Tax for Small Businesses

Content of the session

- Turnover tax
- VAT
- CGT
- Small Business Corporations

Turnover Tax

Background

Why?

- Reducing compliance costs; and
- Giving relief from the administrative burden of compliance to tax legislation.

What?

- It “replaces” separate VAT, Income Tax (including CGT) and Dividend tax (up to an extent) payable by small businesses
- All-encompassing tax

Where?

- Sixth Schedule of the Income Tax Act.

Working of the Sixth Schedule

Normal

Income		xxx
Less exemptions		(x)
Less deductions		(x)
Plus taxable capital gains		xx
Taxable income		xxx
Tax payable	xx	

Turnover tax

Taxable turnover		xxx
Tax payable	xx	

Turnover tax rates

Total annual turnover	Tax payable
R0 – R335 000	0%
R335 001 – R500 000	1% of amount above R335 000
R500 001 – R750 000	R1 650 + 2% of amount above R500 000
R750 001 and above	R6 650 + 3% of amount above R750 000

Individual Tax tables

2016/2017		2017/2018	
Taxable Income (R)	Rate of Tax (R)	Taxable Income (R)	Rate of Tax (R)
0 – 188,000	18%	0 – 189,880	18%
188,001 – 293,600	33,840 + 26%	189,881 – 296,540	34,178 + 26%
293,601 – 406,400	61,296 + 31%	296,541 – 410,460	61,910 + 31%
406,401 – 550,100	96,264 + 36%	410,461 – 555,600	97,225 + 36%
550,101 – 701,300	147,996 + 39%	555,601 – 708,310	149,475 + 39%
701,301 +	206,964 + 41%	708,311 – 1,500,000	209,032+ 41%
		Above 1,500,000	533,625+ 45%

Comparative example 1

Micro business	Sole proprietor	Small CC
Taxable turnover = R500 000	Taxable income = R300 000	Taxable income = R300 000
(R500 000 – R335 000) x 1%	R61 910 + 31% x (R300 000 – R296 540)	R300 000 x 28%
= R1 650	Less: Rebate R13 635	R84 000
	= R49 348	

Comparative example 2

Micro business	Sole proprietor	Small CC
Taxable turnover = R500 000	Taxable loss = - R50 000	Taxable loss = - R50 000
(R500 000 – R335 000) x 1%	R0	R0
= R1 650		

Registration

<u>Who can register?</u>

- Sole proprietor and Partnership
  - Business income – turnover tax
  - Other income (e.g. Dividends, interest, etc.) – taxed as it would normally be taxed
- Close Corporation
- Company
- Co-operatives

<u>Registration</u>

- Complete a Turnover tax registration form (TT01)
- New business that starts trading
  - Must submit TT01 within 2 months from when trading commences
- Existing business that would like to convert to Turnover tax
  - Must submit TT01 before the start of a new tax year

<u>Payments</u>

- Complete Payment advice (TT02) and submit
  - 31 August
  - 28/29 February

<u>Annual compliance requirements</u>

- Complete Turnover tax return (TT03)

Qualifying turnover

Qualifying turnover < R1 million in a year of assessment

- If the business did not trade for a full 12 months?

Qualifying turnover is the total receipts from the carrying on of business activities, but excludes:

- Specific income that is exempt from normal tax in terms of section 12P
- Amounts of a capital nature

Taxable turnover

Definition

- Be an amount not of a capital nature;
- Received by the business;
- During the year of assessment;
- From the carrying on of business activities in SA

Specific inclusions

50% of capital receipts
If related to
- The disposal of immovable property
  - To the extent used for business purposes
- The disposal of movable property used mainly (i.e. more than 50%) for business purposes
  - Full capital receipt

Investment income of companies, close corporations and co-operatives
- All investment income will be included in taxable turnover, except local and foreign dividend income

Taxable turnover : Specific exclusions

<u>Investment income of natural persons</u>

- Subject to the normal rules and principles

<u>Amount already subject to normal tax</u>

- Amount received that had accrued prior to registration as a micro business and that amount accrued was subject to normal tax
- Small Business (Pty) Ltd is subject to turnover tax from 1 March 2015 – 28 February 2016, and was subject to normal tax until 28 February 2015. During the 2015 year of assessment, an amount of R100 000 accrued to Small Business (Pty) Ltd and was therefore included in taxable income in the 2015 year of assessment and therefore was subject to normal tax at a rate of 28%. This amount was actually received during the 2016 year of assessment (when Small Business (Pty) Ltd is subject to turnover tax), but would specifically be excluded from taxable turnover since it has already previously been subject to normal tax

<u>Specific exemp government grants – Section 12P</u>

Disqualifications

Interests in other companies

- Businesses or natural persons holding shares of having any interest in a private company, close corporation or co-operative;
- Shareholders or members of any company, close corporation and co-operative who hold any interest in any other private company, close corporation and co-operative

Therefore, allowed interests are:

- Shares in a listed company
- Portfolio in a collective investment scheme
- Interest in Venture capital company, etc.

