

**A comparative study of tax incentives available for
small businesses in
South Africa, Australia and Canada**

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SUMMARY

The comparative study of tax incentive legislation in South Africa, Australia and Canada for small businesses confirmed that tax incentives in South Africa are on par with those of said developed countries. The study compared tax incentives for income tax, capital gains tax and sales tax after the operation of the specific taxes was researched and the tax incentives identified.

It is concluded in the study that there are tax incentives legislated in Australia and Canada that may enhance current South African tax incentives or which may be introduced as new tax incentives. These incentives may facilitate and stimulate economic growth and development in the country.

OPSOMMING

Die vergelykende studie van belastingvergunnings vir klein besighede in Suid-Afrika, Australië en Kanada het bevestig dat belastingvergunnings in Suid-Afrika op standaard is met dié van ontwikkelde lande. Die studie het inkomstebelasting, kapitaalwinsbelasting en verkoopsbelasting vergelyk nadat die werking van die gespesifiseerde belastings nagevors en die belastingvergunnings van toepassing geïdentifiseer is.

In die studie word daar tot die gevolgtrekking gekom dat daar belastingvergunnings in Australië en Kanada is wat *of* die huidige belastingvergunnings in Suid-Afrika kan uitbrei *of* as nuwe belastingvergunnings in Suid-Afrika geïmplementeer kan word. Die gewysigde en nuwe belastingvergunnings mag moontlik bydra tot verdere groei en ontwikkeling in Suid-Afrika.

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1 INTRODUCTION

1.1 Background information

Small businesses form an integral part of *all* economies *everywhere* in the world. In developing countries small businesses are important, especially where there are challenges relating to unemployment and income distribution. This fact is clearly illustrated by Professor Albert Berry of the University of Toronto during his opening speech at the *International Conference on the Taxation of Small and Medium Enterprises* in October 2007 in which he stated: “On what we may call the ‘static’ front, SMEs contribute to output and to the creation of ‘decent’ jobs; on the ‘dynamic’ front they are a nursery for the larger firms of the future, are the next and important step up for expanding micro enterprises, they contribute directly and often significantly to aggregate savings and investment, and they are involved in the development of appropriate technology” (Berry, 2007:1).

In view of the current global economic recession, President Barack Obama stated in his weekly address of 24 October 2009, that more than half of all Americans are employed by or own a small business (Gov Monitor, 2009). These businesses furthermore represent a segment of the American economy that has been the most affected by the recession. President Obama also emphasized that small businesses have always been the “engine” of the American economy, creating 65% of all new jobs over the past decade and a half. He emphasized that these small economic powerhouses must be at the forefront of the economic recovery. Based on this, the *Recovery Act of 2009* was designed in America to assist small businesses in expanding and creating jobs by providing \$5 billion worth of tax relief.

It is evident from the aforementioned that small businesses form an integral part of the economy. Governments recognize this fact and therefore incentives, in the form of tax relief and concessions to assist with growth, have been provided to assist these small businesses.

In South Africa, Muneer Hassan, project director of tax at the South African Institute of Chartered Accountants, called on Finance Minister Pravin Gordhan to go out of his way to do something for small business which constitute “the backbone of the nation’s economy” (Temkin, 2010).

In view of Hassan’s above statement, and to once again reiterate the tremendous importance of small businesses in South Africa, it is worthwhile to contemplate the latest statistical data available as per Nieman in the report of the *Global University Entrepreneurial Spirit Students’ Survey* (Scheepers, Solomon & De Vries, 2009:10-11). This report states that in the year 2002, small medium enterprises (SMEs) contributed 36.1% to the gross domestic product (GDP) and in the same year the small business sector contributed 55.9% of the private sector employment. As pertains to the size of the small medium and micro enterprises (SMME) sector, the report further states that the small business sector is the largest of all private sector enterprises in South Africa, with 52% of all private sector enterprises falling into the category of *small*, while 37% of South African enterprises are deemed *very small* or *smaller*.

The writer has recognized that prominent individuals have expressed their concern regarding the growth and development of SMEs and the importance of instituting tax incentives to this group.

The writer thoroughly reviewed the Survey on the Taxation of Small and Medium-sized enterprises (Weichenrieder, 2007) which summarized the questionnaire responses of the 20 member countries of the *Organisation for Economic Co-operation and Development* on the taxation of SMEs. Information published in this study highlighted that the taxation policies regarding SME’s in Australia and Canada are similar to those in South Africa.

Further research revealed that in Australia there are approximately 1.93 million active small businesses which represent 96% of all businesses (Sherry, 2009). Small businesses employ over 5 million people which accounts for around 51% of private sector

employment. Furthermore, small businesses contribute over one third of Australia's total GDP. It is therefore not surprising that in the current economic climate Australia has also been actively supporting this significant segment of their economy through tax relief. As per Sherry, the Australian Government's Small Business and General Business Tax Breaks have assisted businesses and consequently this has resulted in a 2% growth in total new business investment in the June 2009 quarter. According to Sherry, the Treasury estimated that business investment would have plummeted if it had not been for the impact of the Tax Break. It will be appropriate to conclude that Australia should also be included in a comparative study with South Africa.

Initial research regarding Canada revealed that the Canadian Minister of State for Small Business and Tourism (Tradingmarkets.com, 2010) Mr Rob Moore, held forth that small businesses are the "engines" of economical growth. He confirmed that this is the very reason why the Canadian Government is committed to working *with* the private sector to implement meaningful changes for small businesses which in turn create jobs and could lead the country on the road to economic recovery. The Canadian Government has been at the forefront in assisting small businesses. One of these measures in the government's Economic Action Plan is *tax relief to small businesses* as already reflected in the 2007 Budget where major initiatives aimed at reducing taxes, lessening the paperwork burden and improving access to skilled labour were incorporated. The 2008 Budget built on the foundations laid in 2007 by reducing paperwork requirements for small businesses with 20%. Duplicate requirements and overlapping obligations were eliminated and filing frequency and requirements were drastically curbed.

Canadian Prime Minister Steven Harper, at the start of the 30th annual Small Business Week in Canada, said: "Through their hard work, dedication and vision, small business owners are generating jobs and economic growth that is making Canada a competitive and modern economy. They are helping to ensure that our economy emerges from the global economic recession stronger than ever. Small businesses are, in fact, the backbone of the Canadian economy, accounting for 98% of all businesses in Canada" (Weese, 2010). The online article further stated that over one million small businesses in Canada

employ the majority of this country's private sector employees and it also mentioned that new small businesses are created at the rate of 130 000 a year in Canada.

Taking the above into consideration, the writer concludes that Canada is representative of a country with an active SME economy where tax legislation has been adapted to assist these specific businesses. Canada will therefore also be included in this comparative research study with South Africa.

This research study aims to offer a conclusion as to whether tax incentives for SMEs in South Africa are comparable to those available in Australia and Canada for similar organizations.

1.2 Research Objective

The research objective of this comparative study is to compare the incentives available for small businesses in South Africa to those available in Australia and Canada. This comparison should position the writer to suitably comment on the *similarities* and the *differences* revealed through the research. A further possible result of the research may be the identification of incentives, available in Australia and Canada, which can then be implemented in South Africa. The scope of this research however does *not* include the evaluation of the success or possible changes to identified incentives suitable to South Africa.

1.3 Importance of the research

In the current economic slump there is a dire need for small businesses to contribute even more to job creation and economic growth. Statements recently made by prominent individuals, such as president Obama and Muneer Hassan, indicate that small businesses are an important part of the economy and that they do merit special governmental focus.

In 2007 the International Monetary Fund in their Background paper for the *International Tax Dialogue Conference* held in Buenos Aires already expressed an increased awareness of SMEs and their critical role in fostering innovation, employment and growth in both *developed* and *developing* countries. Privatization and deregulation have encouraged the development of the SME sector and with that a specific tax treatment (IMF, 2007:1).

The data pertaining to cross-country SME taxation analysis is limited. There is however ample literature which deals with the challenges faced in the designing of tax regimes for SMEs (IMF, 2007:2). The writer recognized the lack of available data as regards a comparative SME taxation analysis between countries and has made this research project study the subject thereof.

Australia and Canada were selected based on the fact that small businesses account for 96% and 98% of all businesses respectively in both these economies. Research also indicated that these countries have developed their tax systems to accommodate these businesses by providing tax relief and concessions. This is evident from the fact that it takes only two to three days to fully register a business in Australia and Canada (IMF, 2007:44).

A comparative review of the South African tax incentive legislation for small businesses to that of first world countries, such as Australia and Canada, will reveal whether tax incentives in South Africa are on par with those of said developed countries. Such a review may also highlight areas where the implementation of possible new tax incentives could assist in further enhancing growth and development in South Africa.

1.4 Research methodology

The researcher used the *historic method* as chosen research methodology. A review of the literature was undertaken with the aim of identifying available incentives of certain types of taxes in South Africa, Australia and Canada. These could then be compared in order to identify *similarities* and *differences*.

This research study has mainly centered on information supplied by the different tax authorities of the selected countries. Internet research revealed that the Australian Taxation Office publishes numerous guidelines to assist taxpayers. The Canadian authorities also have guidelines available but research revealed that they operate in a paperless environment with more frequent submission of information and assessment. In the case of South Africa, the study will focus on South African legislation, guidelines published by the South African Revenue Services as well as books written by respected tax experts as listed in the bibliography.

1.5 Course of the study

The study commences with an identification of the different types of taxes that will be researched in order to identify incentives. In Chapter 2 different taxes are discussed with further brief explanations as to *when* these taxes are levied and *the rate applicable*.

Following on from the understanding of the identified taxes constructed in Chapter 2, Chapter 3 will discuss the *incentives* available for each of these taxes as legislated in South Africa, Australia and Canada.

Chapter 4 presents an *evaluation* of the similarities and differences between South Africa, Australia and Canada regarding the incentives available for the selected taxes as identified in Chapter 3.

In Chapter 5 the writer *concludes* with a brief discussion of those incentives available in Australia and Canada that could possibly be introduced to South Africa.

1.6 Limitation of scope of study

It is evident from past studies that tax administration has high implementation costs when compared to the resultant low level of potential tax revenue from a large number of small

taxpayers (IMF, 2007:4). The burden of tax administration costs will *not* form part of this research.

The focus of this study will rather be on the *taxes applicable to small businesses* with the emphasis on the *incentives* available in the different tax categories for small business to alleviate their tax burden. The aim of identifying these incentives is to assist small businesses in growing and therefore empowering them to help address the unemployment and income distribution issues in the country.

The research will only focus on incorporated entities and will be limited to income tax, capital gains tax and sales taxes. Turnover tax will form part of the study as a form of sales tax and income tax combined. Dividend tax will not be included in the research as the focus of the research is on taxes that affect the trading activities of the entities. Dividend tax is levied on the return on investment in a business in the form of dividends.

2 Different types of taxes

2.1 Australia

2.1.1 Income tax

In Australia, a company pays income tax based on its assessable income (profits) at the company tax rate, which is currently 30 %. Companies have to submit an annual tax return which reflects their *income*, *deductions* and *income tax payable* based upon a self-assessment system. The amount of tax which a company is liable to pay is reduced by any PAYG (Pay As You Go) installments it had made during the year. There is no tax-free threshold for companies (*Tax basics for small business*, 2010:12).

2.1.2 Capital gains tax

A *capital gain* or *capital loss* is the difference between the amount you receive when you sell an asset and the amount that the asset had originally cost you. Capital gains tax affects the amount of income tax that the taxpayer is liable to pay because it must include any net capital gain accrued in the entity's assessable income to be taxed at the income tax rate of 30%. The net capital gain is the total of the taxpayer's capital gains for the year, less any capital losses for the year or earlier years, and any relevant concessions (*Tax basics for small business*, 2010:34).

2.1.3 Sales tax

Sales tax in Australia is called GST (Goods and Services Tax) and is levied at a rate of 10% on most goods and services in Australia (*Tax basics for small business*, 2010:37).

A company must register for GST when it is carrying on an enterprise and the annual GST turnover of said enterprise is \$75 000 or more (*Tax basics for small business*, 2010: 12). If a company's annual GST turnover is below \$75 000, GST registration is voluntary. Companies that provide taxi travel or want to claim fuel tax credits are compelled to register for GST, regardless of their turnover level (*Tax basics for small business*, 2010:14).

There are three types of GST sales: taxable sales, GST-free sales and input taxed sales. Most goods and services sold in Australia are *taxable sales*, including the sale of business assets. *GST-free sales* include basic food items, exports, some health services and educational courses, some activities of charitable institutions, childcare, religious services, water and sewerage services and the sale of a going concern. *Input taxed* sales include financial supplies and residential rent.

GST is reported on an activity statement sent out in accordance with your reporting period. A small business will normally have a quarterly tax period, but it may choose to file a monthly report. If eligible, the taxpayer can choose to pay quarterly installments that are calculated by the Australian Taxation Office and an annual GST return will consequently be submitted. If the taxpayer voluntarily registered for GST, the GST is reported and paid annually (*Tax basics for small business*, 2010:38).

