tax returns is a significant burden on them (Anon, 2009).

### **2.3.2 Provisional tax**

SMEs and larger entities both settle their income tax liability by making provisional tax payments during the year. This ensures that tax is paid systematically at set times during the year. Provisional tax is set out in part three of the fourth schedule to the Income Tax Act (No. 58 of 1962). The timing of provisional tax payments is detailed in paragraph 23 of this part. It is

imperative that provisional tax is paid on time and that the basis used to estimate the payment amount is in accordance with paragraph 23. Provisional tax returns risk incurring penalties on late submission as well as interest on late payment (Income Tax Act No. 58 of 1962). In addition, the second provisional payment risks understatement penalties if the estimate of taxable income is not carried out with due care (Income Tax Act No. 58 of 1962, schedule 4).

Paragraph 19 of Chapter Three to the fourth schedule details the method for estimating a provisional tax payment. The second provisional tax return must be based on a reasonable estimate of taxable income by the SME for the year. Any understatement penalty depends on whether the taxpayer's actual taxable income was more than or less than R 1 million for the year. Entities with a taxable income of greater than R 1 million are required to base their second provisional payment on an estimate that is within 80% of their actual taxable income. An entity with a taxable income under R 1 million may base its second provisional payment on the lesser of the basic amount of 90% of the actual taxable income without incurring any underestimation penalty (Income Tax Act No. 58 of 1962, schedule 4). This allows smaller businesses more flexibility when making their second provisional tax payment. However, the entity will need to have a complete understanding of the legislation regarding provisional tax in order to make use of this concession.

An article by Vanek (2009) pointed out that it is almost impossible to accurately estimate tax liability and that since even large financial institutions are unable to do this accurately, he questions how small businesses are supposed to achieve this. Vanek lists one of the reasons why SMEs will be unable to make an accurate estimate: they have their books done just once a year and will therefore only know their profits once their financial statements are compiled. Although legislation allows an amount of flexibility within the 80% and 90% rule, even this is an administrative nightmare for SMEs to attempt to estimate (Vanek, 2009).

### **2.3.3 Dividends tax**

Dividends tax is another tax that an SME needs to take into consideration. This is a tax on dividend distributions made by an entity. After an SME's profits are subject to income tax, the distribution of these profits to owners is then subject to dividends withholding tax. Dividends withholding tax replaced the secondary tax on companies (STC) regime on 1<sup>st</sup> April 2012. Although the introduction of dividends tax simplified tax from the perspective of foreign investors, it introduced a number of complexities for local companies. The concept of a simplified regime for foreign investors is due to the fact that the new dividend withholding tax regime brings South Africa in line with most international regimes dealing with tax on dividends. The complex provisions from the perspective of local companies require SMEs, in addition to other companies, to apply these provisions.

The change brought with it the complexities of unutilised STC credits that were allowed to be used for a period of five years from the date of change. Other complexities that accompanied the change were the introduction of a class of exempt organisations and the principle of contributed tax capital (Mazansky, 2009). These latest legislative provisions accompanying the current dividends withholding tax regime referred to by Mazansky, will have to be applied by SMEs whose knowledge and resources, as discussed in Chapter One, may be limited.

### **2.3.4 VAT**

Income tax and dividends withholding tax are direct taxes levied on entities. These taxes are effectively linked to the profits of an entity. VAT, on the other hand, is an indirect tax that is collected by an entity on behalf of SARS from its customers; as indicated, not all SMEs are VAT vendors. As a result, this research considers the compliance burden of VAT after income tax and dividends withholding tax. VAT has been identified as one of the most difficult taxes for SMEs to comply with if they are registered VAT vendors (Smulders,

2006:31). Oxford (2015:1) stated, “SMEs face an interesting journey through the rocky landscape of VAT”. The article went on to explain that SMEs have many administrative “hoops” to jump through when it comes to VAT, which was referred to as a “tricky topic”. Amongst these “hoops”, Oxford identified form filling, queues, spreadsheets and the infamous VAT legislative regulations.

A taxpayer may register as a VAT vendor, either compulsorily or voluntarily. The compulsory VAT threshold is of specific importance as it determines the amount of taxable supplies a taxpayer needs to make to be required to compulsorily register as a VAT vendor. All legislation relating to VAT is contained in the Value-Added Tax Act, 1991 (Act No. 89 of 1991), hereafter referred to as the VAT Act. It is compulsory for an entity that makes taxable supplies exceeding R 1 million to register as a VAT vendor in terms of section 23 of the VAT Act. The result is that not all SMEs will be registered VAT vendors. For those that are, the onerous provisions of the VAT Act become relevant. Prior to registering as a VAT vendor, there are a number of registration requirements that must be met and documentation required by SARS, which Oxford refers to as one of those administrative “hoops”.

The extent of documentation required to register as a VAT vendor is the primary compliance burden SMEs will be faced with before they even become VAT vendors. The VAT threshold also determines which category a vendor falls into, thereby determining how often VAT returns are submitted, ranging from 1 to 12 returns per annum (Oxford, 2015). VAT is regarded as the most burdensome tax issue from an administrative point of view, because of the number of VAT returns that need to be submitted per annum. The compliance burden is heightened by the amount of calculation that accompanies each VAT return (Smulders and Stiglingh, 2008). VAT legislation does provide a concession to SMEs, allowing them to declare VAT on the payment basis instead of the invoice basis, if they meet certain requirements. These administrative provisions and concessions could either increase or decrease the VAT burden on SMEs. The key factor is the SME’s ability to make sense of VAT legislation, thereby being aware of the different options that are

available to it. However, the VAT system is not simple enough for an SME to just “pick up” without assistance from a professional (Oxford, 2015). The article states that becoming a VAT vendor is an onerous task that an SME owner is burdened with, as they are basically collecting tax on behalf of SARS (Oxford, 2015).

It is evident from the above discussion that applying the provisions of VAT legislation requires the VAT vendor to be knowledgeable from a tax point of view or alternatively, to make use of tax practitioners due to the complexity of the VAT system (Oxford, 2015; Smulders, 2006; Smulders and Stiglingh, 2008). Although the administrative burden of corporate income tax is placed on all SMEs, it can be seen from the above discussion that for those SMEs that additionally register as VAT vendors, compliance becomes even more arduous from an administrative point of view. Once registered for VAT, the calculation and submission of returns become a huge burden on the SME due to the number of returns that are submitted per annum, resulting in the VAT calculation having to be done several times. Larger entities may employ sophisticated accounting systems and experts to assist in these calculations and submissions, unlike, as previously pointed out, SMEs.

### **2.3.5 Employees’ tax**

PAYE is a form of employees’ tax and is similar to VAT in that it is collected from a third party by a business and is paid over to SARS; therefore the business acts as an agent of the Government and SARS (Anon, 2009). As with larger entities, an SME may be required to withhold and pay PAYE on behalf of its employees in terms of part two of the fourth schedule of the Income Tax Act (No. 58 of 1962). The said fourth schedule emphasises the importance of calculating PAYE correctly; the liability to pay over PAYE to SARS ultimately rests with the employer (Anon, 2010). According to a poll conducted in 2011, a large percentage of business owners say the burden of PAYE makes them reluctant to hire employees (Anon, 2013). It is further mentioned that business owners are so concerned about the “logistical

nightmare” of PAYE that they try to employ as few full-time staff as possible, which ultimately hinders the growth of their business (Anon, 2013).

Abrie and Doussy (2006) conducted a study where the resources that SMEs spent on tax activities were quantified, based on which taxes were internally completed and which taxes were outsourced. The study determined that the simpler taxes were completed internally whereas the more complex taxes were outsourced. Amongst those calculated internally were PAYE and SDL. The findings suggest that while this may not be regarded as a burden from an outsourcing point of view, the SME will still need to dedicate internal resources to effecting PAYE and SDL, therefore adding to the tax burden as these resources could be used elsewhere in the business. As mentioned earlier in this research study, SMEs lack the required knowledge and resources for tax compliance purposes (Lubbe & Nienaber, 2012:1). In order to pay over PAYE, it will first need to be calculated per employee in terms of paragraph 2 of part two of the fourth schedule and then submitted to SARS. PAYE is payable on the net remuneration of each employee. There have been various amendments to tax legislation relating to employees tax in recent years. These changes result in SMEs having to gain an understanding of new tax provisions and determining whether or not they are applicable to employees’ PAYE calculations. In an article by Cooper (2012), key changes to tax law relating to payrolls were identified. Amongst these were the medical tax credit principle, employment-related insurance policies and learnership agreements. Medical tax credits replace the previous medical aid deduction, while the new legislation presents a more complex calculation for the out-of-pocket medical expenses (Cooper, 2012). Having said this, only the changes relating to the medical tax credit are applicable from the perspective of an employer calculating PAYE on behalf of its employees.

With regard to the changes to employment-related insurance policies, the legislation has been subject to complex changes over the past few years (Cooper, 2012). The legislation relating to learnerships has also undergone some changes over the past few years, resulting in delays in the registration of learnership agreements (Cooper, 2012). All the changes to PAYE-related

tax legislation relate to employers in general, not specifically (solely) to SMEs. This however, results in an onerous burden on the SME.

### **2.3.6 Administrative legislation**

In addition to the complexities of the Income Tax Act (No. 58 of 1962), SMEs are burdened by the administrative requirements in the Tax Administration Act (No. 28 of 2011). This came into effect on 1 October 2012 and is therefore a fairly new piece of legislation in comparison to the Income Tax Act (No. 58 of 1962). There are many new changes that need to be understood by corporate taxpayers. The Tax Administration Act (No. 28 of 2011) is a complex “body of Law” and the administrative rules impact most corporate taxpayers (Kruger, 2013).