Providing personal services

- At any time of the year of assessment

Labour brokers

- At any time of the year of assessment (without having an exemption certificate)

Providing professional services

- In excess of 20% of the total receipts

Disqualifications

<u>Capital receipts in excess of R1,5 million over the past 3 years</u>

Capital receipts included:

- Capital receipts from the disposal of immovable property
  - Used mainly (i.e. more than 50%) for business purposes
- Capital receipts from the disposal of movable property
  - Used mainly (i.e. more than 50%) for business purposes

<u>Specific entities excluded</u>

- Entities with year of assessments ending on a date other than 28 February;
- Entities with shareholders who are non-natural persons; or
- Public Benefit Organisations or Recreational clubs

<u>Partnerships specifically excluded</u>

- Any partner is not a natural person (which disqualifies all partners from applying the turnover tax system);
- Any partner is also a partner in another partnership; or
- The qualifying turnover of the partnership exceeds R1 million

VAT

Accounting for VAT

Timing

- When will the output VAT be levied or input VAT be claimed?

Value

- What is the Rand-amount of the VAT payable or claimable?

How will VAT be accounted for?

Invoice basis

Earlier

Payments basis

Registering as a vendor

Compulsory registration

- > R1m

- Branches or divisions

- Separately identified in terms of location and activities

- Own independent accounting records

Separate VAT vendor

Separate VAT vendor

Separate VAT vendor

Voluntary registration

- > R50 000
- Regulation 446 – can voluntarily register without meeting threshold (agriculture, farming, forestry and fisheries; mining; ship and aircraft building; manufacture or assembly; property development, infrastructure development and beneficiation)

CGT

Paragraph 57
Small business asset exclusion

What is a small business?

- Business of which the MV of all its assets (as at time of disposal) ≤ R10 million

What is the exclusion?

- R1 800 000 <u>per person per lifetime</u>

Who qualifies for this exclusion?

- Any natural person who:
  - at the time of the disposal, that person **held for his or her own benefit** that active business asset, interest in the partnership, or interest in the company (as the case may be) for a **continuous period of at least five years prior to that disposal**; *and*
  - was **substantially involved in the operations** of the business of that small business during that period; *and*
  - has attained the age of **55 years**; *or*
    the disposal is in consequence of **ill-health, other infirmity, superannuation or death**.

What should be disregarded?

The following capital gains should be disregarded:

- Disposal, by a natural person, of
  - an **active business asset** of a **small business owned by that natural person as a sole proprietor**; *or*
  - an interest in each of the active business assets of a business, which qualifies as a small business, owned by a partnership, upon that natural person’s withdrawal from that **partnership** to the extent of his or her interest in that partnership; *or*
  - an entire **direct interest in a company** (which consists of **at least 10 per cent** of the equity of that company), to the extent that the interest relates to active business assets of the business, which qualifies as a small business, of that company

Small business assets

What is an active business asset?

%

Other assets

Wholly and exclusively for business purposes

Excluding:

- Financial instruments
- Assets held to generate annuity income, rental income, forex gains or royalty income

Additional factors to consider

- Capital gain must be realized within 24 months after disposal
- > 1 small business
  - Include the capital gain of all businesses when claiming the R1 800 000 exclusion, provided that the market value of all of the active business assets < R10 000 000

Example

- On attaining the age of 55 in 2017 Mr. T wishes to retire. Mr. T is substantially involved in a business along with a business partner Mr. Q. They incorporated a close corporation and a company six years ago. The close corporation operates a successful brewery. The market value of the brewing plant and equipment amounts to R2 000 000. A liability amounting to R750 000 in respect of this equipment is still outstanding. The only other asset owned by the close corporation is a 100% shareholding in the company. The company's only tangible asset is the brewery building which is let to the close corporation for a market related rental. The market value of these shares amounts to R1 750 000. Mr. T and Mr. Q each hold a 50% interest in the close corporation. Mr. Q purchased Mr. T's interest in the close corporation upon his retirement for R1 800 000. The member's interest originally cost each party R100 000.

