The Effectiveness of Tax Relief Initiatives on SMEs in South Africa

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Abstract: Tax relief initiatives have been introduced by the South African government in order to assist small business to grow and become sustainable. The high failure rate of businesses coupled with the alarmingly high rate of unemployment in the country is the main reason the government embarked on these initiatives and strategies. The different tax initiatives available to qualifying small businesses include small business corporation tax and turnover tax. The research has been undertaken to determine if small business tax initiatives introduced by SARS are effective and are being utilised by small businesses. A questionnaire was sent to eighty five small business owners to determine if they are aware of small business tax and turnover tax and also to determine if they are utilising these initiatives. The findings from this study reveal that approximately half of the respondents do not know about these specific tax initiatives. Only a small percentage of small business are eligible for small business tax and none of the respondents in the sample are eligible for turnover tax. The majority of small business owners agree and strongly agree that the initiatives introduced by the government are ineffective and need to be revised.

Keywords: SMEs; SARS; Turnover tax; SBC Rates

JEL Classification: G38

1. Introduction

The cost and complexity of tax compliance for small, medium and micro enterprises in South Africa has been highlighted by the National Treasury and South African Revenue Services (SARS) as an important matter (Govender, 2008).

In South Africa, the failure rate of small businesses is extremely high, with a large proportion of these small businesses not developing into established firms (Olawale & Garwe, 2010). This is contrary to the strategic objectives set out by the national government. One of the main reasons for business failure is the excessive regulatory

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burdens that are placed on small businesses. In terms of all regulations and laws, tax compliance costs are considered to be the largest component of all compliance costs incurred by businesses. (SBP, 2004) VAT and other tax related issues are considered to be the most problematic regulations for these small businesses. (SBP, 2004)

Although there has been literature on tax compliance and the costs associated with compliance, there has been limited research about the influence of tax relief initiatives on the small business sector in South Africa.

This study aims to determine if tax relief initiatives introduced by SARS have been successful at addressing compliance challenges for small businesses specifically in the province of KwaZulu Natal. The findings from this study reveal that the current tax relief initiatives introduced are not effective fully and the general perception amongst small business owners is that more initiatives should be introduced by the government to assist these owners.

2. Literature Review

2.1. Tax Relief Initiatives for Small and Medium Businesses

Many high income countries, excluding the United States, have significantly lowered corporate tax rates and introduced special tax regimes to assist with alleviating the tax burden. The purpose of these initiatives are intended to support local economies. Initiatives are specifically introduced to encourage business formation and expansion as well as to improve the international competitiveness of these countries. The United States has not reduced its corporate income tax rate since 1986 and has significantly increased the income tax rates of unincorporated businesses. (Hines Jr, 2017) In order to encourage the development of small companies in Pakistan, a lower corporate income tax rate of twenty percent (20%) is levied on smaller businesses. In addition, the Pakistan government also introduced other incentives pertaining to new investment schemes for the purchase of moveable and immoveable assets as well as miscellaneous direct and indirect tax incentives (Alm & Khan, 2017). In India, small businesses were required to keep track of many various indirect taxes, which made compliance very difficult and costly. The Indian government introduced a comprehensive goods and services tax (GST) which put an end to all the indirect taxes that were previously levied. The introduction of this GST was to integrate India into one economy and remove the multiple taxes that were being levied with the aim of facilitating business expansion, lessening the tax burden and improving profits (Jacob, 2017). The Chinese national government also placed great emphasis on the development of small businesses and small business development has been incorporated into the countries overall strategic planning for national economic and social development. A series of tax initiatives were introduced to assist in the promotion and development of the small business sector and some of the major initiatives included, preferential taxation policies, specific income tax policies for small businesses and taxation policies to promote employment (Chen, 2006).

Government support initiatives for small businesses in South Africa, aim to reduce unemployment and create a more equitable distribution of wealth by creating sustainable employment and increasing turnover for the small business sector (Peters & Naicker, 2013, p. 16). SARS also recognises that new and small businesses are the vital for the economy and are committed to ensuring that these small and medium businesses grow and prosper. (SARS, 2017). In order to assist, SARS has introduced a number of tax relief incentives over the years to help stimulate the growth of small businesses sector in addition to the multiple initiatives and strategies introduced by government.