#### **2.3.6.1 Chapter three: registration**

Sections 22 to 24 of Chapter 3 of the Tax Administration Act (No. 28 of 2011) spell out the registration requirements for new taxpayers. From the date that a person becomes obliged to register as a taxpayer, they have 21 days to submit the relevant documentation to SARS. Should there be a change in the taxpayer’s details such as address, banking details, etc. at any time, they have 21 days to notify SARS of these changes. The duty to report changes to SARS may seem self-evident, but this requirement is often overlooked and could result in serious sanctions in terms of section 23 of the Tax Administration Act (No. 28 of 2011) (Kruger, 2013). In terms of the article by Kruger (2013), it may not be obviously stated in the opening words of section 23 of the Tax Administration Act (No. 28 of 2011) but failure by a taxpayer to notify SARS of a change to their details constitutes a criminal offence. The onus is on the taxpayer to comply with the provisions relating to registration and changes in details (Hall, 2013). Many SMEs do not fully understand their responsibilities in this regard and need to ensure that they comprehensively understand all areas of the Tax Administration Act (No. 28 of 2011) to reduce the risk of transgressing of any of the provisions.

### **2.3.6.2 Chapter four: returns and records**

The administrative provisions relating to the preparation and submission of tax returns have become more complex under the Tax Administration Act (No. 28 of 2011) (Kruger, 2013). Corporate taxpayers are required to submit a “full and true” tax return in terms of the provisions of the Tax Administration Act (No. 28 of 2011), which may require the taxpayer to disclose more information than would otherwise be required. Corporate taxpayers also find it difficult to meet tax return deadlines; SARS is empowered by the Tax Administration Act (No. 28 of 2011) to extend these deadlines “in accordance with procedures and criteria in policies issued by the Commissioners” (Kruger, 2013:4). Kruger (2013) stated that there has been no light shed by SARS on what these procedures and criteria are. From the point of view of an SME, a clear understanding will have to be gained on tax deadlines and requirements or else it runs the risk of incurring non-compliance penalties, as detailed later in this chapter.

From a record-keeping point of view, in terms of section 29, records will need to be kept by an SME for a period of five years after the submission of a tax return. An interesting issue raised by Kruger (2013) is the provision in section 31 of the Tax Administration Act (No. 28 of 2011) which states that the “books of the taxpayer must at all reasonable times during the required period be open for inspection by a SARS official” (Kruger, 2013:6). This provision appears to contradict the search and seizure provisions in the Tax Administration Act (No. 28 of 2011) which require the SARS official to obtain authorisation to enter a taxpayers’ premises. This ambiguity between sections of the Tax Administration Act (No. 28 of 2011) may cause great confusion amongst taxpayers, including any SME, and it makes tax legislation even more complex.

### **2.3.6.3 Chapter fifteen and sixteen: administrative and understatement penalties**

If a taxpayer fails to comply with an obligation imposed under a tax act, SARS may levy an administrative non-compliance penalty in terms of Chapter 15 of the Tax Administration Act (No. 28 of 2011). The fixed penalty is based on the taxpayer's assessed loss or taxable income for the preceding year. The fixed penalty table is detailed in section 211 of the Tax Administration Act (No. 28 of 2011) and is levied on a monthly basis for as long as the non-compliance continues. A percentage-based penalty may also be levied. The non-compliance penalties require a degree of judgment on the part of SARS as it must be determined whether the non-compliance is based on negligence or intent. This is a complex issue that cannot be expected to be understood by SMEs and their owners who most likely lack a detailed understanding of tax legislation, as already discussed.

In terms of Chapter 16, SARS may also levy an understatement penalty. Understatement is defined in section 221 as follows:

“Any prejudice to SARS or the fiscus in respect of a tax period as a result of—

- (a) a default in rendering a return;
- (b) an omission from a return;
- (c) an incorrect statement in a return; or
- (d) if no return is required, the failure to pay the correct amount of tax.”

SARS states that the understatement penalty regime avoids prejudice that was noted under the discretionary penalty regime and is seen to be more objective. This is, however, only partly true as in some instances understatement penalties are levied based on the behaviour of the taxpayer, which would then be regarded as being subjective (Kruger, 2013). This adds to the complexity of taxpayers obtaining an understanding of what behavioural

patterns SARS would classify in each of the respective penalty categories. It has been noted earlier in this research that SMEs most likely lack even a basic tax knowledge and cannot reasonably be expected to make observations in this regard.

If a taxpayer is aggrieved by a penalty levied by SARS, they may request a remission of that penalty (Kruger, 2013). Once again, the legislative provisions in the Tax Administration Act (No. 28 of 2011) relating to this request are onerous and will only add to the administrative burden for SMEs. Due to these complex provisions, it is now very important for entities to outsource the advice of tax practitioners to ensure they understand the provisions relating to penalties and to avoid penalties being raised against them (Hall, 2013). This applies even more so to SMEs as their knowledge of tax is most probably limited as discussed earlier.

## **2.4 Conclusion**

This research has presented a discussion of the tax burden placed on SMEs. The aim of this chapter is to provide an overview on the extent of legislation applicable to SMEs and whether or not these provisions may be regarded as being complex. Although all taxpayers are required to comply with tax legislation, the findings of the review suggest that SMEs experience this to be more of a challenge due to their limited resources and lack of knowledge (Rametse, 2010). The complexity of legislation that has been identified in this chapter adds to this burden and SMEs will continue to struggle with the complex, constantly changing tax legislation.

The Income Tax Act (No. 58 of 1962) has been amended numerous times as discussed in the introduction to this chapter, which has resulted in legislation that is now complex and fragmented (Mandy, 2013).

As discussed above, there are many provisions contained in the Tax Administration Act (No. 28 of 2011) that require a detailed understanding by

an SME that wants to operate in a tax-compliant environment. In addition to this, any concessions or extensions that the SME will be entitled to are contained within the onerous provisions of the Tax Administration Act (No. 28 of 2011) and will need to be interpreted and understood if the SME intends to make use of them.

The complexity of a tax system adds to the tax burden placed on businesses (Gelbart, 2013). As mentioned in the article by Mandy, the Income Tax Act (No. 58 of 1962) needs to be simplified. In addition to this, changes to legislation should be kept simple and to a minimum. It is clear from the discussion in this chapter that tax legislation in South Africa is regarded as complex and the provisions onerous and difficult to understand. This is particularly so from the perspective of an SME. Unfortunately, to operate in a tax-compliance environment, the SME is bound by tax legislation and is required to comply with all provisions contained in the Acts that are relevant to it. The entrepreneurial spirit of the SMEs may be hindered due to the effort required to satisfy the conditions of complex tax legislation.

## **CHAPTER 3: THE TAX BURDEN ON SMES AND CONCESSIONS TO ALLEVIATE THIS BURDEN**

### **3.1 Introduction**

The aim of this chapter is to explore the importance of SMEs to the South African economy and provide an explanation on the burdensome regulatory environment faced by SMEs. A discussion is provided giving reasons why SMEs are so crucial to the growth of the economy, taking into account incentives that the government has introduced to alleviate the obstacles faced by them. The discussion regarding the regulatory environment goes into further detail to discuss the specific tax burden faced by SMEs in South African and globally. This will identify past research papers and articles where tax compliance is specifically described as being a burden for small businesses and will provide evidence that tax is in fact regarded as a burden by SMEs, more so than by other taxpayers and the reasons thereof. Lastly, this chapter goes on to discuss the concessions that have been made available to SMEs from a tax point of view in order to reduce the tax compliance burden and whether or not these have been effectively utilised.

Tax compliance may be viewed from different perspectives; the related compliance costs are defined as the costs incurred by a business in the course of complying with regulations (Smulders, 2006). Some of these regulations have been discussed in detail in Chapter Two in order to provide an indication of the vast amount of legislative requirements SMEs are required to comply with. There are many different areas of tax compliance and compliance activities vary, extending beyond the preparation and filling in of tax returns (Surveys & Govender, 2008). Smulders and Stiglingh (2008) stated that tax compliance was highly regressive in firm size, meaning the smaller the business, the higher the tax compliance burden.

This chapter is divided into the following sections:

- The chapter commences with an explanation as to why SMEs make a contribution to the economy that distinguishes them from larger entities and the importance of this unique contribution
- The general regulatory burden was discussed in chapter two and in the early part of chapter three which leads to the identification of the tax compliance burden. This will be considered from an international perspective and then, in more detail, from a South African perspective
- The tax burden from a South African perspective will be researched to a larger extent explaining the reasons for the existence of this burden to SMEs
- The latter part of the chapter will consider how SARS has attempted to assist in alleviating the tax compliance burden by introducing a number of tax concessions for SMEs.

### **3.2 The Importance of SMEs to the Global and South African Economy**

As discussed in Chapter two, SMEs possess characteristics and attributes that are unique and distinguish them from larger entities. One of the key differentiating characteristics is entrepreneurial involvement resulting in the entrepreneur being permanently accessible. This allows the SME to conduct business activities in a very singular way, encompassing flexibility and rapid decision-making. As mentioned earlier, formal regulations may result in a restriction of the flair of the entrepreneur and may hamper the growth and success of the SME (McKierman & Morris, 1994). Due to this distinctive contribution to the economy, SMEs should, from a regulatory perspective, be treated differently. The burden should be kept to a minimum to allow SMEs to focus on developing their business. Many countries have emphasised the importance of SMEs to their respective economies (Rametse, 2010). Smulders and Stiglingh (2008) averred that many governments all over the world have realised the importance of small businesses for the economy.

SMEs have been acknowledged for their contribution to entrepreneurship, economic growth and employment, being referred to as “engines of world economies” (Rametse, 2010:2). Small businesses in Africa have been recognised as playing an important role in stimulating development and helping to alleviate poverty (Rametse, 2010), thereby reinforcing the concept that SMEs are important from a global perspective.