2.2 Canada

2.2.1 Income tax

In Canada a company needs to report its business income annually for its fiscal period. The company needs to file its income tax return within six months from the end of its fiscal period (*Guide for Canadian Small Businesses*, 2009:26).

The rate of tax applicable to companies in Canada is more complex than that in Australia and South Africa as there is not only a *basic tax rate* of 38 % but also a *provincial or territorial rate*. The basic tax rate is reduced by federal tax abatement to a rate of 26.5%. Canadian-controlled private corporations, which claim a small business deduction, have a net tax rate of 9.5%. Provinces and territories have two income tax rates namely a *lower rate*, applicable to income eligible for the federal small business deduction, and a *higher rate* that applies to all other income. The table below sets out the provincial and territorial tax rates as effective on 1 January 2011. Quebec and Alberta do not have

corporation tax collection agreements with the Canadian Revenue Agency and they are therefore not included in the table.

Table 2.2.1 Corporation tax rates applicable to provinces and territories in Canada

Province or territory	Lower rate	Higher rate
Newfoundland and Labrador	4%	14%
Nova Scotia	4.5%	16%
Prince Edward Island	1%	16%
New Brunswick	5%	11%
Ontario	4.5%	12%
Manitoba	Nil	12%
Saskatchewan	4.5%	12%
British Columbia	2.5%	10%
Yukon	4%	15%
Northwest Territories	4%	11.5%
Nunavut	4%	12%

(Corporation tax rates, 2011)

Taxable income, which is earned and allocated over more than one province or territory, also results in any income eligible for the federal small business deduction to be proportionally allocated (*T2 Corporation – Income Tax Guide 2010*, 2010:75).

2.2.2 Capital gains tax

A capital gain or loss is created when capital property is sold or considered to be sold. The sale of the property is recorded in the calendar year (January to December) in which it is sold. Where a business has a fiscal year end other than 31 December, the sale of the capital property is still recorded in the calendar year in which it takes place, even though the sale may be after the fiscal year end date. The capital gain or loss is calculated by deducting the adjusted cost base (ACB) and the outlays and expenses incurred when selling the capital property, from the proceeds received from the disposition. Only half of

the *capital gain* is taxable and only half of the *capital loss* can be set off against taxable capital gains and the net amount is included in normal taxable income (*Capital Gains 2010*, 2010:10).

Capital gains tax came into effect in 1972 and special rules apply when the capital gain is calculated for capital property where any capital gains were accrued before 1972 (*Capital Gains 2010*, 2010:11).

A capital gain may be *deferred* by claiming a reserve, or it may be *reduced*, or part or all of the gain may be *offset* by claiming a capital gains deduction. The maximum period over which a capital reserve can be claimed is 5 years (*Capital Gains 2010*, 2010:11).

A capital loss can be used to reduce the capital gains in a fiscal year to zero. In cases where the capital loss is greater than the capital gain, the net capital loss can be used against taxable capital gains of the preceding three years and for taxable capital gains of any future years (*Capital Gains 2010*, 2010:13).

When the capital loss is carried back to a preceding tax year, the taxpayer may choose the year it should relate to. The result would be a reduction in the taxable income for that year but the net income, which is used to calculate certain credits and benefits, would remain unchanged (*Capital Gains 2010*, 2010:31).

2.2.3 Sales tax

Sales tax in Canada is referred to as either Goods and Services Tax (GST) or Harmonized Sales Tax (HST). GST is a tax that applies to the majority of the supply of goods and services in Canada. The participating provinces in Canada harmonized their provincial sales tax with GST to create the HST (*Guide for Canadian Small Businesses*, 2009:16).

From July 2010 GST/HST registrants, who produce taxable supplies in Canada, collect tax at the applicable HST rate as per Table 2.2.3.

Table 2.2.3 GST/HST rates applicable as from 1 July 2010

Ontario	HST at 13 %
British Columbia	HST at 12 %
Nova Scotia	HST at 15 %
New Brunswick	HST at 13 %
Newfoundland and Labrador	HST at 13 %
Territories and other provinces in Canada	GST at 5 %

Most services and goods supplied in or imported into Canada are subject to GST/HST.

Supplies are taxable at a rate of 5 %, 12 %, 13 % or 15 % on the following:

- Sales of new housing.
- Sales and rentals of commercial real property.
- Sales and leases of automobiles.
- Car repairs.
- Soft drinks, candies and potato chips.
- Clothing and footwear.
- Advertising.
- Taxi and limousine transportation.
- Legal and accounting services.
- Franchises.
- Hotel accommodation.
- Barber and hairstylist services.

Supplies taxable at a rate of 0 % include:

- Basic groceries such as milk, bread and vegetables.
- Agricultural products such as grain, raw wool and dried tobacco leaves.
- Most farm livestock.
- Most fishery products such as fish for human consumption.
- Prescription drugs and drug-dispensing services.
- Medical devices such as hearing aids and artificial teeth.
- Exports.

- Many transportation services where the origin or destination is outside Canada.

The following are *exempt* supplies on which no GST/HST is charged and no input credits can be claimed:

- Sale of housing where the accommodation was last used by an individual as a place of residence.
- Long-term rentals of residential accommodation and residential condominium fees.
- Most health, medical and dental services performed by licensed physicians or dentists for medical reasons.
- Child care services that provide care and supervision to children 14 years of age or younger for periods of less than 24 hours per day.
- Most domestic ferry services.
- Legal aid services.
- Educational services.
- Music lessons.
- Most services provided by financial institutions such as lending money or operating deposit accounts.
- The issuance of insurance policies by an insurer and the arranging for the issuance of insurance policies by insurance agents.
- Most goods and services provided by charities and public institutions.
- Certain goods and services provided by non-profit organizations, provincial and territorial governments, and public service bodies such as municipal transit services and standard residential services such as water distribution.

(General Information for GST/HST Registrants, 2010:8-9)

The company needs to register for GST/HST if it provides taxable supplies in Canada and it is not a small supplier. A company is deemed a *small supplier* if its total revenue from taxable supplies is \$30 000 or less in the last four consecutive calendar quarters or in any single calendar quarter. Total revenues from taxable supplies refer to worldwide revenues from supplies subject to GST/HST. Taxi and limousine businesses and non-resident performers selling admissions to seminars, performances and other events must

register for GST/HST even if their supplies will be less than \$30 000 (*General Information for GST/HST Registrants*, 2010:10).

2.3 South Africa

2.3.1 Income tax

In South Africa section 5(1) of the Income Tax Act of 1962 determines that a company or close corporation will annually pay, to the benefit of the National Revenue Fund, an income tax in respect of the taxable income received or accrued during every financial year (SAICA, 2010:30).

Income tax is levied for a company or close corporation at the fixed rate of 28% for all years ending 31 March 2012. Where the company or close corporation qualifies as a *small business corporation* or a *micro business*, the rate of 28% is not applicable and special tax rates apply. The special tax rates has a tax free threshold available for small business corporations which is R57 000 for all financial years which ends between 1 April 2011 and 31 March 2012 (Stiglingh, 2010:2).

Companies and close corporations lodge an annual income tax return in which they declare their income and the allowable tax deductions are then claimed which results in the net taxable income. The income tax return is lodged electronically and then assessed by the South African Revenue Services (SARS). An assessment, containing the assessed tax for the year less any provisional tax payments that were made during the year and the consequent balance owing, is then issued.

Income tax is paid on a provisional basis every six months with the first provisional payment six months into the financial year which coincides with the fiscal year. At year end the second provisional payment is made and then a third provisional payment is due at the earliest of assessment or 7 months after the financial year end.

2.3.2 Capital gains tax

In South Africa there is no separate capital gains tax system. Capital gains tax is deemed part of the normal income tax that is paid over. Section 26A of the Income Tax Act 1962 determines that the taxable capital gain, as calculated in terms of the Eighth Schedule to the Act, will be included in a taxpayer's taxable income for the year of assessment when there is a capital gains tax event (Stiglingh, 2010:828).

Capital gains tax is applicable to all disposals or deemed disposals of assets after 1 October 2001. To calculate your taxable capital gain, the following four requirements need to be met:

- There must be an asset.
- There must be a disposal or a deemed disposal of an asset.
- You need to determine the base cost of the asset which includes the original cost of the asset or the valuation value on 1 October 2001 plus any costs relating to improvements and any direct costs relating to the acquiring and disposal of the asset.
- You need to determine the proceeds from the disposal or deemed disposal of the asset.

(Stiglingh, 2010:830-831)

Where the taxpayer is a company or close corporation, 50% of the net taxable capital gain will be included in the normal taxable income to be taxed at the fixed rate of 28% unless the company or close corporation is a *small business corporation* or a *micro business*. The net taxable capital gain is calculated by determining the aggregate capital gain for the year, which is all the capital gains and losses after the application of exclusions, limitations and deferral relief, less any assessed capital loss brought forward from the previous year. Where the result is a net *capital loss*, it will be carried forward to the next tax year. Where the net result is a *capital gain*, it is then included at the rate of 50% of the net capital gain in the taxable income of the company or close corporation (Huxham and Haupt, 2011:769-773).

2.3.3 Sales tax

In South Africa an indirect system of taxation levies a sales tax, called Value-Added Tax (VAT), on the supply of goods and services by persons registered as vendors in terms of the Value-Added Tax Act no. 89 of 1991. The VAT system in South Africa is referred to as a “destination based, consumption type, invoice VAT” (Huxham and Haupt, 2011: 871). This means that the tax is imposed in the country in which consumption takes place and not where it originates from. Therefore *imports* and not *exports* are taxed in South Africa.

Goods or services are either *taxable supplies* or *exempt supplies* in the application of the VAT Act. Where a person only makes exempt supplies, it is deemed that he is not carrying on an enterprise and can therefore not register as a vendor. Examples of exempt supplies are:

- Supply of residential accommodation in a dwelling.
- Educational services.
- Transport by road or railway.
- Trade union subscriptions.
- Supply by an association-not-for-gain of certain donated goods.
- Supply of goods by a non-resident.
- Supply of crèche or after-school care for children.
- Sale or letting of land outside the Republic.
- Supply of services to members in the course of management of a sectional title body corporate, a share block company and any housing development scheme for aged persons.
- Supply of lodging or board and lodging by a local authority which operates a hostel or boarding establishment for non-profit purposes.
- The letting of land for the purpose of erecting a residential dwelling.
- Certain financial services as defined in section 2 of the VAT Act.

(Huxham and Haupt, 2011:897-900)

Taxable supplies of goods and services can either be levied at the standard rate of 14% or zero-rated. Where a taxpayer's turnover is more than R1 million and he makes taxable supplies, the taxpayer must register as a vendor for VAT purposes if he carries on an enterprise. In summary the following supply of goods and services are *zero-rated*:

- Goods or services that are exported.
- Export of second-hand goods.
- Supply of a going-concern.
- Fuel levy.
- Sale of animal feed, animal remedy, fertilizer, pesticide, plants and seed.
- Sale of basic food items such as government regulation brown bread, maize meal, unprocessed samp, unprocessed mealie rice, certain dried mealies, unprocessed dried beans, lentils, pilchards or sardinella, certain milk powders, certain dairy powder blends, rice, "unprocessed" vegetables, "unprocessed" fruit, vegetable oil, certain cultured milk, brown wheaten meal, raw hen's eggs and edible legumes. If the aforementioned is supplied as part of a meal, the full cost of the meal is subject to VAT.
- The sale of goods to a vendor in a customs controlled area.
- Certain sales of goods paid for out of international donor funds.
- The sale of petroleum oil and oils obtained from bituminous minerals.
- The sale of gold coins issued by the Reserve Bank.
- The disposal of certain "old" mining and prospecting rights.
- Supply of goods by an inbound duty free shop.
- Supply of imported goods not yet entered for "home consumption" for Customs and Excise purposes.

Section 11(1) and (2) of the VAT Act contains all the goods and services that are zero-rated (Huxham and Haupt, 2011:891-897).

Section 27 of the VAT Act determines different categories of vendors. Each category has a different tax period which is listed in Table 2.3.3:

Table 2.3.3 Categories of VAT Vendors

Category	Period	Ending on	How determined
A	2 months	Uneven months: January, March, May etc.	Taxable supplies not exceeding R30 million in a 12 month period.
B	2 months	Even months: February, April, June etc.	Taxable supplies not exceeding R30 million in a 12 month period.
C	1 month	Last day of every month.	Taxable supplies exceeding R30 million in a 12 month period or applied for in writing or vendors who have repeatedly defaulted against the VAT Act.
D	6 months	February and August.	Taxable supplies limited to agricultural activities of less than R1.5 million in a 12 month period.
E	12 months	Last day of year of assessment.	Companies and trust funds that lease fixed or movable property to connected persons or administer or manage companies connected to the vendor.
F	4 months	June, October and February.	Small business with taxable supplies of less than R1.5 million.