(Sieberhagen, 2008) Identified the following tax relief incentives that were introduced:

- Reduced tax rates and accelerated depreciation for incorporated small businesses (2001);
- Capital gains tax relief for small businesses (2001 and 2006);
- Skills development relief levies (2005);
- Small business tax amnesty (2006/2007);
- Reduced annual VAT returns (2005);
- Introduction of the small retailers VAT package (2005/2006);
- Increased VAT registration threshold (2008);
- The introduction of a simplified VAT process (2008) and;
- Turnover for small businesses with a turnover of less than R1 million a year (2009)

For the purposes of this study, only two of the more common initiatives will be discussed, which is small business corporation tax and turnover tax.

2.2. Small Business Corporation Tax (SBC)

The definition of a small business as per Section 12E of the South African Income Tax Act is as follows:

- The small business must be a company, close corporation or co-operative as defined in terms of section 1 of the Companies Act, 2008;
- Gross income for the year does not exceed R20 million (2013: R14 million);

- All shareholders or members throughout the year of assessment are natural persons who hold no shares in other private companies or members' interests in any other close corporation or co-operative except in limited cases;

- Not more than 20% of the gross income and all the capital consists collectively of investment income and income from rendering a personal service;

- The company, close corporation or co-operative is not an employment entity. (Davis Tax Committee, 2014)

Section 12E of the Income Tax Act was created for the specific purpose of encouraging new ventures together with employment creation and also presents the opportunity for small businesses to benefit from reduced rates of taxation. (BizCommunity, 2013) The tax relief for small business corporations is essentially in two forms which are favorable and graduated tax rates and secondly accelerated depreciation allowances. (SARS, 2017)

2.3. Favorable and Graduated Tax Rates

Rates applicable to small business corporations for years of assessment ending between 1 April 2017 and 31 March 2018:

Table 1. Rates of taxation applicable to small business corporations

Taxable income	**Rates of tax**
R0 – R75 750	0% of taxable income
R75 751 – R365 000	7% of the amount over R75 750
R365 001 – R550 000	R20 248 + 21% of the amount over R365 000
R550 000 and above	R59 098 + 28% of the amount over R550 000

Small business corporations with a taxable income of up to R75 750 do not pay any tax. The rates of taxation are much lower for small business corporations with taxable incomes up to R550 000. All taxable income in excess of R550 000 is taxed at the normal South African company tax rate which is currently levied at twenty eight percent (28%) of taxable profits.

2.4. Accelerated Depreciation Allowances

There is an immediate write-off in the year of assessment during which all plant or machinery is brought into use for the first time by a small business corporation in that year for the purposes of its trade (other than mining or farming) and is used directly in a process of manufacture or similar process. (Stinglingh, et al., 2014)

With regard to plant or machinery that is used by an SBC for purposes of its trade, other than miming, farming or those used in a process of manufacturing or similar process, they can be written off over a period of three years as follows:

- fifty percent (50%) of the cost of the asset in the year during which that asset was brought into use for the first time;

- thirty percent (30%) of the cost in the second year; and

- twenty percent (20%) of the cost in the third year. (Stinglingh, et al., 2014)

Currently the Davis Tax Committee has acknowledged that the SBC tax system is fundamentally ineffective, because the tax benefits are being utilized more by service related small business corporations that were never intended to be the main users of the this SBC initiative (Davis Tax Committee, 2016).

2.5. Turnover Tax

In the 2008 Budget Review, it was proposed that an elective turnover tax system be implemented for micro businesses with a turnover up to R1 million per annum. This elective turnover tax is incorporated in the Sixth Schedule to the Income Tax Act and is applicable for all years of assessment beginning on or after 1 March 2009. Despite this tax being incorporated as a Schedule to the Income Tax Act, it is a totally separate from other forms of taxation such as normal tax, donations tax, or dividends tax. Simplistically speaking turnover tax is a tax calculated on the turnover or total receipts of a micro business and not on its profit or net income. This need has seen the need for keeping detailed records of expenses being eliminated. Taxpayers are allowed the choice of selecting this tax and determining whether they should apply to the activities of their micro business. Where the qualifying turnover of any micro business does not exceed R1 million in a given year of assessment, the business is able to elect to be taxed in terms of this regime. To be classified as a micro business, qualifying persons or taxpayers should formally register with SARS. The following persons with a turnover that does not exceed R1 million are allowed to register as micro – businesses:

- incorporated bodies such as companies, close corporations and co-operatives;
- natural persons that are either sole traders or partnerships;

The following persons are specifically excluded as qualifying micro businesses:

- A trust, which is not included in the definition of a micro business and therefore cannot elect to pay turnover tax;

- Persons with interests in other companies which include incorporated entities and natural persons that, at any time during the year of assessment, hold any shares or have any interests in the equity of a private company, close corporation or co-operative or;

- Companies, close corporations and co-operatives, if any holder of its shares or members hold any shares or have any interests in any other private company, close corporation and co-operative. (Stinglingh, et al., 2014)

Table 2. Rates of turnover tax for the period ending 28 February 2018

Taxable turnover (R)	Rate of tax (R)
0 - 335 000	0%
335 001 - 500 000	1% of the amount above 335 000
500 001 - 750 000	1650 + 2% of the amount above 500 000
750 001 and above	6 650 + 3% of the amount above 750 000

Table 2 illustrates the rates of taxation that micro businesses will be subject to if they register for turnover tax. Micro businesses with a qualifying turnover of up to R335 000 do not pay any tax. Business with a qualifying turnover of between R335 000 and R500 000 only pays tax at one percent (1%) of the qualifying turnover. Business with a turnover between R500 000 and R750 000 pay tax of R1 650 plus two percent (2%) of the amount above R500 000. The maximum rate of taxation is three percent (3%) of qualifying turnover for micro business that have a turnover in excess of R750 000.

2.6. Reasons for Tax Relief Initiatives not being Utilized

A large proportion of small businesses in South Africa are not aware of the tax relief initiatives that are available and many believe that the tax systems are considered too complex. These small business owners in South Africa lack the necessary tax skills and the SARS campaigns used to promote these tax initiatives are considered ineffective in attracting small businesses to utilise these initiatives. (Abrie & Doussy, 2006)

According to Smulders, et al., (2003) the total time spent by micro businesses that are registered for turnover tax, on complying with tax is slightly less than two thirds of the time taken by a normal business that is not registered for turnover tax. This indicated that the turnover tax regime is meeting one of its objectives of reducing tax compliance costs by reducing the time spent on tax compliance activities. It was also established that there were additional benefits to tax compliance such as keeping more accurate records, which in turn led to a better knowledge about the financial performance and position of their business. The reduced risk of being selected for a tax audit by SARS is also another benefit that was identified.

Visser (2016), argues that the turnover tax system is simply unhelpful and the requirements to register are too onerous. One of the major problems with the turnover tax system was that a small business would be required to pay tax on its income even if the company was making losses and many start-up companies remain in a loss making position for the first two to three years. Currently not more than eight thousand (8 000) businesses have elected to use the turnover tax regime.

Clerq & Venter, (2007) agreed that many small and medium sized businesses in South Africa do not utilise the support programs made available to them. The main reasons for not making use of these incentives are firstly, small and medium enterprises are generally unaware of the different incentives and secondly, the requirements and processes to apply for these incentives are possibly a limiting factor (Clerq & Venter, 2007).

According to Smulders, et al., (2012) many small business owners were not eligible for small business tax concessions or they were unsure if they were eligible and the general perception is that small business tax concessions are more complex than useful and are not worth the effort. Atawodi & Ojeka, (2012) recommends that small and medium enterprises should be levied lower amounts of taxes and the government should increase tax incentives and exemptions, as this will assist businesses so that they will have enough funds for other activities which that may lead to business growth and assist in surviving in a competitive market.

Due to the importance that small businesses play in any economy, fixing and developing and effective tax system for small businesses is of paramount importance to any government. Tax systems should be developed and designed in order to minimise the costs of compliance. A good tax system should have contain characteristics of simplicity, certainty, fairness and the tax compliance burdens should be proportionate to the size of the business. (Ponorica & Al-Saedi, 2015, p. 135).