SMEs have also been identified as being important to the South African economy (Rametse, 2010). A study by Upstart Business Strategies in 2004 argued that small businesses in South Africa have the ability to reduce unemployment and drive growth. According to Smulders and Naidoo (2011) small businesses could help develop the economy through job creation and a consequent reduction in poverty. In an article by Standard Bank published in 2014, it was pointed out that SMEs are key drivers of economic growth and employment in South Africa (Standard Bank, 2014). This sector has a greater ability to create jobs than capital-intensive larger entities (Surveys & Govender, 2008). According to an article by BDLive published in 2013, the number of employers in the SME sector rises by an average of 6% each year, resulting in a sector that is growing and contributing to job creation. According to Habberton and Notcutt (2010), SMEs are regarded as the building blocks of any society. This statement was based on the fact that SMEs make up 91% of formal businesses in South Africa and contribute between 55% and 57% to the country’s GDP. According to this article, SMEs also contribute approximately 61% to employment. The article goes on to make the following important statement: “SMEs form the bread and butter of our country as job providers, poverty reducers, service delivery agents and economy boosters” (Habberton and Notcutt, 2010:1).

In terms of the 2030 National Development Plan (NDP) devised by the National Planning Commission of South Africa in 2012, by the year 2030, 90% of new jobs will be created by SMEs. All of the above indicates that they are crucial for the purposes of employment and job creation in South Africa.

In 2015, SAICA conducted an SME survey, the findings of which were released in its SME Insights Report on 15 September 2015. The report provided insight into what needs to be done by different participants in the economy to encourage employment growth in line with the NDP. One of the objectives of the survey, as detailed on page 3 of the report, was “to understand the needs of SMEs better so that SAICA could engage with the national government and SMEs with the objective of improving the performance of the sector given its critical role in the NDP” (SAICA, 2015:3). Another finding from the report was that government needs to focus more on growing SMEs and keeping them in business in order to derive the benefit of the number of jobs these SMEs create in the economy. The SME sector plays an important economic role in terms of wealth and job creation (Venter & de Clereq, 2007). It is expected that growth in the SME sector will have a significant impact on the GDP of South Africa in future years through the creation of wealth and sustainable employment (Impact Trust, 2012).

The South African government has acknowledged the importance of SMEs by introducing incentives made available exclusively to them. Some of these are discussed in the paragraphs that follow. The aim of these incentives is to lessen the burdensome regulatory environment and allow SMEs to focus on business development and growth. The importance of the SME sector has been acknowledged by the South African government through the establishment of many bodies to support the start-up and growth of SMEs (Ferreira, Strydom & Nieuwenhuizen, 2010). In 2009, the Department of Trade and Industry (dti) introduced the incubation support programme (ISP) to assist in developing and creating successful SMEs by ensuring that the SME has access to skills, enterprise development plans, supplier development plans and marketing opportunities (Tustin, 2015). There are currently a variety of government support programmes run by the dti for the benefit of SMEs. These include the Small Enterprise Development Agency, the National Empowerment Fund, the National Small Business Advisory Council, the SA Micro Finance Apex Fund, etc. (Tustin, 2015). SMEs have these programmes at their disposal to assist with some of the obstacles faced by them. The

National Small Business Act (102 of 1996) was introduced into legislation in order to promote small business in South Africa.

As may be noted from the discussion above, it is clear that SMEs are crucial to the global and South African economy, not only currently but for the future as well.

### **3.3 The Identification of Tax Compliance as a Burden to SMEs**

#### **3.3.1 The international perspective**

As discussed above, from a global perspective, SMEs have been identified as being instrumental in the growth of the global economies. Many countries acknowledge the tax burden that has been placed on SMEs by providing certain measures of tax relief or incentives. A study by Rametse (2010) reported that the Australian Bureau of Statistics raised the concern that compliance with government regulations had impacted SMEs, resulting in them having to bear a disproportionate burden of compliance cost in relation to their size. It has been noted that the smaller the business, the higher the percentage of compliance costs (Rametse, 2010). Rametse also stated that this situation is experienced by SMEs in South Africa and other African countries. This provides evidence that the compliance burden relating to tax is experienced by SMEs in other countries as well as South Africa. Many countries have implemented tax policies to provide relief for SMEs in order to decrease their tax regulatory burden and give them room to prosper (Impact Trust, 2012). Some of these tax policies as discussed in the Impact Trust Interim Report are detailed below:

- Many OECD countries allow SMEs to pay tax at lower rates to foster their competitiveness. Examples of these are France, Romania and Finland. This places SMEs in a better competitive position when competing in the same markets as larger entities.

- Certain European Union member states allow SMEs accelerated depreciation allowances as well as preferential tax rates. In addition taxpayers whose turnover falls below a certain threshold can choose to opt out of being subject to VAT.
- The United Kingdom is considering implementing provisions in tax legislation where SMEs may calculate tax on a cash basis and use simplified expense rules. In addition, the UK tax authority allows SMEs to pay tax at preferential tax rates.
- Italy allows SMEs to operate in “duty-free” zones where they can benefit from lower tax rates and a reduction of their tax wedge.
- Mauritius offers many support schemes to assist SMEs from a tax perspective including bad debts allowances, lower tax rates and exemptions of Customs Duty.
- Singapore offers SMEs a once-off income tax rebate and many other tax schemes to benefit the SME.

Based on the above discussion, tax compliance, from an international perspective, has very clearly been identified as a burden on SMEs. The next section considers the impact of this burden from a South African perspective.

### **3.3.2 The South African perspective**

As discussed in Chapter One and elsewhere, the issue of tax compliance has been identified as a burden on SMEs in South Africa. The extent of this has been covered in a plethora of research papers and journal articles and is subdivided into the sections that follow.

### **3.3.2.1 *The general compliance burden***

In an article by Steve Curr in 2011, he asserted that SMEs face tax nightmares that are time consuming and costly. According to Habberton and Notcutt (2010), the key factors limiting growth for SMEs include government taxes and regulations. Even though SMEs are considered to be valuable to the economy to aid in the promotion of economic and social development, there are concerns about the constraints imposed on this sector. Many studies have identified tax compliance regulations as being extremely onerous for small businesses. In addition to general tax compliance being onerous, as indicated the complexity of ensuring compliance was also raised as a significant challenge for SMEs in South Africa (Surveys & Govender, 2008). In the 2015 SAICA SME survey (referred to above), participants identified the most difficult barriers to entry when starting a new business. Amongst these, the following were noted:

- Registering for PAYE and UIF
- Compliance with legislation
- Registering for tax
- Registering for VAT

As can be seen from the above, tax compliance issues are an important factor to consider when starting a new business. Newly formed SMEs need to consider the regulations involved in registering for the different types of taxes as well as all the types of tax legislation that need to be complied with. Tax compliance can therefore be regarded as a burden to new SMEs as well as to established SMEs.

An interesting point of view is SMEs' perception of issues that are obstacles to their growth and which of those obstacles hinder the most. Strategic Business Partnerships (SBP) environment specialists conducted research in February 2013 entitled the headline report of SBP's SME growth index: *Easier, harder for small business in South Africa*. This report went into much detail to obtain

a better understanding of the factors influencing SME growth in South Africa. The latter part of the research dealt with opinions from those SME participants as to the ten areas most hampering the growth of SMEs. The tax burden was named as one of these and participants suggested that this should be reviewed with a view to correcting SARS' deficiencies as well as simplifying tax matters.

An article by Smulders in 2014 argued that in order to assist small businesses with their administrative and compliance tax burden, their accounting and tax treatment of business transactions should be aligned. There are certain instances where the accounting and tax treatment of a transaction may differ, as the tax treatment must comply with tax legislation. An example of this is the section 11(e) Wear and Tear allowance as per the Income Tax Act (No. 58 of 1962). Section 11(e) provides write-off periods that may differ from the accounting write-off periods. This subsequently results in a temporary difference between SARS taxable income and accounting net profit. From the perspective of an SME, Smulders (2014) states that differences such as this increase the administrative tax burden on SMEs because transactions need to be considered and calculated from both the accounting and tax point of view.

### **3.3.2.2 Government initiatives**

Government acknowledgement of the burden is reflected in the NDP which states that one of its objectives by the year 2030 is to simplify the regulatory environment for SMEs, including regulations such as tax (National Development Plan, 2012: 147). The aim of the 2015 SAICA survey was to provide research and results which could be used to encourage the government to create an environment in which SMEs will thrive (SAICA, 2015). This is perceived by SAICA to be in line with the objectives of the NDP (SAICA, 2015). In her 2015 Small Business Development budget speech, Minister Lindiwe Zulu stated, "the government recognises the need to review the policy and regulatory environment that continues to hinder development, growth and competitiveness of small businesses". This provides further

evidence that small businesses have proven to be vital to the South African economy and have been recognised as such by Government authorities.

From the perspective of the DTC, general tax compliance issues for SMEs have been raised by many of the submissions to the DTC (DTC, 2014). The DTC reported that the tax compliance burden remains a major area of concern for SMEs and that the cost of complying with VAT requirements is the highest of all taxes as SMEs are required to complete an average of six VAT returns per annum. The time that staff spend dealing with tax regulations or the cost of outsourcing consultants have been identified by the DTC (2014) as impediments to the growth of SMEs. The regulatory cost for small firms is excessive while the benefits of the compliance are perceived as insignificant (DTC, 2014).

The Impact Trust Interim Report included government taxes and regulation as one of the key limitations to the growth of SMEs in South Africa.

As mentioned, the Government has recognised that the regulatory environment needs to be simplified for SMES in order to allow them to thrive and develop. An important part of this environment has been identified as tax compliance regulations as is clear from the discussion above.

### **3.3.2.3 A comparison to larger entities**

As intimated, SMEs in South Africa bear a disproportionate burden as a result of compliance regulations (Falkena *et al.* 2001). This means that they face high compliance costs and have less of a capacity to absorb the expenditure as they have less capital and resources than larger companies (Falkena *et al.* 2001). “The cost of regulation falls disproportionately on smaller firms, particularly with respect to tax costs” (DTC, 2014: 10). Although smaller firms have tax costs similar to larger firms, these costs comprise a greater percentage of total regulatory costs for the small firm than for the large firm. The result is that the SME incurs higher compliance costs than larger entities

do, yet SMEs do not have the same amount of capital invested or turnover to recover from these costs (Falkena *et al.* 2001; Chen, Lee & Mintz, 2002). The costs can then impact negatively on the resources required in the daily running of the SME. Compliance costs therefore burden SMEs more than larger entities as SMEs lack internal tax experts resulting in them outsourcing tax professionals which increase the compliance burden from a cost point of view (Chen, Lee & Mintz, 2002). It is therefore evident that tax compliance is specifically seen to be a burden more to smaller entities than to larger ones.