(Stiglingh, 2010:993-994)

Section 23(8) of the VAT Act provides that a micro business may not register as a vendor. With effect from 1 March 2011, anyone registered as a *VAT vendor* may not also register as a *micro vendor* (Huxham and Haupt, 2011:882).

Vendors have to charge VAT (output VAT) on the value of all taxable supplies made by them in the course or furtherance of their enterprise (Huxham and Haupt, 2011:872). VAT charged to a vendor by another vendor for the supply of goods and services or VAT paid on the import of goods can be claimed as input VAT by the vendor. The vendor will

therefore declare the output VAT and input VAT on the VAT return (Huxham and Haupt, 2011:904).

The VAT system is a self-assessment system and VAT returns are submitted electronically. The vendor declares all *standard rated*, *zero-rated* and *exempt supplies* and the related output VAT on the VAT return. Input VAT is declared, differentiating between capital goods and services and non-capital goods and services. The VAT due or refundable for the period is then determined. Where the output VAT exceeds the input VAT, the vendor has to pay the difference to SARS, but where the input VAT exceeds the output VAT, SARS refunds the vendor (Huxham and Haupt, 2011:873).

3 Incentives available

3.1 Australia

3.1.1 General

The threshold for qualifying as a small business in Australia is an aggregated annual turnover of less than \$2 million. Where the taxpayer's aggregated turnover is \$2 million or more, the business may still be eligible for the small business Capital Gains Tax (CGT) concession if it satisfies the \$6 million maximum net asset value test. The *aggregation rules* and the *net asset value test* are used to determine the annual aggregated turnover (*What are the aggregation rules?* 2010:1).

There are small business concessions for:

- Income tax, including:
 - Small business and general business tax breaks.
 - Simplified trading stock rules.
 - Simplified depreciation rules.
 - Immediate deductions for prepaid expenses.
 - Entrepreneur's tax offset.
 - Two-year amendment period.
- Capital gains tax (CGT), including:
 - CGT 15-year exemption.
 - CGT 50% active asset reduction.
 - CGT retirement exemption.
 - CGT rollover.
- Goods and services tax (GST), including:
 - GST cash accounting.
 - GST installments.
 - GST and annual private apportionment.
- Pay as you go installments (PAYG), including:
 - GDP-adjusted PAYG and GST installment amounts.

- PAYG installments payment option choice.
- GDP adjustment in PAYG installment amount.
- Fringe benefits tax (FBT), that is:
 - FBT on car parking benefits exemption.

(Small business entity concessions essentials, 2010:1)

3.1.2 Qualifying parameters for a small business

The taxpayer needs to determine whether the business in question qualifies as a *small business* which would then be eligible for the *small business entity concessions*. According to Australian Tax legislation there are *three methods* to determine whether the taxpayer qualifies as a small business:

- *Method 1:* the taxpayer uses the aggregated turnover for the previous income year.
- *Method 2:* the taxpayer estimates the aggregated turnover for the current year as it stands at the beginning of the current year.
- *Method 3:* the taxpayer uses the actual aggregated turnover for the current year as it stands at the end of the current year.

The taxpayer needs to use the same method for any connected or affiliated businesses and s/he also needs to keep records showing how the aggregated turnover was calculated. The aggregated turnover is the total turnover of all connected or affiliated businesses of the taxpayer (*Am I eligible for small business entity concessions?* 2008:1).

The *aggregation rules* are used to calculate the aggregated annual turnover or the maximum net asset value. The aggregation rules will apply if another business is the taxpayer's affiliate or connected to the taxpayer (*What are the aggregation rules?* 2010:1).

An *affiliate* is defined as any individual or company that, in relation to their business affairs, acts or could reasonably be expected to act according to the taxpayer's directions

or wishes or “in concert” with the taxpayer. The term “in concert” denotes a substantial degree of dependence on, or connection with the taxpayer (*What are the aggregation rules?* 2010:1). When considering *relatives* as *affiliates*, it is important to note that neither a spouse nor a child under the age of 18 years is automatically regarded as the taxpayer’s affiliate. In these instances one needs to consider if they, in relation to their business affairs, are acting *in accordance to the taxpayer’s directions* and wishes or *in concert* with the taxpayer (*What are the aggregation rules?* 2010:2).

An entity is connected with the taxpayer entity if either of the entities controls the other or if both entities are controlled by the same third entity. *Control* is defined as a situation in which the taxpayer, its affiliates, or *together with* its affiliates have shares and other equity interests in the company that gives the taxpayer and/or its affiliates at least 40% of the voting power in the company, or the right to receive at least 40% of any income or capital the company distributes (*What are the aggregation rules?* 2010:3).

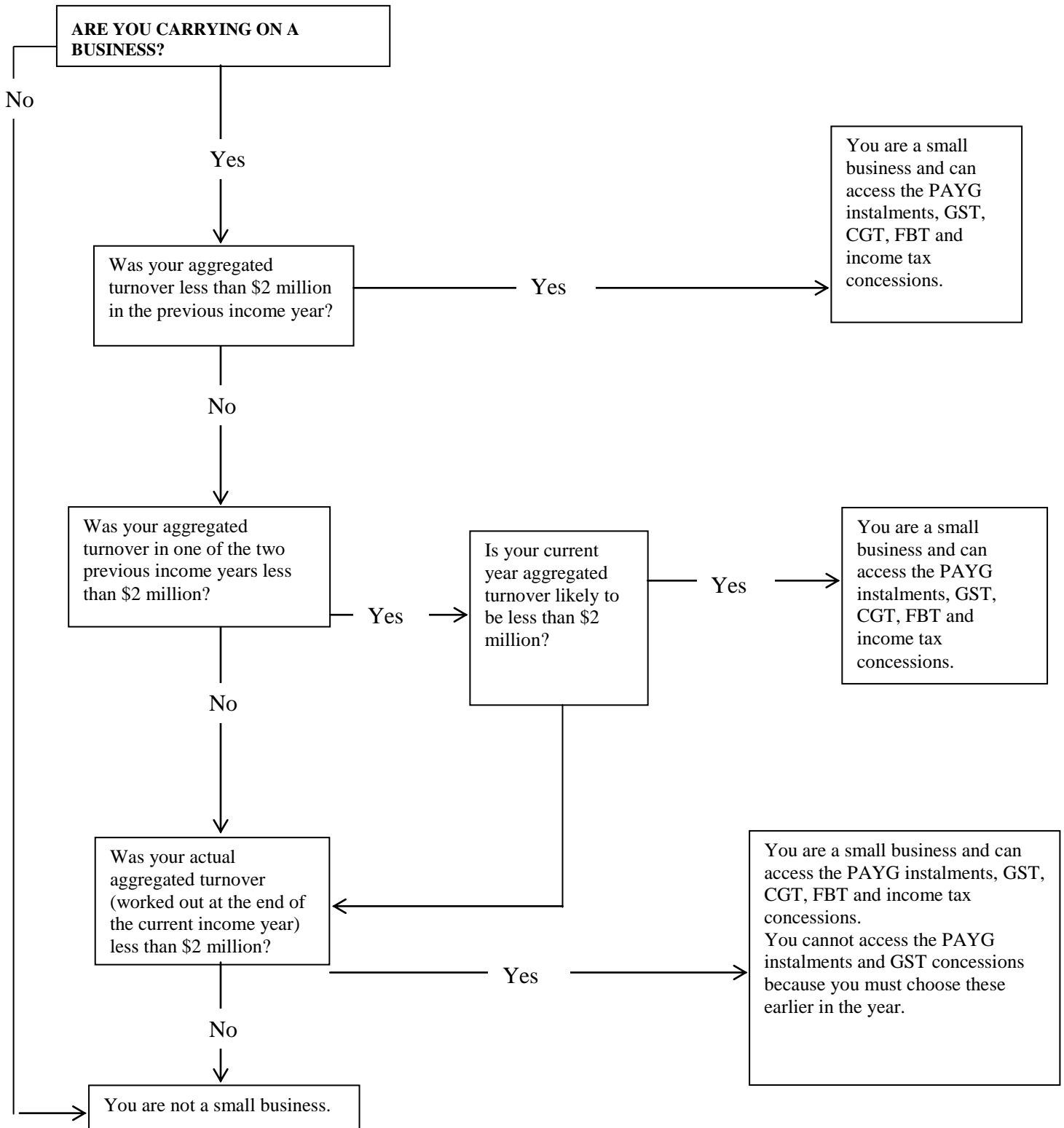
Where method 1 is selected, and the aggregated turnover for the previous income year was less than \$2 million, the taxpayer is deemed a *small business* for the current year (*Am I eligible for small business entity concessions?* 2008:1).

Where method 2 is selected, and the estimated aggregated turnover for the current year is less than \$2 million, the taxpayer is deemed a *small business*. This method can only be used if the taxpayer’s aggregated turnover was less than \$2 million for one of the last two income years excluding the current year.

With method 3 the actual aggregated turnover at the end of the current year is less than \$2 million and the taxpayer is thus deemed a *small business* for the current year (*Am I eligible for small business entity concessions?* 2008:2).

Flow chart 3.1 illustrates the process one needs to follow to determine whether you are a small business.

Flow chart 3.1 Are you a small business?



(Flow chart taken from: *Am I eligible for small business entity concessions?* 2008:6)

3.1.3 Income tax concessions

3.1.3.1 Simplified trading stock rules

Trading stock includes anything produced, manufactured, acquired or purchased for manufacturing, selling or exchanging. Trading stock also includes livestock. Trading stock does not include:

- Standing or growing crops, timber or fruit – these only become trading stock once harvested, felled or picked.
- Stocks of spare parts which are held for repairs or maintenance to plant and equipment.
- DVDs owned by a DVD lending business where they are used to earn income by hire or rental, rather than manufacture, sale or exchange.
- Consumables used in manufacturing trading stock, such as cleaning agents or sandpaper (*Concessions for small business entities*, 2010:57).

The taxpayer can choose not to conduct a stock take and account for changes in the value of its trading stock if there is a difference of \$5 000 or less between the value of its stock on hand at the start of the income year and a reasonable estimate of the value of its stock on hand at the end of the income year indicating that there have been minimal movement in the stock levels during the income year (*Small business entity concessions essentials*, 2010:2).

If the taxpayer chooses *not* to account for the stock difference as per the simplified trading stock rules, the value of the trading stock on hand at the end of the year will be deemed to be the same as at the start of the year (*Concessions for small business entities*, 2010:58).

When estimating the stock value, the taxpayer needs to take into account all relevant factors and considerations likely to affect the number and value of the trading stock on hand. The taxpayer needs to further undertake this estimate in good faith, follow a

rational and reasoned process and should lastly also be able to explain and verify the process to a third party. The factors to be considered are the following:

- The type of trading stock held.
- Where and how the stock on hand is stored.
- The valuation method used for items of stock (cost, market selling value or replacement value method).
- Whether the value of the stock varies from previous income years or during the income year.
- How sales and purchases are recorded and how accurate these records are.
- The inventory systems used and their accuracy.
- The quantity and value of stock on hand in previous income years.
- Information from any stock takes previously undertaken.
- Significant changes to the type and/or quantity of stock held.

(Concessions for small business entities, 2010:58)

The taxpayer can access this concession at the end of the financial year when calculating and completing the annual tax return. The taxpayer does not notify the tax authorities of the decision to make use of this concession. The taxpayer needs to keep a detailed record of how the estimated value of the trading stock on hand was calculated (*Small business entity concessions essentials, 2010:2*).

3.1.3.2 Simplified depreciation rules

The *simplified depreciation rules* concession allows the taxpayer to pool most of the assets and claim one deduction for the whole pool compared to the normal depreciation rules where a depreciation calculation needs to be performed for each individual asset. The concession therefore simplifies the calculations for the taxpayer as only one calculation per pool of assets is performed (*Small business entity concessions essentials, 2010:3*).

The taxpayer must pool depreciating assets, with an effective life of less than 25 years, in a *general small business pool* and claim a 30% deduction for them each year. Depreciating assets, with an effective life of 25 years or more, must be pooled together in a *long-life small business pool* for which a 5% deduction can be claimed each year. The taxpayer can claim a deduction for most assets that are newly acquired at either 15% or 2.5% in the first year, regardless of when the assets were acquired during the year (*Concessions for small business entities*, 2010:3).

For assets, held by the taxpayer *before* starting to use these rules and claimed deductions under the general capital allowance rules, the taxpayer must use the asset's *adjustable value* (cost less decline in value) at the end of the previous year as the opening balance in the pool of assets (*Concessions for small business entities*, 2010:39).