Solution

The calculation of the capital gain in respect of the sale of the brewery is as follows:

Proceeds	R1 800 000
Base cost	R 100 000
Capital gain	R1 700 000

The question then arises which portion of this gain will qualify for the paragraph 57 relief.

Active business assets to the total assets (2m/(2m + 1,75))		53.33%
Capital gain attributable to active business assets *(R1 700 000 x 53.33%)*		R906 667
Small business asset exclusion	(R906 667)	
	R0	
Balance of the capital gain (R1 700 000 – R906 667)	R793 333	
Annual exclusion	(R40 000)	
	R753 333	
Inclusion rate	40%	
Taxable capital gain	R301 333	

Working from home - Primary residence exclusion

Gains / losses?

- R2 000 000 **per residence**
- owned and occupied by a natural person and/or special trust in which a natural person or a beneficiary of a special trust:
  - Ordinarily reside as his or her main residence; **and**
  - Use it mainly for domestic purposes

Apportionment required

- Qualifying size
- Period ordinarily resident
- Non-residential use

Qualifying size of a primary residence

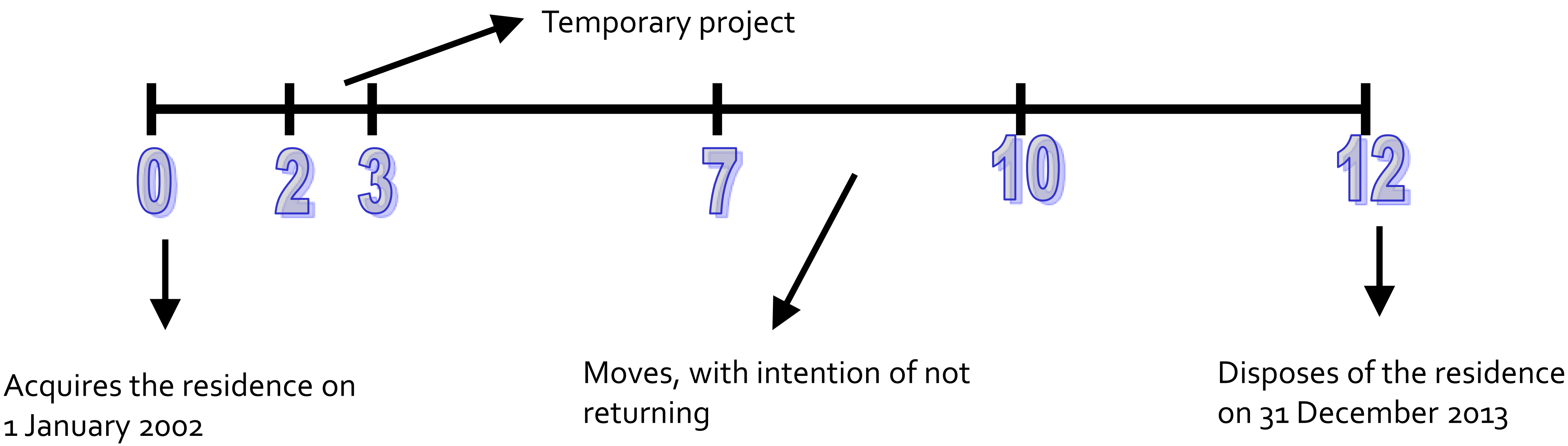
- The exclusion will apply to land which:
  - Does not exceed 2 hectares **AND**
  - Is used together with the residence mainly for domestic or private purposes **AND**
  - Is disposed of at the same time and to the same person as the residence

Holiday home → Primary residence

Apportion gain that will qualify for the R2 000 000 exclusion

Interrupted ordinary residence

- ✘ away for extended period for business or holiday
- ✓ when deems another residence as primary residence



Deemed ordinary residence

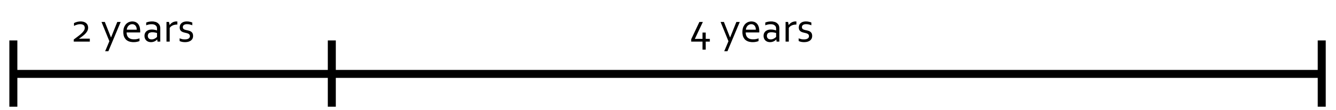
- Residence remains unoccupied, but deemed to be ordinarily resident for max of 2 years
  - Offered for sale and vacated the residence due to (intended) acquisition of a new primary residence ***OR***
  - Residence being erected on land acquired for purpose of being used as primary residence ***OR***
  - Accidentally rendered uninhabitable, e.g. flood, earthquake ***OR***
  - Death of the person
- ✓ more than 1 primary residence
- Apportion if > than 2 years