#### **3.3.2.4 *Internal vs. outsourcing tax activities***

Tax compliance activities can be completed either internally using the SMEs own staff or externally by outsourcing the services of tax professionals. As Smulders and Naidoo (2011) observe, one of the many obstacles and challenges that SMEs face is the complexity of the South African tax system (see also Luiz, 2002). According to Surveys and Govender (2008), already mentioned, when dealing with tax compliance there are many areas that extend beyond simply calculating taxes and completing tax returns. In their study, different areas of tax compliance costs were identified as follows:

- Costs incurred for the purpose of record-keeping
- Costs incurred in preparing and submitting tax returns
- The amount of time staff of a small business spend in ensuring proper tax compliance
- Costs incurred to make use of the services of tax practitioners, accountants and other consultants to assist in tax compliance or resolving disputes with SARS
- All other incidental costs incurred in the course of tax compliance.

Each area of tax compliance identified above attracts different costs and while some of these areas can be conducted internally others have to be outsourced. In 2008, as noted, Smulders and Stiglingh conducted a study on the annual tax compliance costs for SMEs. This summarised the costs of

compliance per turnover category and subsequently quantified such costs as a percentage of turnover. These were specifically considered from the perspective of outsourcing tax practitioners. The study examined the cost incurred by SMEs in preparing, completing and submitting income tax, provisional tax, employees' tax and VAT returns. The study also calculated the general cost of paying tax practitioners a tax retainer to retain their services on an annual basis for all types of tax compliance matters. In the 2008 study by Smulders and Stiglingh, the average total tax compliance cost for an SME averaged R 7 030 per annum for completing income tax, provisional tax, employees tax and VAT returns only, or R 25 158 per annum to retain a tax practitioner's services for a period of one year. When expressed as a percentage of turnover, the minimum tax compliance costs incurred are higher for smaller businesses than for larger businesses. The SMEs considered in the survey had turnovers ranging from R 0 to R 14 million. Those SMEs in the lowest turnover bracket reported a tax compliance cost averaging 2.2% of their turnover while SMEs in the highest turnover bracket reported a cost averaging 0.1% of their turnover. From this, it is evident that the smaller the SME, the higher the tax compliance cost. This further supports the argument that tax compliance costs are regressive in nature for SMEs.

It is clear from the above information that tax is also seen as burdensome to SMEs from a South African perspective. The next section of this research presents a discussion on the different reasons for this.

### **3.4. Reasons for the Existence of the Tax Compliance Burden**

Tax compliance, as previously discussed, has been identified in many research studies and articles, as a burden for SMEs. There have been different reasons behind the identification of this burden. The following sections provide an examination of the possible reasons for this condition. The reasons will be looked at from an internal and external perspective. The internal factors include the SME, its staff and business activities while the

external factors are the use of tax practitioners and the role SARS in the tax compliance process.

### **3.4.1 The awareness and capabilities of SMEs from a tax point of view and the hiring of tax practitioners**

The starting point of the reasoning behind the tax burden on SMEs is to consider the characteristics of the SME itself and its internal capabilities. As mentioned earlier, SMEs are not always knowledgeable from a tax point of view and cannot be expected to keep abreast with tax information and legislation. Not all SMEs, as noted, are aware of the extent of the legislation with which they are required to comply (FIAS, 2007). Small businesses cannot afford to spend excessive amounts of time completing tax forms and trying to understand complex tax legislation therefore forms and changes to legislation should be kept to a minimum (Smulders, 2014). From a general compliance point of view, the DTC reported that the SME sector does not have the required internal resources to meet the compliance burden. As intimated, the consequences of not complying with legislation as detailed in the Tax Administration Act (No. 28 of 2011) are severe and place a huge financial burden on SMEs. In addition to this, it may be difficult for SMEs to comprehend the provisions of the Tax Administration Act (No. 28 of 2011). The DTC recommended that SARS need to establish separate lines of communication and offices for SMEs as well as training for SARS officials on how to deal with SME matters. The study by Surveys and Citizen in 2008 revealed that there was a trend relating to tax compliance and the related cost: this revealed that the more complex the tax requirements, the higher the compliance costs. This occurred due to small businesses having poor or insufficient in-house capacity to deal with tax compliance, resulting in them having to outsource tax functions (Surveys & Govender, 2008). SMEs spend minimal funds on the development of tax skills within the enterprise; therefore the development of tax skills by the Government could assist SMEs to reduce the compliance burden as they will need to place less reliance on external tax experts (Venter & de Clereq. 2007).

The reference to outsourcing tax functions by Surveys and Govender (2008) introduces the external factor of utilising the services of tax professionals to assist in tax compliance activities. In the study undertaken by FIAS, it was noted that tax practitioners regard tax legislation as being too complex for most taxpayers to understand; SME's therefore have to resort to hiring accountants to manage their tax obligations. This circumvents the burden of performing complex calculations and completing tax returns: straightforward for tax practitioners, who are more than capable of performing on the SMEs' behalf. Many of the smallest firms, however, struggle with tax compliance as they cannot afford the fees payable to tax practitioners (Coolidge, Ilic & Kisunko. 2009). Thus, the cost of hiring tax professionals adds to the burden that is experienced by an SME (FIAS, 2007). In this report, tax practitioners stated that approximately 21.19% of their work relates to redoing calculations due to the SME owners' lack of tax knowledge about the legislative requirements. Higher mandatory VAT thresholds SMEs do not have the financial resources to outsource assistance to meet the requirements of compliance (DTC, 2014).

As may be deduced and as evident from existing research, many SMEs utilise the services of tax professionals. Although this reduces the burden from an administrative point of view, it simply adds to it from a cost point of view. Approximately 43% of SMEs do all their tax compliance work internally. Eleven per cent outsource all of their tax work while the remainder make use of a combination of internal and outsourced activities for tax compliance purposes. The method of conducting tax compliance activities will have an effect on the compliance costs incurred and subsequently the tax burden.

#### **3.4.2 Reliance on information prepared by SMEs**

The tax burden can often arise and worsen due to mistakes that SMEs make within their business. This section therefore considers the internal operations and characteristics of the SME and the effect it has on the tax burden. The

article by Steve Curr published in 2011 asserted that amongst some of the tax nightmares faced by SMEs, are those relating to tax queries and disputes with SARS. Curr lists three internal mistakes that SMEs make:

- Inaccurate accounting information
- Not taking ownership for tax
- Missing the SME tax detail

The three internal mistakes made by SMEs referred to above require further discussion in terms of what they mean from the perspective of the SME. As tax information is compiled from accounting records, the concept of inaccurate accounting information focuses on having a bookkeeping function that is correct and properly functioning. Curr suggested the following mitigations:

- Employing a bookkeeper who is competent enough to maintain correct accounting records
- Make use of the correct expense and income accounts for accounting purposes as well as control accounts that are reconciled on a monthly basis
- Establish clear guidelines for recognising income and expenses as well as the difference between private and company expenditure
- For SMEs that hold inventory, ensure there are correct processes in place for recording and counting stock

As may be observed from these suggestions by Curr, an efficient accounting function is imperative for preventing mistakes from a tax point of view. This will impose a further burden to SMEs as their focus is usually on developing their business rather than on administrative issues. In addition to this, SMEs might not have the financial resources at the disposal to outsource the services of a professional accountant to assist with an efficient accounting system.

The second mistake listed is that the SME does not take ownership for its tax obligations, implying that owners of SMEs place the tax responsibility on a third party and do not understand or keep abreast of tax as they should. Approximately 11% of SMEs outsource the entire tax function as discussed below. The article by Curr states that this could result in SME owners being unaware of tax deadlines, resulting in possible interest and penalties due to mistakes made. He recommends the following preventative steps to keep the SME owner up to date with tax compliance matters:

- Taxes should be included in monthly cash flow projections (if these are done). This could help SMEs to anticipate the outflow of funds that will be required to settle tax liabilities as well as fees that may be required to be paid to tax practitioners to comply with tax matters
- Separate bank accounts should be maintained to which taxes can be transferred in anticipation of payment allowing SMEs to ensure funds that need to be used for tax compliance purposes are not depleted during business operations
- Taxes should be included in annual planning forecasts to ensure that tax liability can be provided for. This will allow SMEs to make provisions for tax in the long-term and allow for better financial planning
- An external tax advisor may have to be employed to conduct an overall tax review if regarded as necessary by the SME owner. This may provide the extra advice from a tax professional that the SME requires in order to comply with the more complex areas of tax.

This third mistake listed by Curr relates to the concept of SMEs missing the tax detail and is described in the article as small business owners not being fully aware of those aspects of tax legislation that are less obvious. These are often linked to fringe benefits arising from business expenses that are paid for by the employer. This may sometimes also require professional advice from a tax advisor.

As evident from the above discussion, many reasons have been identified for the existence of the tax compliance burden on SMEs. These range from complex tax legislation to SMEs lacking knowledge and resources as well as SARS not being efficient enough. On the other hand, SMEs have the option of outsourcing tax knowledge and skills by making use of tax experts, but may not have the necessary funding to do so.

### **3.4.3 Weaknesses within the tax system**

In contrast to the tax burden from the SME's internal perspective, the burden can be considered from an external perspective i.e. SARS and the tax system.

The study by the FIAS in 2007 involved a survey relating to the tax compliance burden from the perspective of tax practitioners in South Africa.