The taxpayer must review the *taxable purpose proportion* of each asset allocated to the general and long-life pools. The taxable purpose proportion is how much the taxpayer will use a depreciating asset for a taxable purpose. The general pool assets should be reviewed every year for the first three years after the year in which the assets were first allocated to the pool to determine if there should be an adjustment. If the taxable purpose proportion changes by more than 10% from the most recent estimate, an adjustment must be made. The long-life pool assets should be reviewed each year for the first 20 years after the year in which they were first allocated to the pool. If the taxable purpose proportion changes by more than 10% from the most recent estimate, an adjustment must also be made. The most recent estimate may be the original estimate or a previously adjusted estimate. The adjustment formula is the following:

$$\text{Adjustment} = \text{Reduction factor} \times \text{Asset value} \times (\text{Current year taxable purpose proportion} - \text{Most recent taxable purpose proportion})$$

When ascertaining the reduction factor for general pool assets one needs to determine whether the assets were first used, or installed ready to be used, for taxable purposes whilst the taxpayer *was* or *was not* using the simplified depreciation rules. Where the simplified depreciation rules *were used*, the reduction factor will be:

- 0.85 for the income year after the asset was first allocated to the pool,
- 0.595 for the income year after that and
- 0.417 for the income year after that.

Where the simplified depreciation rules *were not used*, the reduction factor will be:

- 0.7 for the income year after the asset was first allocated to the pool,
- 0.49 for the income year after that and
- 0.343 for the income year after that.

(Concessions for small business entities, 2010:41-42)

The *depreciation deduction* is calculated using the diminishing value method. Adjustment to half of the pool rate for assets purchased partway through the year and changes in business use are not made to the individual assets but to the pool of assets. An immediate deduction can be claimed for most assets costing less than \$1 000 each (*Small business entity concessions essentials, 2010:3*).

The *depreciation rates*, as per the simplified depreciation rules, will be applied to the closing pool balance after taking into account the matters discussed. Table 3.1.3.2 illustrates how the closing pool balance should be calculated at the end of each income year.

Table 3.1.3.2 Calculation of closing pool balance

	A	Opening pool balance for the year.
Plus (+)	B	Taxable purpose proportion of the adjustable value of assets that you first used, or installed ready to use, for a taxable purpose during the year.
Plus (+)	C	Taxable purpose proportion of the cost of any cost addition amounts, including improvements, you made to assets in the pool during the year.
Less (-)	D	Taxable purpose proportion of the termination value of any pooled assets you disposed of during the year.
Less (-)	E	Deduction allowed for assets you held at the start of the year.
Less (-)	F	Deduction allowed for assets you first used during the year.
Less (-)	G	Deduction allowed for cost addition amounts, including improvements you made to the pooled assets during the year.
Equals (=)		Closing pool balance for the year.

(Concessions for small business entities, 2010:46)

This concession also does not require the taxpayer to inform the tax authorities of the decision to make use of the simplified depreciation rules. The taxpayer's records and depreciation schedules for the annual tax return must rather reflect that this method was used to calculate the depreciation deduction (*Small business entity concessions essentials, 2010:3*).

The simplified depreciation rules are *not* available to the following types of assets:

- Assets that are rented or leased to others unless the assets are leased out under a hire purchase agreement or a short-term hire agreement.
- Assets allocated to a low-value pool before using the simplified depreciation rules.
- Horticultural plants including grapevines.
- Expenditure incurred in the developing of software that was allocated to a software development pool before the use of the simplified depreciation rules.
- Deductions for most buildings and structural improvements.
- Investments in Australian films and

- Assets previously deductible under the research and development provisions.

(Concessions for small business entities, 2010:49)

If the taxpayer chooses to stop using the simplified depreciation rules, the taxpayer cannot choose to use them again until at least five years after the income year in which the use of this method was stopped. The assets can still be operated in the general and long-life small business pools but the deductions claimed will be according to normal capital allowances. If the taxpayer is disqualified from using these rules because the concern is no longer deemed a small business, deductions can still be claimed for assets in these pools but according to the capital allowances. If however the taxpayer meets the small business eligibility requirements in a later year, the taxpayer can choose to use the concession again in the year that the concern qualifies, without having to wait five years *(Concessions for small business entities, 2010:48)*.

3.1.3.3 Immediate deductions for prepaid expenses

The taxpayer may pay for expenses in the current income year, relating to the next income year, for services relating to the next 12 month period or less. These are known as *prepaid expenses* and this concession allows the taxpayer to claim an immediate deduction in the current income year for expenses relating to the next income year *(Small business entity concessions essentials, 2010:3)*.

The prepayment rules mean that certain prepaid expenses, of \$1 000 or more, must be apportioned over the income years in which the goods or services are provided. However, a small business that meets the 12-month rule can choose to deduct those prepaid expenses immediately *(Concessions for small business entities, 2010:53)*.

The 12-month rule is met when an eligible prepaid expense is incurred, for a service to be rendered over a period of 12 months or less, and the service period ends in the income year following the year the expense is incurred. Where a prepayment does not meet the 12-month rule, an immediate deduction cannot be claimed and therefore the expense

needs to be apportioned over the period of the services rendered, up to a maximum of 10 years (*Concessions for small business entities*, 2010:54).

Prepaid expenses that will qualify are expenses such as subscriptions to professional associations, rent and insurance payments (*Concessions for small business entities*, 2010:3).

The following prepaid expenses do *not* need to be apportioned and an immediate deduction can be claimed where the expense meets the requirements of the general deduction rules and is not private, domestic or capital, even though the service period can be more than 12 months:

- Goods and services that you receive in full in the same income year you incur the expense.
- Goods and services that cost less than \$1 000.
- A prepayment of salary or wages under a contract of service.
- Expenses incurred due to law such as statutory fees and vehicle registration fees.

(*Concessions for small business entities*, 2010:54)

The taxpayer will access the concession by claiming an immediate deduction for the prepaid expense in the tax return and, once again, does not need to notify the tax authorities of the decision to use the concession (*Small business entity concessions essentials*, 2010:3).

3.1.3.4 Entrepreneurs' tax offset

The entrepreneurs' tax offset concession allows the reduction of tax payable by the taxpayer on its business income by up to 25% if the business has an aggregated turnover of less than \$75 000. The taxpayer can access this concession by completing the relevant sections on the tax return (*Small business entity concessions essentials*, 2010:4).

The taxpayer may be eligible for this concession if both of the following criteria apply:

- The taxpayer's aggregated turnover for the year is less than \$75 000 and
- the taxpayer has a net small business income for the year (*Concessions for small business entities*, 2010:23).

To calculate the amount of entrepreneurs' tax offset that the taxpayer can claim, the taxpayer needs to determine the taxable income (total assessable income minus all allowable deductions) and basic income tax liability. The basic income tax liability is the tax payable on your taxable income, taking into account any special rules that apply, and before reducing it by any offsets (*Concessions for small business entities*, 2010:23).

The entrepreneurs' tax offset is equal to 25% of the income tax payable if the aggregated turnover is \$50 000 or less. Where the aggregated turnover is more than \$50 000, the offset is phased out so that it stops when the turnover reaches \$75 000 (*Concessions for small business entities*, 2010:22).

Table 3.1.3.4 illustrates the steps to follow when determining the entrepreneurs' tax offset for a company.

Table 3.1.3.4 Steps to follow when determining Entrepreneurs' tax offset for a company

Step 1	Work out your taxable income for the year.
Step 2	Work out 25% of the basic income tax liability on that taxable income (use the applicable tax rates and take into account any special rules that affect the liability, but do not take any tax offsets into account).
Step 3	Work out the small business percentage using the formula: $\frac{\text{Net small business income for the year}}{\text{Taxable income for the year}} \times 100$ If the result is more than 100%, the small business percentage is 100%.
Step 4	If the aggregated turnover is \$50,000 or less, the tax offset is: Step 2 amount x small business percentage
Step 5	If the aggregated turnover is more than \$50,000, adjust the offset by the small business phase-out fraction. Work this out using the formula: $\frac{\$75,000 - \text{the aggregated turnover for the year}}{\$25,000}$ The tax offset is: Step 2 amount x small business percentage x small business phase-out fraction.

(*Concessions for small business entities*, 2010:29-30)

The tax offset can *only reduce* the amount of tax payable in the current year. The offset cannot refund any unused tax offset, defer it to reduce the tax liability in a later income year or transfer it to another taxpayer to reduce their tax liability (*Concessions for small business entities*, 2010:23).

3.1.3.5 Small business and general business tax break

In Australia a small business, with an annual turnover of less than \$2 million, can claim the small business and general business tax break relating to eligible new tangible depreciating assets. This tax break provides an extra tax deduction of 50% of the cost of the eligible new tangible depreciating assets, over and above any other capital allowance deduction for assets costing \$1 000 or more. This tax break can be claimed where you committed to investing in the asset between 13 December 2008 and 31 December 2009 inclusive. The asset must also have been used for the first time, installed, or (in the case of a new investment in an existing asset) brought to its modified or improved state on or

before 31 December 2010, the ending date of the concession (*Tax basics for small business*, 2010:31).

The taxpayer can access this concession at the end of the income year when completing the tax return (*Small business entity concessions essentials*, 2010:4).

3.1.4 Capital gains tax concessions

The taxpayer needs to first meet one of the following four basic conditions to qualify for any of the small business CGT concessions. The basic conditions are the following:

- The taxpayer is registered as a small business.
- The taxpayer does not run a business, but the taxpayer's asset is used in a business carried on by a small business that is the taxpayer's affiliate or an entity connected with the taxpayer (passively-held asset).
- The taxpayer is a partner in a partnership that is a small business and the CGT asset is one of the following:
 - The taxpayer's interest is in a partnership asset or
 - An asset the taxpayer owns that is not an interest in a partnership asset.
- The taxpayer meets the maximum net asset value test.

Apart from one of the conditions that the taxpayer must meet above, the taxpayer must also meet the active asset test (*Concessions for small business entities*, 2010:4).

To pass the maximum net asset value test, the total net value of the taxpayer's CGT assets held must not exceed \$6 million. The taxpayer must use the aggregation rules to calculate which businesses should be included when determining whether the taxpayer meets the criteria of the test. The net value of the taxpayer's CGT assets is their total market value less any liabilities owed relating to those assets (*Concessions for small business entities*, 2010:5-6).

The Australian Government also announced, in its 2008 Budget, an increased access to small business capital gains tax concessions for businesses with an aggregated turnover of less than \$2 million via the small business entity test. This is available to taxpayers

owning a CGT asset that is used in the business of a related (affiliated or connected) entity or partners owning a CGT asset used in the partnership business (*Concessions for small business entities*, 2010:5).

There are four CGT concessions available. The taxpayer can use as many concessions as available until any capital gain that was made is reduced to nil. It is important to note that the taxpayer needs to meet the conditions of each concession before it can be used. The rules for the order in which the concession can be applied, are the following:

- Firstly the CGT small business concessions,
- secondly any current year or prior year capital losses and
- thirdly the CGT discount.

The CGT discount as well as the small business concessions may be available if the taxpayer has held the asset for at least 12 months (*Concessions for small business entities*, 2010:5).

3.1.4.1 CGT 15-year exemption

The taxpayer can choose to be exempted from CGT when a business asset, which was continuously owned by the taxpayer for at least 15 years, is sold. The requirement for making use of this concession is that the taxpayer must be at minimum 55 years of age and retiring, or permanently incapacitated at the time of sale. The concession is available to individuals, companies and trusts.

The taxpayer will access this concession by not including this gain in the tax return. Companies may be required to complete a Capital gains tax schedule (NAT3423). This will report to what extent the concession has been accessed (*Small business entity concessions essentials*, 2010:5).

3.1.4.2 CGT 50% active asset reduction

A taxpayer who owned an asset with which he conducted business (an “active asset”) can select this concession to reduce the capital gain by 50% on the sale of this business asset (*Small business entity concessions essentials*, 2010:5).

An asset must meet certain criteria to qualify as an *active asset*. The asset must be used or held ready for use in, or inherently connected with, one of the following:

- The taxpayer’s business or
- the business of the taxpayer’s affiliate or connected entity or
- the taxpayer’s spouse or child under 18 years of age.

A share in a company or an interest in a trust can also be an active asset under certain circumstances. Certain CGT assets cannot be active assets, for example, assets which are mainly used to derive rent. As such, a rental property generally does not qualify as an active asset (*Concessions for small business entities*, 2010:6).

In addition, the CGT asset must be active for one of the following time periods:

- 7,5 years if the taxpayer owned it for more than 15 years or
- half of the total period the taxpayer owned the asset, if the taxpayer owned it for less than 15 years.

These time rules are modified for CGT assets which the taxpayer purchased or acquired under the rollover provisions relating to assets that were compulsorily acquired, lost, destroyed or transferred due to a marriage breakdown (*Concessions for small business entities*, 2010:6).

The taxpayer will access this concession by not including this gain in the tax return. Companies may be required to complete a Capital gains tax schedule (NAT3423). This will report to what extent the concession has been accessed (*Small business entity concessions essentials*, 2010:5).

3.1.4.3 CGT retirement exemption

On retirement there is a CGT retirement exemption concession on the sale of a business asset but limited to a lifetime limit of \$500 000. If the taxpayer is under the age of 55, the concession will only be available where the capital gain is paid into a complying superannuation fund or a retirement savings account.