In his study, Govender, (2008) found that thirty percent (30%) of small business corporations believed that there was nothing that SARS could do to improve compliance. However, the remaining businesses cited the following suggestions to improve compliance:

- A need to have SARS office closer to businesses;

- To increase the overall service levels from SARS;

- More SARS officials to be on hand to address their issues;

- A need for reducing current tax rates;

- A need for reducing interest and penalty rates;

- Procedures for registration and filing should be simpler and more easily accomplished;

- Tax forms should be shortened to enable quicker completion.

South Africa is still in need of a tax reform that simplifies and minimizes its tax compliance costs so that more emphasis is placed on addressing the challenge of reducing poverty and unemployment in the country (Smulders, et al., 2012). Most small businesses consider the taxation system to be biased and unfair to them as they pay the same amounts as large businesses. Government needs to simplify and develop a system that suits small and medium enterprises, which is different when compared to larger entities. (Ponorica & Al-Saedi, 2015).

3. Research Design

No single research method can be considered as the best method in all circumstances. The choice will be dependent on the research question, research objectives, data that is being accessed and precisely what we are expected to do (Smith, 2011, p. 53). Questionnaires have the advantage of obtaining data more efficiently in terms of researcher time, energy and costs. The method of data collection using questionnaires is mostly used for economic and business surveys (Kothari, 2004), and most of the empirical research on tax compliance is based on surveys analysing taxpayers (Gangl et al., 2014). As a result a questionnaire was deemed to be most appropriates for the purposes of this study. The primary participants in this study were the owners of small businesses who are responsible for ensuring the taxes are up to date. The questionnaire was distributed to a sample of 85 SME business owners.

Questions dealt with some of the specific tax relief initiatives that have been introduced by SARS. The two initiatives that are evaluated are small business corporation's tax and turnover tax. This information allowed the researcher to evaluate if business owners are firstly aware of the tax relief initiatives introduces and secondly if these initiatives are actually being utilised. These questions will help to evaluate which specific tax relief initiatives are mainly being used and also determines if these initiatives are effective in meeting the objectives that they were intended for. In addition the perceptions of small business owners over the usefulness and effectiveness of tax initiatives were evaluated.

4. Research Findings

A sample of 85 small and medium business owners were surveyed for the study. The following responses were obtained from the interviews.

Question 1

Table 3. Are business owners aware of tax relief initiatives available for small businesses?

Are business owners aware of tax relief initiatives available for small businesses?			
	Frequency	**Percentage**	**Cumulative Percentage**
Yes	41	48,2	48,2
No	44	51,8	100,0
Cumulative Percentage	85	100,0	

Roughly, half of the business owners are aware of the tax relief initiatives that are available to small businesses. 51.2% of owners are not aware of the various relief initiatives that are available. This indicates that SARS may not be doing enough to promote these initiatives, which may be beneficial in assisting to reduce tax liabilities and improve cash flows.

Question 2

Table 4. Do small business owners utilize tax relief initiatives?

Do small business owners utilize tax relief initiatives?			
	Frequency	**Percentage**	**Cumulative Percentage**
Yes	12	14,1	14,1
No	73	85,9	100,0
Cumulative Percentage	85	100,0	

Only 12 respondents, which represents 14.1% of the sample, have indicated that they utilize the tax relief initiatives that have been introduced by SARS. This indicates that the majority of these small businesses may not be fully befitting from the initiatives that have been introduced and that SARS may have not done enough to promote these initiatives.

Question 3

Table 5. Do small business owners utilize SBC rates?

Do small business owners utilize SBC rates?			
	Frequency	**Percentage**	**Cumulative Percentage**
Yes	12	14,1	14,1
No	73	85,9	100,0
Cumulative Percentage	85	100,0	

All 12 respondents that indicated they are aware of the tax relief initiatives have also indicated that they utilize small business tax. This means that 100% of the business owners who are aware of small business initiatives also apply small business corporation (SBC) rates in calculating their income tax liabilities. 85.9% of small businesses are not aware of the tax relief initiatives and do not utilize SBC rates.

Question 4

Table 6. Do small business owners utilize turnover tax?

Do small business owners utilize turnover tax?			
	Frequency	**Percentage**	**Cumulative Percentage**
No	85	100,0	100,0

All eighty five (85) respondents have indicated that they do not use turnover tax. This indicates that taxpayers do not know about this specific initiative and they may not qualify for turnover tax in terms of the requirements prescribed by SARS. This means that SARS must relook at the specific requirements.