The survey identified the following most burdensome areas from an administrative point of view for each type of tax:

- SARS takes excessive amounts of time to process, capture and correct errors made by them in respect of Income Tax
- Provisional tax penalties and interest are incorrectly raised by SARS
- VAT registration takes an excessively long time.

In addition to the aforementioned, as can be seen from these observations, the burden is also due to inefficiencies within the tax system and can be solved by SARS making improvements to the tax system.

As indicated in Chapter Two, the South African tax system can prove to be complex for any taxpayer to understand and may be still more challenging for SMEs. Rametse (2010) raised the issue of a complex tax system as being one of the reasons SMEs view tax as a burden, suggesting that tax authorities design simple tax systems to alleviate this burden. Another reason for the tax

burden that was advanced in the study by Remetse is that SMEs do not have a knowledge of tax. A suggestion by Rametse is that governments should engage in tax education programmes for SMEs headed by tax professionals who are independent of the tax office. Such an education campaign could help alleviate the tax burden (Rametse, 2010).

Smulders and Naidoo (2011) identified areas where SARS has failed to address the tax compliance burden for small businesses and where further concessions could be made:

- The need for a threshold below which small businesses are required to submit no tax return. This may result in a decreased tax burden for these small businesses as they will not be required to keep accurate records and submit annual tax income tax returns. This will in turn simplify the tax system for smaller SMES and decrease their compliance costs
- The inclusion of tax in the school syllabus. This will assist SMEs in conducting their tax affairs with little or no help from tax professionals resulting in lower tax compliance costs
- A requirement where first-time tax offenders should be required to attend courses instead of levying interest and penalties against them. This will provide a two-fold benefit as the SME would be receiving tax training and education as well as avoiding the additional penalty or interest
- A possible reduction in the interest rates and penalties levied by SARS as SMEs do not have a high level of tax knowledge and non-compliance may be unintentional. They should not be penalised too heavily in this regard.

The study by Smulders and Naidoo (2011) raised two important points on legislative requirements that have been introduced into legislation which have resulted in an increased compliance burden for businesses. Corporate entities are required to submit an Employer reconciliation declaration for the purposes

of PAYE, UIF and SDL twice a year. In addition to this, SARS has introduced a requirement that corporate entities must reconcile their income tax, VAT, employees' tax (PAYE/UIF/SDL) and customs declarations with their annual financial statements, if requested to do so by SARS.

The administrative requirements in respect of income tax are the same for small taxpayers and large taxpayers, which, as intimated, means that tax compliance costs that SMEs have to bear, are proportionately higher than those for larger businesses (Sieberhagen, 2008). It has also been noted in the study by Sieberhagen (2008) and elsewhere that tax compliance is beyond the accounting capabilities of many small businesses.

According to the Interim Report by the DTC (2014), there is much frustration from the SME sector regarding the VAT system. Issues (already mentioned) have been raised regarding the extensive VAT registration requirements and delayed VAT refunds. In addition, some SME owners are of the opinion that the threshold should be increased to R 2 million of turnover so that the VAT compliance obligation only applies to SMEs exceeding that amount. This will result in the VAT compliance burden only applying to those SMEs that exceed this threshold and smaller SMEs having no VAT compliance burden.

This above discussion provides evidence that there are several weaknesses within the tax system and from the perspective of SARS that result in an increased tax compliance burden for SMEs. This links to the lack of tax knowledge and capabilities from the perspective of the SME whereby SMEs cannot understand complex tax legislation or a complicated tax system. Steps can be taken by SARS to help alleviate the tax burden by improving the understanding and efficiency of the tax system.

### 3.4.4 A summary of the reasoning behind the tax burden

The reasoning identified in this section can be summarised as follows:

- The internal capabilities of the SME can prove to be disadvantageous as the SME may be lacking in accounting and tax knowledge. This results in the SME having accounting systems that are inefficient and do not assist in simplifying the tax compliance function. The result is that the SME requires an in depth knowledge of tax to conduct tax compliance activities. This knowledge is not common for SMEs and can raise a serious concern from a tax compliance point of view.
- An efficient accounting function could assist in alleviating the tax burden from an administrative point of view however the SME might not be able to afford the services of a professional accountant. This may be compounded by the fact that an internal accounting process that is lacking and an internal tax knowledge that is insufficient to conduct tax compliance activities may require the SME to outsource the services of a tax professional as well. This can prove to be costly and unaffordable
- The use of tax practitioners stems from the above reasoning as the lack of knowledge results in the hiring of tax professionals. The costs involved in making use of these tax professionals add to the tax compliance burden similarly to the cost of hiring professional accountants
- From an external point of view that is not within the control of the SME, the weakness of the tax system whereby SARS can make improvements to simplify the tax system may make it less burdensome on SMEs.

## **3.5 Tax Concessions Available to SMEs**

### **3.5.1 Tax Legislation and the SME: Concessions**

Chapter Three examined the regulatory burden identified as an obstacle to SMEs; government incentives to ease this regulatory burden were also discussed in chapter three. The tax burden from an international and from a South African perspective was considered later in chapter three. Section 3.4 above provided a discussion on the reasoning behind the tax burden on SMEs in South Africa. Although, government incentives were introduced to aid in alleviating the regulatory burden imposed on SMEs and provide relief from a growth and funding perspective, the burden from a tax point of view and related concessions have not yet been considered and explained. The government has acknowledged the tax burden on SMEs as discussed in chapter three and concessions from a tax point were introduced by SARS in order to ease this tax burden. These concessions will be explained in this section, to provide an indication of the measures taken by SARS to ease the said burden and whether these concessions have addressed the tax compliance burden appropriately or if further measures should be taken.

Many concessions have been introduced by SARS for the purpose of alleviating the tax burden on SMEs. In an article published by *Moneyweb* during 2012 (*Comparing small business tax regimes*, July 2012), Cotton stated that there are a number of tax concessions available to small businesses. Cotton's article goes on to discuss those available to micro businesses that meet the qualifying criteria, allowing them to pay turnover tax instead of a number of other taxes. This is discussed below in relation to the tax legislation identified in Chapter two.

### **3.5.2 Corporate income tax, provisional tax and dividends tax concessions**

Income tax concessions assist in reducing the tax burden that has been imposed on SMEs. The burdens identified in section 3.4 may be alleviated by tax concessions implemented by SARS. In order to determine if this is the case, each of the tax concessions will be reviewed in the paragraphs that follow. Many SMEs may qualify for the tax concessions in the Income Tax Act (No. 58 of 1962) available to SBCs and micro businesses. In order for an SME to claim these, it would have to meet the requirements as detailed in the relevant sections of the Income Tax Act (No. 58 of 1962). Should the SME do so, it will be entitled to preferential rates as detailed in Appendix 2 at the end of this research study.

An SME may qualify as an SBC as defined earlier in this research in terms of section 12E. Should the SME meet these requirements, the following tax concessions are permitted:

- Tax is levied at lower rates ranging from 0% to 28% depending on the SBC's taxable income. This table is detailed in Appendix 2
- Capital allowance write-off periods are accelerated with manufacturing assets being allowed a 100% write-off in year one of acquisition. Normal companies are allowed write-off periods for manufacturing assets based on section 12C of the Income Tax Act (No. 58 of 1962) either four year or five years depending on whether the assets are new or used. New assets are allowed 40% in year one and 20% in years two to four. Used assets are allowed 20% in years one to five
- Non-manufacturing assets are allowed a write-off period of 50% in year one, 30% in year two and 20% in year three. This is also accelerated as normal companies may claim allowances on non-manufacturing assets as per section 11(e) of the Income Tax Act (No. 58 of 1962). These wear and tear allowance periods are published by SARS depending on the category of asset.

The tax concessions allowed in section 12E assist in reducing the tax burden from a financial perspective as the qualifying SME will pay tax at lower rates resulting in a lesser tax liability. From a compliance burden point of view, the accelerated capital write-off period may assist in decreasing the tax burden in the long-term as capital assets can be written off over a shorter period of time.

In addition to this, an SME may qualify as a micro business, resulting in a much more simplified tax regime. The aim of turnover tax is to decrease the cost of tax compliance for very small businesses while not necessarily decreasing their tax liability (Sieberhagen, 2008). Turnover tax is the simplified tax regime introduced on 1 March 2009 for SMEs that meet the requirements to qualify as a micro business. It is a substitute for income tax, capital gains tax and dividends tax (SAIT, 2011) and is a voluntary tax that businesses can elect to pay. Such tax is levied on taxable turnover and not on taxable income as normal corporate income tax. There are certain inclusions and exclusions from taxable turnover as detailed in legislation. The turnover tax table containing tax rates is provided in Appendix 3.

An SME that qualifies as a micro business will not incur capital gains tax (CGT) since the proceeds on sale of any asset are taxed as part of the turnover tax itself. Taxable turnover includes 50% of the proceeds on sale of an asset. An SME that qualifies as a micro business will not be required to pay dividends tax on the first R 200 000 of dividends declared. The SME will not have the administrative burden of calculating capital gains/losses or submitting dividends tax returns for the first R 200 000 of dividends declared. As mentioned earlier, the turnover tax regime was not introduced with the intention of reducing the financial tax burden but rather the compliance and administrative burden. This is why the turnover tax regime is regarded as a simplified tax regime.

Another concession available to SMEs, as mentioned in Chapter Two, relates to corporate income tax which is paid via provisional tax payments. Entities with a taxable income of greater than R 1 million are required to base their

second provisional payment on an estimate that is within 80% of their actual taxable income. An entity with a taxable income under R 1 million may base its second provisional payment on the lesser of the basic amount of 90% of its actual taxable income without incurring any under-estimation penalty. This allows smaller businesses more flexibility when making their second provisional tax payment as they may not have information available to make a very accurate estimate. This provides SMEs that fall in this turnover bracket with some relief from an administrative and compliance point of view.

### **3.5.3 VAT concessions**

As mentioned in chapter two, the VAT threshold has been increased from taxable supplies of R 300 000 to R 1 million per annum. The result is that many SMEs are excluded from the VAT net and avoid the VAT compliance burden.