The taxpayer can access this concession by not including the gain, up to the lifetime limit of \$500 000, in the tax return. Companies may be required to complete a Capital gains tax schedule to obtain the CGT exemption when the company asset is sold (NAT3423). This will report to what extent the concession has been accessed (*Small business entity concessions essentials*, 2010:6).

3.1.4.4 CGT rollover

The CGT rollover concession allows a taxpayer to sell a small business asset and buy a replacement asset or improve an existing asset and defer the capital gain that is made on the sale. The concession allows the taxpayer to roll over all, or part of, the capital gain. The replacement asset needs to be acquired one year before or up to two years after the last CGT event in the income year for which the rollover was selected. Furthermore the tax authorities in Australia may extend the replacement asset period further (*Small business entity concessions essentials*, 2010:6-7).

While the rollover enables the taxpayer to defer a capital gain to a later income year, the taxpayer may be able to use other CGT small business concessions to exempt or reduce the capital gain (*Concessions for small business entities*, 2010:5).

The taxpayer once again accesses the concession by not including the capital gain in the tax return. Companies may be required to complete a Capital gains tax schedule (NAT3423) to report the extent to which the concession has been utilized (*Small business entity concessions essentials*, 2010:6-7).

3.1.5 Goods and services tax concessions

3.1.5.1 GST Cash accounting

The taxpayer can elect, by informing the Australian authorities, to account and pay for GST on a cash basis. The result is that the taxpayer accounts for GST when the taxpayer receives payment for a sale made. Consequently this rule must then also be applied to the purchases of the taxpayer. This means that the taxpayer can only claim GST credits when the taxpayer actually pays for the purchases (*Small business entity concessions essentials*, 2010:7).

A taxpayer is eligible to account for GST on a cash basis if any one of the following criteria is met:

- The taxpayer is a small business with an annual turnover (including the turnover of related entities) of less than \$2 million.
- The taxpayer is not operating a business but is carrying on an enterprise with a GST turnover of \$2 million or less.
- The taxpayer accounts for income tax on a cash basis.
- The taxpayer is carrying on an enterprise which the Australian Tax Authorities have determined is able to account for GST on a cash basis regardless of the GST turnover.
- The taxpayer is an endorsed charitable institution, trustee of an endorsed charitable fund, gift-deductible entity or government school, regardless of the GST turnover (*Cash and non-cash accounting*, 2010).

3.1.5.2 GST Installments

This concession allows the taxpayer to pay GST by means of *installments* calculated by the Australian Taxation Office. This amount can vary each quarter. The taxpayer needs to lodge an annual GST return if this method of payment is used (*Small business entity concessions essentials*, 2010:8).

There are four criteria that the taxpayer needs to meet to be eligible to pay GST by way of installments:

- The taxpayer does not lodge an activity statement monthly.
- The taxpayer has lodged an activity statement for at least two quarters or four months if the taxpayer previously lodged monthly activity statements.
- The taxpayer has lodged all previous activity statements as required.
- The taxpayer was not in an overall GST net refund position in the previous year. This does not include the first activity statement that the taxpayer would have lodged.

(Concessions for small business entities, 2010:8)

The Australian Taxation Office will notify the small business taxpayer on its first quarterly activity statement for the income year, which is for the period 1 July to 30 September, if the taxpayer is eligible to pay GST by way of installments. The taxpayer then notifies the Australian Taxation Office of its intention to select this option on its first quarterly activity statement (*Small business entity concessions essentials, 2010:8*).

3.1.5.3 GST and annual private apportionment

A small business taxpayer can choose to account for the private portion of its business purchases annually. This concession allows the taxpayer to claim the full GST credits for these items on its activity statements, and then make a single adjustment to account for the private use percentage after the end of the income year (*Small business entity concessions essentials, 2010:8*).

The taxpayer can access this concession if s/he does not operate a business but is carrying on an enterprise with a GST turnover of \$2 million or less and does not pay GST by means of installments or reports GST annually (*Concessions for small business entities, 2010:8*).

The taxpayer *does not* need to notify the Australian tax authority but *does need* to keep a record of this election, detailing the date the election was made and the date it took effect (*Small business entity concessions essentials*, 2010:8).

3.2 *Canada*

3.2.1 **General**

From a detailed review of the relevant literature the author concluded that there are various tax incentives available to a Canadian-controlled private company (CCPC). To qualify for these incentives, a company needs to be classified as a CCPC. All of the following requirements need to be met to be classified as a CCPC:

- It is a private company.
- The company is resident in Canada during the tax year.
- The company is not controlled directly or indirectly by one or more non-resident persons.
- The company is not controlled directly or indirectly by one or more public companies, except for a prescribed venture capital company.
- The company is not controlled by a Canadian resident company that lists its shares on a designated stock exchange outside of Canada.
- The company is not controlled directly or indirectly by any combination of persons described in the three previous conditions.
- A company, where all its shares are owned by a non-resident person, by a public company that is not a venture capital company or by a company with a class of shares listed on a designated stock exchange, was owned by one person, that person would not own sufficient shares to control the company and
- a company where no class of shares is listed on a designated stock exchange.

(T2 Corporation – Income Tax Guide 2010, 2010:18)

If a company, during a tax year, becomes or ceases to be a CCPC the tax year is deemed to end immediately before the change occurs. After the end date due to the change, the

company can choose a new tax year end within 53 weeks (*T2 Corporation – Income Tax Guide 2010*, 2010:19).

Canadian-controlled private companies can also be associated with one another. In such instances, certain small business tax advantages are shared amongst these entities.

3.2.2 Income tax incentives

3.2.2.1 Small business deduction

The small business deduction (SBD) reduces the tax that a company is liable to pay. Companies that were CCPCs throughout the tax year may qualify for this deduction. The SBD rate is 17 % and it is multiplied by the *least* of the following amounts:

- Income from active business carried on in Canada.
- Taxable income.
- Business limit.
- Reduced business limit.

Active business income is income earned from a business source including incidental income. Income from a specified investment business such as rent, interest, dividends and royalties will only be considered as income eligible for the SBD if the company employs more than five full-time employees in the business throughout the year or an associated company provides managerial, financial, administrative, maintenance or similar services to the company while carrying on an active business and the company would have to employ more than five full-time employees if these services were not performed by the associated company. The aforementioned requirement is also applicable to a personal services business (*T2 Corporation – Income Tax Guide 2010*, 2010:53).

The business limit for calendar years 2009 and later is \$500 000. Where CCPCs are associated with one or more companies, a percentage of the business limit is allocated to each company (*T2 Corporation – Income Tax Guide 2010*, 2010:54).

The business limit is reduced on a straight-line basis where CCPCs have taxable capital employed in Canada of between \$10 million and \$15 million in the previous year. A CCPC that has more than \$15 million taxable income employed will not qualify for the SBD (*T2 Corporation – Income Tax Guide 2010*, 2010:55).

The only province that has a different level for the business limit is Nova Scotia where the business limit is \$400 000 (*T2 Corporation – Income Tax Guide 2010*, 2010:79).

Companies making use of the SBD benefit do not qualify for the reduction of 11.5% of the 38% tax rate as per the general tax reduction for CCPCs. CCPCs will benefit from the general tax reduction only on taxable income that is subject to a rate of 38% (*T2 Corporation – Income Tax Guide 2010*, 2010:56).

3.2.2.2 Manufacturing and processing profit deduction

Manufacturing and processing profits, which are not eligible for the small business deduction and which have been earned from a small manufacturing company, are eligible for the manufacturing and processing profits deduction (MPPD). The MPPD is calculated at a rate of 7% on income and reduces the tax payable. The company needs to derive at least 10% of its gross revenue from the manufacturing or processing of goods in Canada for sale or lease.

All of the following requirements need to be met to qualify as a small manufacturing company:

- Activities during the year were mainly manufacturing or processing.
- Active business income of the company and any associated Canadian companies were not more than \$200 000.
- The company was not engaged in any activities specifically excluded from manufacturing and processing.

- The company was not engaged in processing ore, excluding iron ore and tar sands ore, from a mineral source located outside Canada at any stage that is not beyond the prime metal stage or its equivalent.
- The company was not engaged in processing iron ore from a mineral source located outside Canada to any stage that is not beyond the pellet stage or its equivalent.
- The company was not engaged in processing tar sands located outside Canada to any stage that is not beyond the crude oil stage or its equivalent.
- The company did not carry on any active business outside Canada at any time during the year.

(T2 Corporation – Income Tax Guide 2010, 2010:61)

3.2.2.3 Scientific research and experimental development tax credit and refund

In Canada companies can, in certain circumstances, claim an investment tax credit (ITC) to either reduce their income tax liability or to attain a refund. An ITC can be claimed for scientific research and experimental development (SR&ED) expenditure. Companies can earn a non-refundable ITC of 20% of the SR&ED qualified expenditure pool. However, a CCPC can claim an additional ITC of 15% on the SR&ED qualified expenditure pool up to the expenditure limit, therefore qualifying for a refundable ITC at the rate of 35% on current and capital SR&ED expenditure (*T2 Corporation – Income Tax Guide 2010, 2010:65*).

The expenditure limit is \$3 million and this amount decreases when the taxable income and the taxable capital employed in Canada, by the CCPC and its associated companies, increases. The expenditure limit decreases when the taxable income for the previous year is \$500 000 proportionally and the expenditure limit becomes nil when the taxable income for the previous year is \$800 000 or higher. The expenditure limit will also decrease when the taxable capital, employed in Canada, of the CCPC and its associated companies in the previous year reaches \$10 million. This amount will decrease

proportionally until it becomes nil at \$50 million taxable capital employed (*T2 Corporation – Income Tax Guide 2010*, 2010:65).

For a CCPC the ITC earned on current SR&ED expenditure is 100% refundable and for capital SR&ED it is 40% refundable if the ITC cannot be used in the current year (*T2 Corporation – Income Tax Guide 2010*, 2010:65).

3.2.2.4 Incentives of provinces and territories

3.2.2.4.1 Newfoundland and Labrador

The province of Newfoundland and Labrador will issue a Small Business Tax Holiday Certificate to eligible new businesses that were incorporated between 1 April 2003 and 31 March 2006. These businesses need to operate in designated growth sectors of the economy and may not be associated with any other business. The time frame for this tax holiday is three years for businesses located in the Northeast Avalon Peninsula and five years for all other eligible businesses (*T2 Corporation – Income Tax Guide 2010*, 2010:77).

3.2.2.4.2 Nova Scotia

In Nova Scotia new small businesses that qualify as CCPCs and companies incorporated outside the province of Nova Scotia, but that pay at least 25% of its wages to employees who are resident in the province and have its head office in Nova Scotia, will qualify for a tax reduction for the first three years. If the company qualifies for the federal small business deduction (SBD) for the year, it can claim this reduction to reduce the Nova Scotia income tax payable (*T2 Corporation – Income Tax Guide 2010*, 2010:80).

3.2.2.4.3 Ontario

The Ontario small business deduction reduces the Ontario basic income tax of a corporation that was a CCPC during the tax year. The small business deduction is calculated by multiplying the rate of 7.5% with the Ontario small business income. The Ontario small business income is calculated by multiplying the Ontario domestic factor, the ratio of the company's Ontario taxable income to the company's total taxable income from all provinces and territories, with the least of the following amounts:

- The income from an active business carried on in Canada.
- The federal taxable income less adjustment for foreign tax credit or
- the unreduced federal business limit adjusted for Ontario's higher business limit of \$500 000 for days in the tax year that were in 2008.

(T2 Corporation – Income Tax Guide 2010, 2010:82-83)

3.2.2.4.4 Manitoba

In the Manitoba province there is not a tax relief for small business by applying a lower rate of tax or a small business deduction, but rather a small business venture capital tax credit for companies that invest in qualifying community enterprises.

A company can claim a non-refundable tax credit if it is not a prescribed venture capital company or labour-sponsored venture capital company and directly invested a minimum of \$20 000. The company will receive a tax credit receipt from the Province of Manitoba for the qualifying investment.

The credit is equal to 30% of the amount invested but limited to a lifetime maximum investment of \$450 000. The annual investment limit is also \$450 000 and the maximum amount of the tax credit that you can earn in a given year is \$135 000, this being 30% of \$450 000. The maximum amount that you can apply for, in a given year against the provincial taxes, is \$45 000. The balance is carried forward for a maximum of 10 years
(T2 Corporation – Income Tax Guide 2010, 2010:95-96).

3.2.2.4.5 British Columbia

British Columbia has a similar small business venture capital tax credit to that of the province of Manitoba. Companies investing in shares of a registered venture capital company, or eligible business corporations, can claim a British Columbia venture capital tax credit. The British Columbia government issues a certificate which enables companies to claim the tax credit. This credit will be first applied to reduce the British Columbia provincial tax payable for the year to zero. Unclaimed credits can be carried forward for a period of four years (*T2 Corporation – Income Tax Guide 2010*, 2010: 100).