The above findings are consistent with the literature and specifically with the studies done by (Abrie & Doussy, 2006) and (Clerq & Venter, 2007) which found that the relief initiatives introduced are not sufficient and are not being fully utilised efficiently by small and medium businesses.

Question 5

Table 7. Why do you not utilize the initiatives?

Why do you not utilize the initiatives?			
	Frequency	**Percentage**	**Cumulative Percentage**
Not applicable to my business	51	69,9	69,9
Does not add value or save costs	7	9,6	79,5
Do not understand the rules	12	16,4	95,9
SARS does not assist me in implementing these rules	3	4,1	100,0
	73	100,0	

An overwhelming 69.9% of respondents indicated that the main reason for not utilizing tax relief initiatives is because they are not applicable to their businesses. This indicates that the initiatives that SARS have made available are not necessarily addressing the needs of the majority of businesses out there and they may not be effective as intended. Of the remaining 30.1% of the respondents, 9.6% feel that the initiatives do not add value or save costs, 16.4% do not understand the rules and 4.1% feel that SARS does not assist in implementing these initiatives. These findings are consistent with the findings (Smulders et al., 2012), and highlight the fact that the tax initiatives currently available are not adequate to assist small businesses.

Question 6

Table 8. Have initiatives been successful in assisting with compliance?

Have tax initiatives been successful in assisting with compliance?			
	Frequency	**Percentage**	**Cumulative Percentage**
Strongly disagree	24	28,2	28,2
Disagree	35	41,2	69,4
Neutral	23	27,1	96,5
Agree	3	3,5	100,0
	85	100,0	

An overwhelming 69.4% of respondents have indicated that they disagree or strongly disagree that that the tax initiatives introduced by SARS have been successful in assisting with tax compliance. 27.1% of respondents are neutral, which indicates that these respondents are not certain if the tax initiatives introduced have been successful, or not in helping with compliance. Only 3.5% of respondents agree that the initiatives introduced have been successful. Zero respondents strongly agree that the initiatives introduced are successful. These findings are consistent with the findings from (Visser, 2016) the findings from the Davis Tax Committee, (2016).

Question 7

Table 9. Should more tax relief initiatives be introduced?

Should more tax relief initiatives be introduced?			
	Frequency	**Percentage**	**Cumulative Percentage**
Strongly disagree	1	1,2	1,2
Neutral	16	18,8	20,0
Agree	39	45,9	65,9
Strongly agree	29	34,1	100,0
	85	100,0	

Eighty percent (80%) of respondents agree and strongly agree that SARS must introduce more tax relief initiatives to assist small businesses with compliance. 18.8% of the respondents are neutral indicating that they are not sure if SARS should introduce more initiatives or not. This clearly highlights the fact that the current initiatives are not adequate and much more assistance and initiatives are required by small businesses. Only one respondent strongly disagrees with the above statement, that more tax relief initiatives should be introduced. The findings are consistent with studies conducted by Atawodi and Ojeka, (2012) and Govender, (2008) who have also found that small business owners believe that SARS is not doing enough to assist with tax compliance.

5. Conclusion

Approximately 50% of respondents do know about the tax relief initiatives that have been introduced by SARS. However, only 14.1% of respondents have indicated that they actually utilize these initiatives. Small business corporation tax is the only initiative that was utilized. None of the respondents indicated that they adopted turnover tax. This is in line with the other responses, where it was established that tax relief initiatives are not applicable to 69.9% of the respondents. The remaining 30.1% of respondents have indicated that these initiatives do not add value or save costs, business owners do not understand the rules and SARS does not assist in implementing the rules. 69.4% of respondents have also indicated that SARS initiatives have not been successful in assisting with compliance and an overwhelming 80% of respondents have indicated that more initiatives need to be introduced. This is in agreement with the literature review, which has indicated that tax relief initiatives introduced are not achieving the objective they were intended to meet and there is an urgent need for a change in tax policies that regulate the small business sector to support small and medium businesses in accomplishing these objectives. In addition SARS should try and reduce the qualifying criteria for small businesses to benefit from these initiatives as many of them do not qualify and are struggling to pay tax at the normal rates applicable to the larger businesses.

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