Another VAT concession that is in place allows SMEs with supplies not exceeding R 2.5 million to report income and expenditure on a cash basis instead of an accrual basis. The latter creates a larger compliance burden and, as pointed out, many SMEs do not maintain effective accounting systems (DTC, 2014). Reporting on an accrual basis requires SMEs to keep accurate accounting records and can also place a huge financial burden on SMEs as VAT may need to be paid to SARS even before payment is received from customers. The cash basis of reporting VAT requires less administration from an accounting point of view and allows the SME to pay VAT as and when payment is received from their customers. This removes the possible financial imbalance of funds from a VAT point of view. The DTC interim report recommends that this cash basis be allowed to all VAT vendors that meet the Income Tax Act (No. 58 of 1962) requirements of an SBC in terms of section 12E.

### **3.5.4 Employees' tax concessions**

Employees tax was introduced in chapter two as an aspect of tax legislation that created an additional burden for the SME as they collect tax from the salary of their employees and pay it over to SARS therefore effectively acting as an agent for SARS. This created a huge administrative burden as employees tax returns need to be submitted every month with reconciliations completed twice a year. An important provision affecting employers that are liable to withhold PAYE is the Employment Tax Incentive (ETI) which was introduced by SARS on 1<sup>st</sup> January 2014 under the Employment Tax Incentive Act, 2013. The ETI provides an incentive to employers that are registered for PAYE giving them a financial incentive for certain PAYE-paying employees. The aim is to encourage employers to employ unskilled youth. The DTC interim report has identified the ETI to be a concession that might be beneficial to SMEs if correctly utilised. Although it is an incentive that has been introduced to all employers, not only SMEs, it could be beneficial to SMEs specifically, with regard to their growth and development. Its effect is to reduce the cost of hiring young workers as the government shares in a portion of the cost. It was introduced by SARS in line with the announcement by the President during his State of the Nation Address in 2010 and will run for a period of three years and will end on 31<sup>st</sup> December 2016. The ETI allows employers a rebate from SARS for PAYE paid on the remuneration of certain qualifying employees. The DTC has identified that the initial problem with the ETI is that SMEs that are not registered for tax have nothing to gain from the ETI. A general reaction to the ETI, as reported by the DTC in its Interim Report, is that the ETI is too complicated and for this reason is not of much use to the SME sector. The DTC has also reported that another problem arising from the ETI is that it is given to taxpayers in the form of reducing their PAYE liability for the month and not as a refund if the PAYE liability is lower than the ETI. The DTC recommends that a regulation pertaining to refunding the amount by which the ETI exceeds PAYE should be implemented as a matter of urgency. This may make the ETI more attractive to SMEs and assist in their growth and development (DTC Interim report, 2014). In order for an SME to make use of the ETI, it would first need to understand the complex

legislative provisions which would then add to the tax burden and further supports the notion that tax legislation is too complex for SMEs.

From an employees tax point of view, SMEs may also be liable to pay SDL on behalf of their employees if they meet the requirements to do so. In terms of the Skills Development Levy Act of 1999 (SDL Act), SDL is only payable by those employers whose annual payroll exceeds R 500 000. One per cent of remuneration for these qualifying employers is paid over by an employer on behalf of their employee in terms of section 3 of the SDL Act. The threshold was increased from R 250 000 to R 500 000 in 2005; the change is regarded as a tax concession to SMEs since smaller SMEs with a payroll below R 500 000 will not be liable for SDL. The amendment will therefore exclude certain SMEs from the SDL net. SMEs will need to keep up to date with tax legislation to understand how the change in the SDL threshold affects them and their liability for SDL. The increased threshold could be beneficial to many SMEs as it keeps them out of the SDL net therefore reducing the tax compliance burden.

### **3.5.5 Concluding remarks: Concessions**

As can be noted from the discussion above, there have been many tax concessions introduced into legislation to assist in alleviating the tax burden on SMEs. Despite this, many research studies have made recommendations to help alleviate the tax burden even further. This raises the question of why further recommendations are made and whether or not they are necessary? In a statistical survey by Abrie and Doussy (2006), it was identified that fewer than 50% of SMEs are aware of the tax incentives available to them. The reasons may be that the tax system is too complex and/or SMEs are lacking in the required tax skills. Some of the recommendations that follow in Chapter four relate to training and educating SME owners and their staff to make them more knowledgeable from a tax perspective. This could possibly assist in keeping them informed of changes to legislation and the tax concessions available to them. A costly solution to this, as suggested earlier, is outsourcing

tax and accounting professionals to assist in tax compliance however this proves to be very expensive and simply adds to the SME's tax compliance burden. One of the reasons for further recommendations is to keep the SME informed while other recommendations relate to simplifying the tax system even further and allowing SMEs more flexibility from a legislative and compliance point of view. Although many of these concessions have provided tax compliance relief to SMEs to some extent, numerous recommendations have been made to alleviate the tax burden for SMEs even further as the concessions thus far do not reduce the tax burden to the extent that tax is no longer seen as a significant regulatory burden. The tax concessions discussed above have been introduced over many years; however, recent research studies still identify tax compliance as a burden to SMEs. Tax compliance is a major area of concern for SMEs (DTC, 2014) and compliance with government taxes is a key limitation to the growth of SMEs (Impact Trust, 2012). The tax compliance burden and compliance with tax legislation requires attention on the part of SMEs (Smulders, 2014, SAICA, 2015). This indicates that although the concessions may have assisted in alleviating the tax compliance burden, they are not sufficient and the recommendations presented in chapter four are applicable and may assist in further reducing the tax burden.

### **3.6 Conclusion**

The discussion in Chapter Three has provided confirmation of the importance of SMEs to the South African economy; it has also provided evidence of the tax burden imposed on these SMEs. The discussion explained the possible reasons for the existence of this burden as well as providing a detailed discourse on the tax concessions that have been made available to SMEs due to their vital role in the economy and their part in the NDP for 2030. Despite this, as per section 3.5, further concessions are still required as current research studies still identify tax compliance as a burden to SMEs.

The discussion in Chapter Three can be summarised as follows:

<b>Tax burden</b>	<b>Concessions</b>
<p>SMEs, their owners and staff may lack the necessary skills and knowledge to calculate and submit tax returns as well as not understand or be able to interpret tax legislation.</p>	<p>A simplified turnover tax system for Micro businesses provided an all-in-one tax encompassing income tax, capital gains tax and dividends tax and reducing the extent of tax compliance for SMEs. Even SMEs with limited or no tax knowledge may be able to navigate through the turnover tax system with ease.</p> <p>SDL is only payable by businesses whose payroll exceeds R 500 000 therefore reducing the SDL compliance burden by keeping smaller SMEs out of the SDL net and not requiring them to use their limited knowledge of tax to understand and comply with SDL legislation.</p> <p>The VAT threshold has been increased to R 1 million therefore removing many SMEs from the VAT net and eliminating the VAT compliance burden. These SMEs will not be required to have an in depth knowledge of the VAT system and legislation.</p> <p>Certain SMEs with taxable supplies not exceeding R 2.5 million are</p>

	<p>allowed to report VAT on a cash basis instead of an invoice basis therefore aligning with business activities and recording and reducing the administrative burden for the SME.</p>
<p>SMEs have internal deficiencies that result in an increased tax burden which can be reduced if these deficiencies are corrected.</p>	<p>SARS has not provided support to SMEs to assist in developing their internal knowledge and processes. In recent years however, SARS offices have dedicated a section to assist SMEs with tax-related problems which may aid in correcting internal deficiencies should the SME choose to utilise this facility available to them.</p>
<p>SMEs do not have adequate financial resources to outsource the services of tax professionals and tax experts.</p>	<p>A better understanding of the tax system will result in SMEs not requiring the services of tax practitioners. This has been addressed by SARS in many ways as identified above where tax concessions have been introduced to reduce the tax compliance requirements for SMEs.</p> <p>The introduction of turnover tax provides a simplified tax system for SMEs whereby they may not require the services of tax professionals and can complete tax submissions internally.</p> <p>The increased VAT/ SDL thresholds</p>

	<p>remove some SMEs from the VAT/SDL net thereby eliminating the compliance requirements from this point of view resulting in the SMEs needing less assistance from tax professionals thus reducing compliance costs.</p>
<p>For those SMEs that do register as taxpayers and either outsource tax professionals or conduct tax compliance internally; compliance costs comprise a greater percentage of costs when compared to larger entities.</p>	<p>The concessions referred to above also assist in a reduction in outsourcing therefore lower compliance costs. As mentioned above, the turnover tax system and higher thresholds for VAT/SDL result in simplified tax requirements for some SMEs and will result in a decrease in tax compliance costs both internally and externally.</p>
<p>The tax system has been referred to as onerous and complex with SARS officials and internal processes referred to as inefficient.</p>	<p>Once again, the introduction of the turnover tax system has provided an opportunity whereby tax compliance is greatly simplified for those SMEs that qualify as micro businesses.</p> <p>The Tax Administration Act (No. 28 of 2011) aims to simplify the duties and responsibilities of the taxpayer (SME) and SARS thereby providing some relief from a complex and onerous tax system.</p> <p>The introduction of SME-dedicated desks at SARS offices may help</p>

	bridge the communication gap between SARS and SMEs making relationships between SARS officials and SMEs more efficient.
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## **CHAPTER FOUR: RECOMMENDATIONS FOR FURTHER TAX CONCESSIONS**

### **4.1 Introduction**

As may be understood from section 3.5.5, several tax concessions have been introduced into legislation in order to simplify the tax burden placed on SMEs. Recent studies have still however identified tax compliance as a key factor that is limiting the growth of SMEs. As a result, many research studies provide recommendations to SARS to assist in further reducing the tax compliance burden. These recommendations will be discussed in detail in the paragraphs that follow.