In British Columbia a CCPC can also claim a scientific research and experimental development (SR&ED) refundable tax credit. The amount of this credit is equal to 10% of the lesser of the SR&ED qualified British Columbia expenditure for the tax year or the expenditure limit of \$500 000. Where the amount for SR&ED expenditure is more than the expenditure limit, a non-refundable tax credit can be claimed. The non-refundable tax credit is 10% of the SR&ED qualified British Columbia expenditure for the year, less the total of the refundable tax credit and any amount renounced for the year. The maximum non-refundable tax credit must be claimed against the income tax payable for that year. Unclaimed credits can be carried forward for a maximum of ten years (*T2 Corporation – Income Tax Guide 2010*, 2010:100).

3.2.2.4.6 Nunavut

In the province of Nunavut a company that qualifies as a small business, as per the federal small business deduction, can claim a tax credit for a 12-month period from 1 April to 31 March at \$10 000 per employer. The tax credit is effective from 1 April 2009 and expires on 31 March 2014. The tax credit is calculated at a rate of 30% of the business training expense that is provided by a company that has a permanent establishment in Nunavut and which provides qualified training to eligible employees

who, in turn, successfully complete the training during the year (*T2 Corporation – Income Tax Guide 2010*, 2010:106-107).

3.2.3 Capital gains tax incentives

3.2.3.1 Capital gains deduction for qualified small business corporation shares

The capital gains deduction reduces the taxable capital gains by claiming a deduction where certain properties are sold. The lifetime capital gains deduction is \$750 000 of which half can be claimed against your taxable capital gains, therefore a lifetime deduction of \$375 000. Capital gains eligible for this deduction are the following:

- Disposition of qualified small business corporation shares.
- Dispositions of qualified farm property.
- Dispositions, after 1 May 2006, of qualified fishing property and
- a reserve brought into income in 2010 from any of the above.

(Capital Gains 2010, 2010:12)

A share of a corporation can be considered to be a *qualified small business corporation share* if all of the following conditions are met:

- At time of disposal the share was owned by the individual taxpayer, the taxpayer's spouse or common-law partner or a partnership of which the taxpayer is a member.
- Throughout the 24 months immediately before the share was disposed of, the share was owned as described before and it was a share of a Canadian-controlled private corporation and more than 50% of the fair market value of the assets of the corporation were used mainly in an active business carried on primarily in Canada by the Canadian-controlled private corporation, or by a related corporation, or certain shares or debts of connected corporations, or a combination of these two types of assets.
- Throughout the 24 months immediately before the share was disposed of, no one other than the taxpayer or the aforementioned parties owned the share.

Where a corporation issued a share after 13 June 1988 to a taxpayer, a person related to the taxpayer or a partnership of which the taxpayer is a member, it is considered that, immediately before the share was issued, an unrelated person owned it. To meet the 24-month holding-period requirement, the shares need to be held by the taxpayer from the date of issue to the date of disposal. This holding-period does not apply where the shares are issued as payment for other shares or as payment for dividends or are issued for the disposal of a property to the corporation (*Capital Gains 2010*, 2010:8).

3.2.3.2 Capital gains deferral for investment in small business

This capital gains tax incentive is available to eligible small business corporations. These are Canadian-controlled private corporations where all, or substantially all, of the fair market value of its assets are used principally in an active business that is carried on primarily in Canada. It can also be shares of, and/or a debt issued by other eligible small business corporations or a combination of such assets, shares or debt. The issuing corporation must be an eligible small business corporation at the time the shares were issued. An eligible small business corporation does not include:

- A professional corporation.
- A specified financial institution.
- A corporation whose principal business is leasing, renting, developing or selling real property that it owns or any combination of these activities.
- A corporation where more than 50% of the fair market value of its property is attributable to real property.

(Capital Gains 2010, 2010:6-7)

Individual taxpayers may defer capital gains incurred on the sale of small business investments, i.e. shares in eligible small business corporations, where the proceeds are used to acquire an investment in an eligible small business corporation. The adjusted cost base of the new investment is reduced by the capital gain deferred from the initial investment (*Capital Gains 2010*, 2010:26).

The capital gains deferral only applies to eligible small business corporation shares. These shares have the following characteristics:

- They consist of common shares issued by the corporation to the investor.
- The issuing corporation must be an eligible small business corporation (as defined above) at the time the shares were issued.
- The total carrying value of the assets of the eligible small business corporation cannot exceed \$50 million immediately before and immediately after the shares were issued.
- While holding the shares, the issuing corporation is an eligible active business corporation.

(Capital Gains 2010, 2010:27)

A further requirement for deferral is that the eligible small business shares should have been held for more than 185 days from the date of acquisition. The replacement shares have to be acquired at any time in the year of disposal or within 120 days after the end of that year. The deferred capital gains do not qualify for the capital gains deduction (*Capital Gains 2010, 2010:27*).

3.2.3.3 Capital gains reserve

The deferral of a capital gain by claiming a reserve is normal over a maximum period of 5 years. Where the capital gain relates to the transfer of small business corporation shares to the taxpayer's child, the period to claim the reserve is extended to 10 years (*Capital Gains 2010, 2010:11*).

3.2.3.4 Employee security options

For shares bought by an employee, through an employee security option granted by a Canadian-controlled private corporation with which the employee dealt at arm's length, the taxpayer does not include the taxable benefit in its income in the year the securities

are acquired. The taxable benefit will only be declared in the year the securities are sold (*Capital Gains 2010*, 2010:11).

3.2.3.5 Allowable business investment loss

When a taxpayer sells a share in a small business corporation or incurs a loss due to a debt owed to the taxpayer by a small business corporation, the business investment loss that is incurred can be claimed as an allowable business investment loss (ABIL) where dealings are done at arm's length. For the application of the ABIL, a small business corporation includes a corporation that was a small business corporation at any time during the 12 months before the loss was incurred (*Capital Gains 2010*, 2010:38).

The ABIL deduction can also be claimed where the loss is incurred due to a debt that is owed by a small business corporation that turned into a bad debt at the end of the year. An ABIL deduction can be claimed where the taxpayer owns a share in a small business corporation that has gone bankrupt during the year or is deemed to be insolvent or for which a winding-up order has been granted (*Capital Gains 2010*, 2010:38).

The ABIL is calculated as half of the loss incurred and can be deducted from other sources of normal taxable income. Where the ABIL amount exceeds that of the other sources of income, the balance can be deducted as a non-capital loss. A non-capital loss can be carried back 3 years and carried forward for 10 years. An ABIL that has not been used in 10 tax years will become a net capital loss in the eleventh year (*Capital Gains 2010*, 2010:38).

3.2.4 GST/HST incentives

A company with annual worldwide revenue from taxable supplies amounting to \$200 000 or less, including zero-rated supplies and GST/HST, in any four consecutive fiscal quarters over the last five fiscal quarters, can use the Quick Method of accounting to

calculate GST/HST. This is a simpler way of calculating GST/HST liability. The \$200 000 revenue limit does not include:

- Supplies of financial services.
- Sales of real property.
- Sales of capital assets.
- Goodwill.

(General Information for GST/HST Registrants, 2010:27)

Businesses such as accountants, bookkeepers, financial consultants, lawyers, actuaries, notaries public, listed financial institutions, audit services and tax return preparation services or tax consultants cannot use the Quick Method *(General Information for GST/HST Registrants, 2010:27)*.

When using the Quick Method you charge and collect GST/HST on taxable goods and services in the normal way. When you calculate the net GST/HST to be remitted, you multiply your taxable supplies including the GST/HST during the reporting period by the applicable Quick Method remittance rate *(General Information for GST/HST Registrants, 2010:27)*.

The remittance rate is dependent on whether you are in the service, retail or manufacturing business, what province your permanent establishment is located in as well as the province where your supplies are made or your services provided. The remittance rate is lower than the GST/HST rate which results in the fact that only part of the taxes collected will be remitted. The unremitted part of the GST/HST collected will form part of the income for income tax purposes *(General Information for GST/HST Registrants, 2010:28)*.

When using the Quick Method, it is not allowed to claim input tax credits for operating expenses. The Quick Method remittance rates take into account the GST/HST paid on these operating expenses. It is only allowed to claim input tax credits when they relate to

capital purchases such as land, computers, vehicles etc. (*General Information for GST/HST Registrants*, 2010:28).

It is necessary to select a method before submitting the GST/HST return using the Quick Method. If this method is employed, the taxpayer commits to using it for at least a year (*General Information for GST/HST Registrants*, 2010:28).

3.3 South Africa

3.3.1 General

In South Africa there are tax incentives for small and micro businesses. To qualify for these incentives the company, or close corporation, needs to meet the requirements set out in the Income Tax Act of 1962 as amended to benefit from these incentives.

3.3.1.1 Small Business Corporation

Section 12E(4) of the Income Tax Act defines a small business corporation as any close corporation or company where all the shareholders are natural persons for the entire year of assessment. None of the shareholders or members may at any time during the year of assessment hold any share or have any interest in the equity of any other company other than certain permitted investments. The permitted investments are the following:

- Shares in a listed company.
- Any portfolio in a collective investment scheme.
- Any interest in a sectional title body corporate, share block company and association formed to manage the collective interests of members.
- Less than 5% in a social or consumer co-operative or a co-operative burial society or any other similar co-operative if all of its income is solely derived from its members.
- Less than 5% in a primary savings co-operative bank or primary savings and loan co-operative bank.
- Any venture capital company.

- Any friendly society.
- Any company, close corporation or co-operative that has not traded during any year of assessment and has not ever owned assets of more than R5 000 in value.
- Any company or close corporation that has taken steps to liquidate, wind up or deregister.

(Huxham and Haupt, 2011:313)

The *type of income* received also has a bearing on whether the company or close corporation qualifies as a small business corporation. A small business corporation (SBC) does not have investment income and income from *personal service* that contributes more than 20% of the sum of the revenue receipts and accruals and capital gains of the corporation. Investment income is defined as dividends, royalties, rental from immovable property, annuities, interest and the proceeds from investment or trading in financial instruments, marketable securities or immovable property. *Personal service* is defined as any service in the following fields if it is rendered personally to clients by a person who holds an interest in the company or close corporation: accounting, actuarial science, architecture, auctioneering, auditing, broadcasting, consulting, draftsmanship, education, engineering, financial service broking, health, information technology, journalism, law, management, real estate broking, research, sport, surveying, translation, valuation and veterinary science (Huxham and Haupt, 2011:313).

The aforementioned *personal services* restriction does not apply if the SBC employs three or more persons and the following strictures apply:

- The persons are employed full time.
- They are engaged *full time* in the business of the SBC providing services to the clients.
- They are not shareholders or members of the SBC.
- They are not connected to any of the shareholders or members of the SBC.

(Huxham and Haupt, 2011:314)

When the company or close corporation completes their annual tax return for income tax purposes they will elect to be taxed as a SBC on the tax return form and the annual turnover will be declared on the return to ensure that the SBC is within the annual limit of R14 million.

3.3.1.2 Micro business

Companies and close corporations can also be classified as *micro businesses*. Section 48 of the Income Tax Act and the Sixth Schedule of the Act determine the taxation of taxpayers that qualify as micro businesses. A micro business pays turnover tax instead of value added tax and income tax. The main requirement is that the “qualifying turnover” for a year of assessment should not exceed R1 million (Huxham and Haupt, 2011:672).

Paragraph 3 of the 6th Schedule sets out the circumstances under which a taxpayer does *not* qualify as a micro business:

- Where the company or close corporation has a year of assessment that does not end on the last day of February.
- Where the shareholder/s is a person other than a natural person at any time during the year of assessment.
- Where the shareholders or members have an interest in the equity of any other company or close corporation at any time during the year of assessment, other than those listed as permitted investments under 3.3.1.1.
- Where the company is a tax-exempt Public Benefit Organisation.
- Where the company is a tax-exempt Recreational Club.
- Where more than 20% of the company or close corporation’s total receipts for the year of assessment consist of investment income and income gained from the rendering of a professional service. Investment income includes rental on immovable property, dividends, interest, proceeds from the disposal of financial instruments, royalties and annuities.

(Huxham and Haupt, 2011:675-676)

If a company or close corporation meets the requirements to be a *micro business*, it needs to register as such before the beginning of the year of assessment. If a micro business commences with trading during a year of assessment, it should register within 2 months of starting the business. A registered micro business cannot voluntarily deregister unless it has been registered for at least 3 years of assessment. A voluntarily deregistered micro business can only reregister again after at least 3 years of assessment have passed. This is also true for a compulsory deregistration. A micro business will be deregistered where the annual turnover exceeds R1 million (Huxham and Haupt, 2011:677).

A specific anti-avoidance rule for the qualifying turnover determines that the turnover of connected persons' business activities will be added together for the purposes of applying the turnover limit of R1 million, even though those businesses may be in separate incorporated entities (*Tax Guide for Micro Businesses 2011/12*, 2011:7).

A micro business registered for turnover tax must notify SARS within 21 days of its qualifying turnover exceeding R1 million for the year of assessment or if there is reasonable grounds to believe that the limit of R1 million will be exceeded. The business will then be deregistered from turnover tax and will be registered for VAT. If SARS is of the opinion that the excess turnover over R1 million is small and temporary, the business can remain on the turnover tax system. Where the business is deregistered from the turnover tax system, the VAT liability will take effect from the beginning of the month following the month in which the qualifying turnover exceeded, or was likely to exceed, the R1 million threshold (*Tax Guide for Micro Businesses 2011/12*, 2011:4).

3.3.2 Income tax incentives

3.3.2.1 Reduced income tax rate for Small Business Corporations

Special tax rates apply to small business corporations. Table 3.3.2.1 illustrates the tax rates applicable for the tax years ending during the 12-months period ending 31 March 2011.

Table 3.3.2.1 Small business corporation tax rate

Taxable income	Rate of tax
Not exceeding R57 000.	0% of taxable income.
Exceeding R57 000 but not exceeding R300 000.	10% of the taxable income exceeding R57 000.
Exceeding R300 000.	R24 300 plus 28% of the taxable income exceeding R300 000.

(*Tax Guide for Small Businesses 2010/11*, 2011:17)

3.3.2.2 Turnover tax for Micro Businesses

Qualifying turnover is the total amount received by a micro business for the year of assessment from the carrying on of business activities. Government grants exempt from income tax are excluded from the qualifying turnover as well as any receipts of a capital nature received from conducting business. The qualifying turnover should not exceed R1 million in any year of assessment (*Tax Guide for Micro Businesses 2011/12*, 2011:6).

The turnover tax is calculated on the taxable turnover. *Taxable turnover* includes the total amount received in cash by the micro business during the year of assessment but excludes government grants. The taxable turnover must include 50% of the amounts received from the disposal of immovable property mainly used for business purposes, other than trading stock and any other asset used mainly for business purposes, other than any financial instrument (*Tax Guide for Micro Businesses 2011/12*, 2011:4). Investment income received by a close corporation or company, excluding dividends, should also be included in the taxable turnover (*Tax Guide for Micro Businesses 2011/12*, 2011:9).

Micro Businesses are required to submit two interim payments and one final payment on assessment. The first interim payment must be based on an estimate of the taxable turnover of the micro business for the year of assessment and amounts to 50% of the turnover tax payable. The payment must be submitted to SARS within six months from the beginning of the year of assessment. The second interim payment will also be based

on an estimate of the taxable turnover of the year of assessment and a calculation of the turnover tax payable on the estimate. The calculated turnover tax payable less the first interim payment should be paid before the end of the year of assessment. A further payment of tax will be necessary where the assessed turnover tax on the actual taxable turnover for the year of assessment exceeds the two interim payments which had already been made (*Tax Guide for Micro Businesses 2011/12*, 2011:11-12).

Table 3.3.2.2 illustrates the rates in respect of any year of assessment during the period of 12 months ending on 31 March 2012 that are applied to the taxable turnover to calculate the turnover tax payable.

Table 3.3.2.2 Turnover tax rate for Micro Businesses

Taxable turnover	Rate of tax
Not exceeding R150 000.	0% of taxable turnover.
Exceeding R150 000 but not exceeding R300 000.	1% of the taxable turnover exceeding R150 000.
Exceeding R300 000 but not exceeding R500 000.	R1 500 + 2% of the taxable turnover exceeding R300 000.
Exceeding R500 000 but not exceeding R750 000.	R5 500 + 4% of the taxable turnover exceeding R500 000.
Exceeding R750 000.	R15 500 + 6% of the taxable turnover exceeding R750 000.

(Huxham and Haupt, 2011:672)

3.3.2.3 Section 12E Capital allowances

Small business corporations qualify in terms of section 12E of the Income Tax Act of 1962 for a deduction of 100% of the cost of plant and machinery brought into use during the year of assessment. The asset must be owned or acquired by the taxpayer under an installment credit agreement and brought into use for the first time by the taxpayer on or after 1 April 2001. The asset must be used by the taxpayer directly in a manufacturing or similar process (Huxham and Haupt, 2011:178).

Non-manufacturing assets may be written off either in terms of section 11(e) of the Income Tax Act that is available to all types of businesses or in terms of section 12E(1A)

for small business corporations over a 3 year time period. The *3 year write off* is as follows:

- 50% of cost in the year the asset is brought into use,
- 30% in the next year and
- 20% in the final year.

There is no apportionment of section 12E allowances for part of the year. Where a small asset costs R7 000 or less, it is better to claim the 100% write off available through section 11(e) than the section 12E allowance (Stiglingh, 2010:214).

3.3.2.4 Venture capital company shares

A deduction can be claimed in terms of section 12J of the Income Tax Act by individuals and listed companies and their group subsidiaries for investment in approved venture capital companies (VCCs) shares. In turn, the VCC will invest in qualifying investee companies which are small and medium-sized businesses and junior mining companies (*Tax Guide for Small Businesses 2011/12*, 2011:30).

The deduction that can be claimed under section 12J by individuals is an annual deduction limited to R750 000. This annual deduction has a further lifetime limit of R2.25 million that is also adjusted with recoupment (*Tax Guide for Small Businesses 2010/11*, 2011:30).

The deduction which listed companies and their group subsidiaries can claim under section 12J is 100% of the amount invested in the VCC. Investment by the listed company and its group companies is limited to 40% of the equity shares of the VCC (*Tax Guide for Small Businesses 2010/11*, 2011:30).

3.3.3 Capital gains tax incentives

3.3.3.1 Small business assets exemption

The capital gains tax incentive is available to sole proprietors, partners and owners of an interest of 10% or more in a company or close corporation where the market value of all the assets at the date of disposal of the asset or interest does not exceed R5 million (*Tax Guide for Small Businesses 2011/12*, 2011:42).

Paragraph 57 of the Eighth Schedule to the Income Tax Act of 1962 determines that up to R750 000 of the capital gain will not be subject to tax on the sale of an active business asset. An active business asset is an immovable asset that has mainly been used in the business or any other assets that has been used exclusively in the business. Financial instruments and assets used for the generating of rental income, annuities and foreign exchange profits do not qualify under paragraph 57 for this exemption (Stiglingh, 2010:886).

All of the following requirements need to be met to be able to qualify for the exemption:

- The exemption is only available to a natural person as the owner in the partnership, company or close corporation.
- The asset should have been held for at least five years before the disposal.
- The person should have been actively involved in the business activities of the small business for the aforementioned five year period and should be 55 years old or, if younger than 55, the disposal must be due to ill health, disability or death.
- The full amount of the capital gain should be realized in a period of 24 months from the date of disposal to qualify for the exemption (Stiglingh, 2010:886).

An important limitation of the exemption is that the R750 000 is a lifetime limit. If the individual has more than one business, all those businesses assets are added together to determine the R5 million threshold requirement and the R750 000 exemption applies to the total of the capital gain from the disposal of all the businesses assets (Stiglingh, 2010:886-887).

3.3.3.2 Exemption for Micro Businesses

Micro businesses that are taxed on the turnover tax basis will be specifically exempt from capital gains tax. The exemption refers to immovable assets mainly used for business purposes and movable assets exclusively used for business purposes (Stiglingh, 2010:887).

A taxpayer is disqualified as a micro business if the receipts from the disposal of the aforementioned two classes of capital assets exceed R1.5 million in a three-year period that covers the year of assessment during which the capital proceeds were received and the two years immediately preceding the assessment. The three-year period accommodates the occasional disposal of a higher value asset such as land and buildings (*Tax Guide for Micro Businesses 2011/12*, 2011:10).

3.3.4 Value added tax (VAT) incentives

3.3.4.1 Relief from exit VAT

A vendor that deregisters from the VAT system is required to pay exit VAT on the lesser of the cost or market value of the assets held before deregistration. Vendors that *deregister from the VAT system to register on the turnover tax system* receive the following relief:

- A deduction of up to R100 000 from the value of the assets held by the vendor before registration. This relief equates to a maximum of R12 281 in exit VAT payable.
- Payment of the exit VAT is spread over a period of six months.

(*Tax Guide for Micro Businesses 2011/12*, 2011:4)

3.3.4.2 Extended tax periods

Category D and F provides specific relief to small businesses and farms where the VAT periods have been extended from the normal two month period (*Tax Guide for Small Businesses 2010/11*, 2011:48).

Category D applies to small farmers with an annual turnover of less than R1,5 million. These vendors only need to submit VAT returns and make payment every six months ending August and February of each year (*Tax Guide for Small Businesses 2010/11*, 2011:48).

Category F applies to vendors that qualify as small businesses where the annual turnover is less than R1,5 million. These vendors will submit VAT returns and make payment every four months (*Tax Guide for Small Businesses 2010/11*, 2011:48).

4 Evaluation of incentives

The discussion of the incentives available in South Africa, Australia and Canada for income tax, capital gains tax and sales tax/value added tax, specifically for small businesses, revealed that there are *similarities* but also *differences* in the tax approaches of these three countries. A comparison of these incentives, done according to *tax type* and *country*, will aim to identify these similarities and differences.

4.1 Identification of the small business taxpayer

The incentives are only available to taxpayers which meet certain set criteria. The similarities and differences in these criteria are compared below.

A small business in Australia will qualify for tax incentives if its aggregated annual turnover in the current year *is less* than AUD\$2 million. Where the aggregated annual turnover *is more* than AUD\$2 million, but the net asset value is not more than AUD\$6 million, the small business will only qualify for the capital gains tax incentives.

In Canada and South Africa the small business firstly needs to meet certain requirements which mainly center on *ownership* and *area of business industry*, before the size of the business is considered. In Canada a small business is classified as a Canadian-Controlled Private Company (CCPC) and in South Africa as a Small Business Corporation (SBC). When comparing the requirements for a small business to qualify as a CCPC and SBC, it can be concluded that CCPC requirements state that the control of the company should not be in the hands of non-residents, public companies or companies listed on the stock exchange. In South Africa the owner of the SBC is not allowed to have an interest in another entity, unless it forms part of the permitted list of investments. At first glance the requirements for a CCPC and SBC appear to be similar, but they are in fact different as CCPC requirements look at issues regarding *control* and SBC requirements look at the *interest of the owner in other entities*.

Once a company qualifies as a CCPC in Canada, the different incentives then set out a further list of requirements which relate to turnover, assets and type of income.

In South Africa however, the *ownership requirement* is just the first step. The type of income then needs to be considered to ensure that no more than 20% of the sum of the total revenue is earned from *personal services* and investment income. If the SBC employs three or more full time employees that are not shareholders or members and not connected persons, the *personal services* restriction falls away. The last hurdle in the way of qualifying as a SBC is that the annual turnover of the taxpayer should not exceed R14 million.

South Africa has also introduced another tier of business called a *micro business* which is *not* found in Australia or Canada. The main requirement for qualifying as a micro business is that the qualifying turnover for the year should not exceed R1 million. Other requirements are the same as for a SBC but there is a further criterion and that is that the tax year should end on the last day of February to qualify as a micro business.

The conclusion is thus that South Africa has the most requirements to qualify as a small business taxpayer and this is supported by this comparative research assignment with Australia and Canada. The Australian annual aggregated turnover limit of AUD\$2 000 000 equates to R16 086 500 when converted at the exchange rate of AUD\$1 = R8,043 as provided by Oanda.com on 16 October 2011. Australia's turnover limit for a CCPC in Rand terms is therefore higher than the South African limit of R14 million for a SBC.

4.2 Income tax incentives

4.2.1 Reduction of tax liability

One or other form of small business tax rate incentive or decrease in the amount of tax payable by small businesses is present in Australia, Canada and South Africa. This

comparative research assignment reveals that these incentives are very similar in the three countries.

In Australia the entrepreneur's tax offset reduces the tax payable by a small business with an aggregated turnover of less than AUD\$75 000. The income tax payable is reduced by 25% if the turnover is AUD\$50 000 or less and the 25% incentive is proportionately reduced as the turnover increases up to AUD\$75 000. This tax offset cannot be refunded, deferred or transferred.

Similarly in Canada the income tax liability, calculated at the corporate tax rate of 38%, is reduced by 17%. This reduction is calculated on the least of the income from active business carried on in Canada, taxable income, business limit or reduced business limit for companies that were CCPCs throughout the tax year. The business limit for calendar years 2009 and later is C\$500 000. Nova Scotia is the only province with a different business limit of C\$400 000. The business limit is reduced on a straight-line basis where CCPCs have taxable capital of between C\$10 million and C\$15 million employed in Canada in the previous tax year. A CCPC that has more than C\$15 million taxable capital employed will not qualify for the incentive.

The provinces and territories in Canada also pay governmental taxes. Some of the provinces and territories provide relief on these taxes to small business as discussed in Chapter 3. Table 4.2.1 summarizes the tax liability reduction per province and the qualifying requirements.