### **4.2 Recommendations for Further Tax Concessions that should be Made Available to SMEs**

Numerous research papers on the tax burden as it is perceived by SMEs provide suggestions on additional measures that can be taken to reduce this tax burden. These are discussed below.

#### **4.2.1 Recommendations from a government regulatory perspective**

The initial part of the recommendations will be considered from the perspective of the DTC which was formed for Government regulatory purposes and to provide input to the Minister of Finance regarding tax matters. According to the Interim Report by the DTC in 2014, one of its concerns is to ensure that the tax system promotes SME's activities as per the NDP as well as ensuring that costs of compliance do not hamper the growth of this important sector. The DTC (Interim Report, 2014) has made a recommendation from an overall perspective regarding tax on SMEs. The suggestion is that tax compliant SMEs be allowed tax rebates based on the income bracket in which they are classified. This should take the form of a

refundable compliance rebate for the SMEs that do comply. This could encourage SMEs to pay closer attention to tax compliance activities as compliance could provide a financial incentive that would decrease their tax liability. In addition, a tax clearance certificate should automatically be issued together with the rebate in order to avoid the administrative burden of plying for a tax clearance certificate (Small business, 2014). The DTC also advised that SMEs should be exempt from estimating taxable income at year-end for provisional tax payment purposes, as they do not possess the necessary resources to make an accurate estimate. The estimation deadlines should be moved to after the year-end to reduce the regulatory burden from a provisional tax point of view allowing SMEs to avoid the possible interest and penalties linked to provisional tax. As can be seen from the recommendations made in this Interim report, there is much room for improvement in order to reduce the tax regulatory burden on SMEs.

#### **4.2.1 Recommendations made in earlier studies**

In an earlier study by Abrie and Doussy (2006), the following recommendations were made to the South African Government to further reduce the said burden:

- The different types of taxes that the SME has to administer should be reduced as this will lessen the number of forms the SME needs to submit. This will result in the SMEs' staff having to undergo less training, thereby making the training process simpler.
- The law surrounding income tax should be streamlined and simplified in order to assist SMEs in understanding and implementing tax legislation.
- Additional tools should be made available to SMEs to assist them in tax administration and compliance. A suggestion is that SARS should make a free accounting package available to SMEs which will subsequently pre-populate tax forms for SMEs. There should be little

human effort required, thereby not requiring the SME to have advanced tax skills.

These recommendations made by Abrie and Doussy (2006) will reduce the extent of knowledge required by the SME as referred to in section 3.4.1 and possibly lower this compliance burden. Simplifying tax law is also targeted at reducing weaknesses within the tax system as referred to in section 3.4.3.

The study by the FIAS (2007) made the following suggestions to help ease the tax burden on SMEs:

- A simplified income tax regime for SMEs may solve the problem of SMEs not being able to adhere to the applicable tax laws and legislation.
- Higher mandatory VAT thresholds should be put in place, in this way removing many SMEs from the VAT net and reducing their tax burden
- SARS call centre agents need to be more knowledgeable with regard to tax matters.

The recommendations by the FIAS (2007) once again refer to the extent of knowledge required by the SME in section 3.4.1 and would not need to be so extensive if tax laws (as referred to in chapter 2) were simplified. Exclusion of the SME from the VAT net could simplify tax requirements to the extent of the SME being able to conduct tax compliance activities internally instead of outsourcing the services of tax professionals that could prove to be costly. Knowledgeable call centre agents (also related to weaknesses within the tax system in section 3.4.3) could assist those SMEs that do not have an extensive knowledge of tax internally or those that do not have access to outsourced tax professionals.

In the study by Surveys and Govender in 2008, the following suggestions were ranked by respondents of the survey in order of preference when asked how the compliance burden on SMEs could be further reduced:

1. Direct access to SARS assessors
2. A reduction in penalties and interest
3. Simplified tax registration procedures
4. A higher turnover threshold for compulsory VAT registration
5. A community-based person to assist in confidential tax matters
6. Facilities to allow SMEs to register and amend details online
7. Ensure that SARS decision-making powers are decentralised to the regional offices
8. Provide additional SARS offices in remote areas.

Suggestions 1, 3, 6, 7 and 8 are related to weaknesses within the tax system as identified in section 3.4.3 and improvements in this regard will assist SMEs with tax compliance. Suggestion 2, 4 and 5 will assist SMEs from a regulatory point of view as it will decrease the extent of knowledge and capabilities the SME will require as detailed in section 3.4.1. These suggestions will simplify the tax system for the SME and SMEs in reducing the amount of costs the SME spends on external tax compliance services.

The study by Smulders and Stiglingh in 2008 put forward the suggestion that the government should provide training and mentoring programmes free of charge to assist SMEs with their lack of expertise. This would result in a potential saving, as SME owners may be able to complete their own taxes and not have to outsource this function to tax practitioners. This is also directed at the burden identified in section 3.4.1.

In 2011, Smulders and Naidoo published their (previously mentioned) research study on the compliance burden and identified the following areas where further simplification is required, as SARS has only partially addressed the burden:

- The complex language that is used in tax laws and legislation
- There is a lack of software available from SARS to assist small businesses with the record-keeping for tax compliance purposes
- The second provisional payment estimate is subject to penalties if it is under-estimated for those small businesses with a taxable income greater than R 1 million.

The above three observations require further discussion. As discussed in Chapter Two, tax legislation is not only lengthy but also complex. There are many provisions and rulings that an SME will need to comply with to avoid interest and penalties. The first observation by Smulders and Naidoo is in line with the discussion in Chapter Two as it implies that tax legislation needs to be further simplified for small businesses to understand and therefore encourage tax compliance. This links to section 3.4.1 regarding the lack of tax knowledge on the part of the SME as well as the costs involved in outsourcing tax professionals. With regard to observation two above, the research states that SARS' role in software development is debatable. However, an initiative on the part of SARS may encourage further tax compliance by small businesses. This links to section 3.4.2 which details internal errors made by the SME and a tax-related accounting package can assist in this regard. Concerning the third observation, it is noted that the initiative addressed by SARS relates to second provisional payments for taxpayers with a taxable income less than R 1 million. This concession has been discussed above. The observation by Smulders and Naidoo (2011) refers to taxpayers with a taxable income greater than R 1 million as these taxpayers need to base their second provisional tax payment on an estimate that is within 80% of actual taxable income as per legislation discussed in Chapter Two. If not, they risk an understatement penalty. The abovementioned study states that this needs to be further researched and amended to ensure that the compliance burden is adequately addressed in these areas. Many areas are however, receiving attention from SARS for future initiatives in order to empower small businesses to grow and develop (Smulders & Naidoo, 2011).

Although these recommendations were made in much earlier studies, most of these recommendations have not yet been implemented and subsequently not contributed in decreasing the tax burden on SMEs.

#### **4.2.3 Recommendations made in recent studies**

The paragraphs that follow provide a discussion on the recommendations made in more recent studies.

The interim report by the Impact Trust (2012) makes the following recommendations that aim to reduce compliance costs for SMEs:

- The administrative burden could be reduced by creating an all-in-one form for all tax-related registrations. This is essentially the same as the first suggestion by Abrie and Doussy (2006) and targets the same aspect of the tax burden
- A single tax number should be used for all taxes across a single entity thereby requiring less administrative work for the SME
- The VAT threshold should be increased to R 5 million which will remove many SMEs from the VAT net reducing their tax compliance requirements as well as the extent of knowledge they are required to have as mentioned in section 3.4.1
- The existing VAT category thresholds should be amended to reduce the administrative burden imposed on SMEs to submit multiple VAT returns each year. This also reduces a administrative burden and will decrease the extent of capabilities the SME is required to have as explained in section 3.4.1
- SARS should set up an SME office aimed at providing education, support and training to SMEs to assist in reducing the tax burden. This type of support and training could assist in reducing the tax burden as explained in section 3.4.1 and 3.4.3 as it could assist the SME from an internal perspective.

In a more recent study, Smulders (2014) makes the following suggestions regarding measures to reduce the tax compliance burden:

- Definitions contained in tax legislation should be simplified which would be aimed at targeting the burden identified in section 3.4.1 and allow SMEs with limited tax knowledge and capabilities to conduct tax compliance activities
- SMEs and SARS officials should be provided with more training to make tax compliance less of a burden. This would increase the value of the assistance that SARS officials can provide to SMEs thereby dealing with the weakness of the tax system (section 3.4.3) and at the same time making SMEs more knowledgeable from a tax perspective
- VAT reporting and recording should be allowed on a cash basis for all SMEs therefore aligning the accounting and tax treatment. This will reduce the internal errors made by SMEs as referred to in section 3.4.2 and effectively reduce this aspect of the tax burden.

In an article in 2014, Smulders recommended the following additional concessions for small businesses. The article focused on comments by the South African Institute of Tax Practitioners (SAIT) on the DTC Tax policy interventions:

- The VAT and SDL thresholds should be increased. This will exclude many SMEs from the VAT and SDL net and reduce their compliance with regards to these types of taxes
- Changes to legislation and operational or administrative compliance should be kept to a minimum. This will reduce weaknesses within the tax system as explained in section 3.4.3
- Taxation should be introduced as a subject at high school level to equip all school leavers with basic tax skills
- SARS should provide complimentary workshops to small businesses in order to broaden their tax knowledge and assist them in tax compliance.

The final two recommendations above are aimed at the tax burden explained in section 3.4.1 and 3.4.2 which relate to the SME from an internal perspective. This could strengthen their knowledge of tax and capabilities when conducting tax compliance activities.

Many of these recommendations are similar to those made in section 4.2.2 above. Based on the vast amount of research conducted on these suggested recommendations, it is evident that the implementation may aid in relieving the tax burden even further.

### 4.3 Conclusion

As can be gathered from all of the above information, numerous recommendations and suggestions have been put forward to assist in decreasing the tax burden imposed on SMEs. The implementation of these recommendations over and above the current tax concessions as explained in chapter three have the potential of alleviating the tax burden even further.

A summary of the recommendations made in the various research studies above can be made as follows:

Area of tax compliance	Recommendation
Capabilities of SMEs, their owners and staff	SARS should provide tax training and education to SMEs owners and their staff in the form of tax education at school-leaving level as well as workshops and seminars.
Internal processes of SMEs	SARS should provide SMEs with free software to assist in record-keeping for accounting purposes that will assist in completing tax returns therefore aiding in tax compliance

	activities.
Tax legislation	<p>A simplified tax regime with legislation presented in a simpler more understanding language making it easier for SMEs to understand and implement. Amendments to legislation and the tax system should be kept to an absolute minimum.</p> <p>Higher thresholds for VAT/SDL removing more SMEs from the VAT/SDL net and reducing these compliance burdens.</p> <p>The process surrounding estimating provisional and interim tax payments need to be simplified and more flexibility should be allowed to SMEs with regards to the estimate amount and the timing of the submission of the estimate.</p>
SARS operations	<p>A better level of communication and contact between SARS and the SME in the form of SME-exclusive help centres where SARS staff and better trained and equipped to deal with SME-related issues</p>

The recommendations relating to the first two areas of compliance above will specifically target the tax burden raised in section 3.4.1 by providing SMEs with tax education and training and increasing their capabilities from a tax point of view. This should in turn mitigate the tax burden explained in section 3.4.2 whereby the knowledge gained may assist SMEs in reducing the

internal errors made by it which will in turn decrease the tax compliance burden

The recommendations relating to the second two areas of tax compliance above are aimed at the tax burden as explained in section 3.4.3 and will improve the weaknesses within the tax system by strengthening relationships between SARS and SMEs as well as by making the provisional tax process more flexible and SME-friendly.

## CHAPTER FIVE: CONCLUSION

### 5.1 Final Remarks

The following is a quote by a small business owner, citing from the article by Smulders (2014: 3):

I feel that the art of entrepreneurship is being oppressed by red tape and administration. This makes it very difficult for small business to have a competitive edge. I counted and just in my business I need to submit on a yearly basis round about 45 statutory documents and forms. For a small business owner that is not trained and competent in the administration of a business this is a huge amount of work that needs to be correctly submitted to the various stakeholders with severe penalties and interest imposed if there is not compliance on their regulation.

This quote sums up the compliance burden imposed on SMEs. A very important point made in this article is that the main criterion for taxing a small business should be simplicity. SMEs do not have the knowledge, time and resources available for tax compliance and they require excessive amounts of time from tax practitioners in order to gain an understanding of tax matters (Smulders, 2014).

As discussed in Chapter Two, it is evident that there are extensive legal requirements that an SME needs to comply with from a tax point of view. In chapter three, it is suggested that the simplest solution found to the tax burden with regards to SMEs not having the required skills and knowledge is that of engaging the services of tax professionals. This is not always cost-effective, let alone affordable. As a result, an SME has no choice but to conduct its tax affairs using resources that are available internally.

During his 2015 budget speech, South Africa's Minister of Finance Nhlanhla Nene announced that there would be a reduction in tax rates for micro businesses. In addition to this, from 1<sup>st</sup> January 2016, the SBC tax regime that was introduced in 2001 will come to an end. This means that those entities that qualify as SBC's will no longer pay tax at preferential rates but rather at the corporate tax rate of 28%. The end of the SBC tax regime brings with it a tax credit based on the recommendation of the DTC (Timm, 2015). This credit will be allowed to entities that fall within the qualifying tax brackets. SARS also plans to set up small business desks at its regional offices to assist small businesses in complying with tax. These initiatives may provide further relief for SMEs from a tax compliance point of view.

An initiative that has confirmed the reliance which the South African government plans to place on the SME sector is described in the National Development. This details the expectation from SMEs in terms of the number of jobs they are expected to create by the year 2030. The Davis Tax Committee has been formed with this expectation in mind for the purposes of making recommendations to the Finance Minister regarding SMEs and the tax burden imposed on them. The DTC has made numerous recommendations in its Interim Report, many of which were aimed at reducing the tax compliance burden imposed on SMEs by SARS and the Government, including suggesting initiatives on the part of SARS to provide training and skills-based services to SMEs. The DTC has also identified that certain areas of legislation need to be re-examined for the purpose of simplifying the provisions of the relevant sections to make these more understandable for SMEs.

Chapter four of this study makes it clear that although many tax concessions for SMEs have been introduced into legislation in recent years, there is still room for improvement.

## 5.2 Conclusion

As discussed earlier in this research paper, the characteristics of SMEs are unique and this distinguishes them from larger entities. Entrepreneurial involvement is one of these distinguishing features and results in the entrepreneur being permanently accessible therefore allowing the SME to conduct business activities in a very singular way allowing more flexibility and quick decision-making. Formal regulations have been noted to hamper the growth and success of the SME (McKierman & Morris, 1994). Due to this distinctive contribution to the economy, SMEs should, from a regulatory perspective, be treated differently. The burden should be kept to a minimum to allow SMEs to focus on developing their business.

It has been emphasised in the discussion thus far that the tax compliance burden is a major obstacle in the success of SMEs in South Africa. This has been considered specifically from an administrative and compliance point of view. In recent years, the Government has acknowledged the existence of this burden and measures have been taken in an attempt to reduce it. Most of these measures have taken the form of tax concessions on the part of SARS. Although these concessions have assisted SMEs in alleviating part of the tax burden, there is still room for improvement as highlighted in section 4.2 above. The importance of the SME sector has been emphasised by government initiatives over the past few years, however tax is still clearly seen as a burden to SMEs. Tax compliance remains a “notorious burden” for SMEs hopefully with a view to SARS easing this burden in upcoming years.

While the importance of the SME sector has been emphasised by government initiatives over the past few years, tax is still clearly perceived as an encumbrance to SMEs. An analysis undertaken by the Impact Trust (2012) reported that there is still room for improvement with regards to the regulatory framework for SMEs in South Africa. Reducing the burden related to tax compliance for SMEs will drive SME development and growth in the long-term (Rametse, 2010). Tax compliance utilises resources that could be devoted to running the SME’s business more effectively. SARS is in dire need of more

campaigns and initiatives to inform SMEs of the concessions available to them as well as to build SME's confidence in their system. In addition to this, SARS needs to ensure that changes to the tax system do not result in an even more complex system (Abrie & Doussy, 2006). It is evident from the discussion provided in this dissertation that many improvements have been made to the tax system with regards to SMEs and their role in the economy. It is nonetheless imperative that these concessions be accorded a greater deal of attention and that the tax burden on SMEs be reduced to an absolute minimum.

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## APPENDICES

### Appendix One: SMME Classification

EXTRACT FROM THE NATIONAL SMALL BUSINESS ACT (102 OF 1996)

<b>Sector or subsector in accordance with the Standard Industrial Classification</b>	<b>Size of class</b>	<b>The total fulltime equivalent of paid employees</b>	<b>Total turnover</b>	<b>Total gross asset value (fixed property excluded)</b>
Agriculture	Medium	100	R5m	R5m
	Small	50	R3m	R3m
	Very Small	10	R0.50m	R0.50m
	Micro	5	R0.20m	R0.10m
Mining and Quarrying	Medium	200	R39m	R23m
	Small	50	R10m	R6m
	Very Small	20	R4m	R2m
	Micro	5	R0.20m	R0.10m
Manufacturing	Medium	200	R51m	R19m
	Small	50	R13m	R5m
	Very Small	20	R5m	R2m
	Micro	5	R0.20m	R0.10m
Electricity, Gas and Water	Medium	200	R51m	R19m
	Small	50	R13m	R5m
	Very Small	20	R5.10m	R1.90m
	Micro	5	R0.20m	R0.10m

Construction	Medium	200	R26m	R5m
	Small	50	R6m	R1m
	Very Small	20	R3m	R0.50m
	Micro	5	R0.20m	R0.10m
Retail and Motor Trade and Repair Services	Medium	200	R39m	R6m
	Small	50	R19m	R3m
	Very Small	20	R4m	R0.60m
	Micro	5	R0.20m	R0.10m
Wholesale Trade, Commercial Agents and Allied Services	Medium	200	R64m	R10m
	Small	50	R32m	R5m
	Very Small	20	R6m	R0.60m
	Micro	5	R0.20m	R0.10m
Catering, Accommodation and other Trade	Medium	200	R13m	R3m
	Small	50	R6m	R1m
	Very Small	20	R5.10m	R1.90m
	Micro	5	R0.20m	R0.10m
Transport, Storage and communications	Medium	200	R26m	R6m
	Small	50	R13m	R3m
	Very Small	20	R3m	R0.60m
	Micro	5	R0.20m	R0.10m

Finance and Business Services	Medium	200	R26m	R5m
	Small	50	R13m	R3m
	Very Small	20	R3m	R0.50m
	Micro	5	R0.20m	R0.10m
Community, Social and Personal Services	Medium	200	R13m	R6m
	Small	50	R6m	R3m
	Very Small	20	R1m	R0.60m
	Micro	5	R0.20m	R0.10m

## Appendix Two: SBC Tax Rates

(For any year of assessment ending during the period of 12 months ending on 29 February 2016.)

<b>Taxable income (R)</b>	<b>Rate of tax (R)</b>
0 – 73 650	0%
73 651 – 365 000	7% of the amount above 73 650
365 001 – 550 000	20 395 + 21% of the amount above 365 000
550 001 and above	59245 + 28% of the amount above 550 000

(SARS. 2015)

## Appendix Three: Turnover Tax Rates

(For any year of assessment ending during the period of 12 months ending on 29 February 2016.)

<b>Turnover (R)</b>	<b>Rate of tax (R)</b>
0 – 335 000	0%
335 001 – 500 000	1% of each R1 above 335 000
500 001 – 750 000	1 650 + 2% of the amount above 500 000
750 001 and above	6 650 + 3% of the amount above 750 000

(SARS. 2015)