Table 4.2.1 Comparison of provincial tax liability relief in Canada

Province	Incentive	Requirement
Newfoundland and Labrador	Tax holiday for 3 years in Northeast Avalon Peninsula and 5 years for all others.	<ul style="list-style-type: none"> • Incorporated between 1 April 2003 and 31 March 2006. • Operate in designated growth sectors. • Not associated with another business. • Obtain Small Business Tax Holiday Certificate.
Nova Scotia	Tax reduction.	<ul style="list-style-type: none"> • Qualify for federal small business deduction. • If incorporated outside Nova Scotia, then at least 25% of wages are paid to employees resident in Nova Scotia and the head office is located in Nova Scotia.
Ontario	Tax reduction equal to 7,5% of Ontario small business income.	Ontario small business income = Ontario domestic factor X (least of: active business income or federal taxable income less adjustment for foreign tax credit or business limit of C\$500 000).

In South Africa a Small Business Corporation (SBC) is not taxed at the corporate tax rate of 28% but according to a table where the first R57 000 of taxable income is not taxable. Taxable income above R57 000, but below R300 000, is taxed at 10% and only taxable income above R300 000 is taxed at the normal corporate tax rate of 28%.

Micro businesses, which in South Africa are classified as smaller businesses than SBC, pay tax on their taxable turnover according to Table 3.3.2.2 *Turnover tax rate for Micro Businesses*. Micro businesses do not incur a tax liability if their turnover does not exceed R150 000 per annum.

4.2.2 Capital assets incentives

In Australia a small business can classify its capital assets into two pools and then claim one deduction for the whole pool compared to the normal depreciation rules where each asset's individual depreciation calculation should be performed. This simplifies the calculation for the taxpayer. In the *general small business pool* depreciating assets, with an effective life of less than 25 years for which a deduction of 30% can be claimed each year, are grouped together. The *long-life small business pool* consists of depreciating assets with an effective life of 25 years or longer. For this pool a deduction of 5% can be claimed each year.

A small business in Australia, with an annual turnover of less than AUD\$2 million, can claim a small business and general business tax break for eligible new tangible depreciating assets. The deduction is 50% of the cost of the new asset and can be claimed over and above any other capital allowance. There must have been a commitment to invest in the asset between 13 December 2008 and 31 December 2009 and the asset must have been ready for use before 31 December 2010.

In South Africa a SBC can claim a 100% deduction for the cost of plant and machinery used in a manufacturing or similar process in the year of acquisition. A SBC's non-manufacturing assets qualify for a 3 year write off of 50% in the first year of being taken into use, 30% in the next year and 20% in the final year.

When comparing Australia and South Africa to Canada, the research reveals that Canada has no further incentive for the capital assets of their CCPCs.

4.2.3 Venture capital incentive

In the Manitoba province in Canada there is no tax relief, through the application of a lower tax rate, for small businesses. The incentive is available to companies that invest in qualifying community enterprises. The investee company can claim a non-refundable

small business venture capital tax credit. The credit is equal to 30% of the amount invested but limited to a lifetime maximum investment of C\$450 000. The minimum investment is C\$20 000 with an annual limit of C\$450 000. Prescribed venture capital and labour-sponsored venture capital companies do not qualify for the incentive.

In British Columbia a similar incentive to that found in Manitoba can be claimed for small business venture capital tax credit. The tax credit can be claimed where the company invests in the shares of a registered venture capital company.

In South Africa the deduction that can be claimed by individuals and listed companies for an investment in approved venture capital companies' shares can be compared to the incentive in British Columbia. The claimable deduction is limited to R750 000 per annum with a lifetime limit of R2.25 million. Listed companies can claim 100% of the amount invested but the investment is limited to 40% of the equity shares of the venture capital company. The venture capital company will invest in small and medium-sized businesses.

In contrast to Canada and South Africa there is no tax incentive in Australia for investing in small business.

4.2.4 Australian specific incentives

Simplified stock rules and *immediate deduction of prepaid expenses*, highlighted as incentives for small businesses, are only to be found in Australian legislation.

The simplified trading stock rule allows a taxpayer to account for changes in the value of its trading stock by estimating the trading stock on hand at year end. The difference between the stock on hand at the beginning of the year and the estimated stock at year end should not be more than AUD\$5 000. No stock take is performed by the taxpayer at year end. Where the taxpayer chooses not to account for the difference as per the simplified trading stock rules, the value of trading stock on hand at year end is deemed to

be the same as at the start of the year with the differential of AUD\$5 000 still applying to qualify for the incentive.

The incentive for the immediate deduction of prepaid expenses for small businesses allows a taxpayer to deduct prepaid expenses of AUD\$1 000 or more, immediately. Expenses such as subscriptions to professional associations, rent and insurance payments will qualify.

4.2.5 Canadian specific incentives

In Canada small businesses qualify for incentives relating to manufacturing and processing profit deductions, tax credits for training and scientific research and experimental tax credits and refunds.

The manufacturing and processing profit deduction (MPPD) is available to small manufacturing companies that do not qualify for the small business deduction. At least 10% of the company's gross revenue should be derived from the manufacturing or processing of goods in Canada for sale or lease. The MPPD is calculated as 7% of income and this leads to a reduction of the tax payable.

An Investment Tax Credit (ITC) can be claimed in Canada for scientific research and experimental development (SR&ED) expenditure. The ITC will either *reduce* the tax liability or result in a *refund*. Companies can earn a non-refundable ITC of 20% of the SR&ED qualified expenditure pool. A CCPC can claim an additional ITC of 15% and therefore qualify for a refundable ITC of 35% on current and capital SR&ED expenditure. The expenditure limit is C\$3 million and *proportionally decreases* when the taxable income and the taxable capital employed in Canada by the CCPC *proportionally increases*.

In the province of Nunavut in Canada a small business that qualifies for the small business deduction can claim a tax credit of 30% on business training expenses. The

company should have a permanent establishment in Nunavut and should also provide qualified training to eligible employees who successfully completed the training during the year. The tax credit is effective from 1 April 2009 to 31 March 2014 and is limited to C\$10 000 per employer.

4.3 Capital gains tax incentives

4.3.1 Proceeds from the sale of small business assets

Only 50% of the capital gain on the sale of an active business asset in Australia will be subject to CGT. The asset must be used in the taxpayer's business or affiliated business and should have been an *active asset* for at least half of the period that it was owned by the taxpayer.

In Australia the CGT rollover incentive allows the taxpayer to sell a small business asset and buy a replacement asset or improve an existing asset. All or part of the capital gain from the sale is rolled over to the replacement asset that needs to be acquired one year before the sale of the small business asset or two years after the sale of the asset.

4.3.2 Proceeds from the sale of shares in a small business

A capital gain from the sale of shares in a qualified small business corporation in Canada will be reduced by half of the lifetime limit of C\$750 000. A qualified small business corporation share is firstly owned by an individual taxpayer, secondly it had to be a share of a Canadian-Controlled Private Company (CCPC) 24 months before disposal and lastly more than 50% of the fair market value of the assets has been used mainly in an active business.

In Canada a further incentive available on the sale of shares in a CCPC is the *deferral* of the capital gain incurred. The deferral is available where the proceeds are used to acquire an investment in an eligible small business corporation. The base cost of the new investment is reduced by the capital gain deferred. The total net asset value of the

eligible small business corporation cannot exceed C\$50 million. The shares should have been held for more than 185 days before sale and the replacement shares need to be acquired during the year of disposal but not later than 120 days after the end of the year.

In Canada the transfer of small business corporation shares to the taxpayer's child qualifies for the deferral of the capital gain by claiming a reserve over an extended period of 10 years.

CCPC shares, bought by an employee through an employee security option from the taxpayer, will only be declared as a taxable benefit in the year that the employee sells the shares.

4.3.3 Incentives where retirement is a prerequisite

In Australia a taxpayer can choose to be exempt from CGT when a business asset is sold. The asset should have been owned by the taxpayer for 15 years and the taxpayer should be at least 55 years old or permanently incapacitated.

On retirement in Australia the CGT retirement exemption allows a lifetime limit deduction of AUD\$500 000. Where the taxpayer is however under the age of 55, the exemption is only available if the capital gain is paid into a complying superannuation fund or a retirement savings account.

In South Africa the small business exemption also applies where the age of 55 has been reached or otherwise where the sale is as a result of ill health, disability or death. The market value of all the assets at the date of disposal should not exceed R5 million. The exemption of R750 000 of the capital gain relates to the sale of active business assets. The R750 000 limit is a lifetime limit and the R5 million threshold of business assets relates to the total business assets from all businesses held by the taxpayer.

4.3.4 Allowable business investment loss

Unique to Canada is the claiming of an allowable business investment loss (ABIL) where shares in a small business corporation is sold at a loss or the taxpayer incurs a loss due to a bad debt when the small business corporation fails to make payment. The ABIL deduction can be claimed where there is bankruptcy, insolvency or a winding-up order. The ABIL is calculated as half of the loss incurred and can be deducted from other sources of income. Where the ABIL exceeds the other sources of income, the non-capital loss can be carried back for 3 years and carried forward for 10 years. In the eleventh year the unused ABIL will become a net capital loss.

4.4 Sales tax incentives

The incentives relating to sales tax centers on the *submission* and *payment requirements*.

In Australia a small business, with an annual turnover of less than AUD\$2 million, can account for Goods and Services Tax on a cash basis. A small business can also further apply to submit and pay this tax quarterly and not monthly.

Similarly, in South Africa small businesses and farmers with a turnover of less than R1,5 million can apply to submit Value Added Tax returns every 4 or 6 months respectively.

In Canada a company, with an annual turnover of C\$200 000 or less, can select the Quick Method of accounting. The net Goods and Services Tax (GST) or Harmonized Sales Tax (HST) that should be remitted is calculated by multiplying the taxable supplies including the GST/HST by the applicable Quick Method remittance rate. Only part of the taxes collected will be remitted as the remittance rate is lower than the GST/HST rate. The part of the GST/HST not remitted will form part of the income for income tax purposes. No input tax credits can be claimed for operating expenses but input tax can be claimed on capital purchases.

5 Conclusion

The conclusion drawn from the comparative study of tax incentives available for small businesses in South Africa, Australia and Canada is that there are incentives in Australia and Canada that may be considered as incentives in South Africa.

5.1 Identification of small business taxpayer

The requirement to qualify as a small business taxpayer in South Africa is more onerous than in Australia or Canada. The introduction of another tier of taxpayer, being the micro business, is an effort to create a form of tax relief.

The turnover limit for a SBC of R14 million appears to be too low when compared to the Australian turnover of AUD\$2 000 000 that converts to R16 086 500. The suggestion would therefore be to *increase* the annual turnover limit for a SBC to R16 million.

5.2 Income tax incentives

5.2.1 Venture capital incentive

The venture capital company shares deduction in section 12J may be *extended* to include a deduction where investments are made directly in qualifying small businesses. This will be similar to the incentive available in the Manitoba province in Canada. This will encourage investment by companies directly into small businesses and not just investments via a venture capital company.

5.2.2 Simplified trading stock rule

The simplified trading stock rule, which allows a taxpayer to estimate the closing stock value without performing a stock count, will be of assistance to small businesses in South Africa. As the Australian legislation limits the use of this incentive where the differential between the stock value at the beginning of the tax year and the estimated stock value at

year end should not exceed AUD\$5 000, the proposal would be to implement this incentive for the SBCs in South Africa with limited movement in stock levels. This will further reduce the administrative burden on SBCs. A limit should be introduced for the movement in stock levels from the beginning to the end of the tax year. If the current rate of exchange is taken into account, a comparative limit would be R40 000.

5.2.3 Manufacturing and processing profit deduction

The manufacturing and processing profit deduction in Canada, which reduces the income tax payable for small manufacturing companies, should be considered for the South African context. An incentive where the tax liability is decreased, will assist smaller manufacturing concerns in the South African economy to address the unemployment issue, as these concerns are normally labour intensive. As the South African tax legislation is built on a system of *deductions from taxable income*, the incentive should be designed to take this into account.

5.3 Capital gains tax incentives

5.3.1 Capital gain from the sale of shares and sale of small business assets

In South Africa there is only an incentive available for the sale of small business assets in lieu of reaching the retirement age of 55 or due to ill health, disability or death. However, in Australia and Canada a similar relief is also available where the small business assets or shares are sold *not* as a result of age or incapacity. Consideration should be given to extend the incentive to include a limited holding period of 5 years, as currently provided for, but without the limitations of age and incapacity.

5.3.2 Allowable Business Investment Loss

The Allowable Business Investment Loss (ABIL) in Canada, where a loss is incurred on the sale of shares of a small business corporation or the write off of a loan or debt owed

by the small business corporation in case of insolvency, bankruptcy or winding-up, should be considered for the South African context. As the South African legislation does not allow the carry back of losses, the loss should be allowed as an income tax deduction that is assessed and carried forward as part of the assessed income tax loss.

5.4 Sales tax incentives

In South Africa the payment and submission periods for Value Added Tax have been adjusted for small businesses. The turnover tax system for Micro Businesses provides similar relief to the Quick Method of accounting available in Canada.

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