Non-residential use

- i.e. used for carrying on a trade by the person holding an interest in the primary residence
- Applies only to the owner, not by that person's spouse!! (provided that >51% in total used as primary residence)

Temporary letting

- Treat as primary residence for a period of up to 5 years, i.e. no apportionment necessary if:
  - Person (owner, spouse, beneficiary) used the residence as primary residence for a continuous period of 1 year before and 1 year after the period of letting **AND**
  - No other residence treated as primary residence **AND**
  - Temporarily absent from SA or employed/engaged in carrying on a business in SA >250 km away from residence



  - Resides in residence Letting period Sold

Proceeds ≤ R2 million

- Ordinarily resident throughout period of ownership; AND
- Used solely for private and domestic purposes
- Disregard capital gain / loss
  - Therefore, no need to determine BC

What happens to the R2 million exclusion?

Anti-avoidance (para 38)

- Donation; ***or***
- Disposal for consideration not measurable in money; ***or***
- Disposal to connected person not at arm's length

  Disposed at market value AND
  Acquired at market value

Disposal to connected person @ Capital Loss (para 39)

- Disregard in calculation of aggregate capital gain / loss if
  - Connected person / part of the same “group of companies” immediately before
- Can offset against capital gains in future with the same connected person, if still a connected person

Paragraph 39 example

During year 1 ABCD sold a piece of land with a base cost of R500 000 to Nicole (a 30% shareholder) at its market value of R300 000	P = R300 000 BC = R500 000 Clogged Loss = R200 000
Year 2 saw a further sale by ABCD Ltd of land to Nicole. The property had a base cost of R200 000 and a market value of R300 000. This sale was effected at a price of R400 000	P = R300 000 BC = R200 000 Capital gain = R100 000 Clogged loss utilised = R100 000 Clogged loss carried forward = R100 000
During year 3 ABCD Ltd sold a building with a base cost of R1 000 000 to Nicole at a market related price of R900 000	P = R900 000 BC = R1 000 000 Clogged loss = R100 000 Cumulative clogged loss = R200 000
Nicole sold 15% of her shares thereby reducing her shareholding to 15%. Subsequent to this ABCD Ltd sold the remaining property that had been acquired by it at a base cost of R500 000 to Nicole at its market value of R800 000	P = R 800 000 BC = R500 000 Gain = R300 000 Cumulative clogged loss = lost

Deemed disposal

Deemed disposed at Market value

Get it back immediately at a cost equal to that Market value

Personal asset → **Business asset**

Dispose @ MV

✘ **CGT**

BC = MV

✓ **CGT when finally disposed of**

Business asset → **Personal use asset**

Disposal @ MV

✓ **Recoupment and CGT**

Deemed acquisition @ MV

✘ **CGT when ultimately disposed of**

What is a personal use asset and what is not?

Personal use asset

- Any asset used by a natural person or special trust mainly for purposes other than the carrying on of a trade.
- What is NOT a personal use asset? (para 53(3)
  - An aircraft with an empty mass exceeding 450 kg;
  - a boat exceeding ten meters in length;
  - any fiduciary, usufruct or other similar interest, the value of which decreases over time;
  - any lease of immovable property;
  - any time-sharing interest or any share in a share block company with a fixed life, the value of which decreases over time; or
  - any right or interest in any of the above-mentioned assets

Specifically excluded from personal use assets,

Therefore ✓ gain/loss

But, para 15 ✗ loss

Therefore, only gain

Small Business Corporations

Requirements of s12E

1. Close corporation, co-operative or any company registered as a private company;
2. All the shareholders or members were natural persons at all times during the year of assessment;

   Not trading for the whole year?

3. Gross income does not exceed R20 million;
4. None of the shareholders or members at any time during the year of assessment held any interest, **other than** in
   - A company listed on an exchange; *or*
   - A portfolio in a collective investment scheme; *or*
   - Any body corporate, share block company or other association of persons, etc.
5. Investment income and income from the rendering of a personal service does not exceed 20% of the total receipts and all the capital gains of the company or close corporation;
6. The company is not a personal service provider.

Example of gross income limitation SARS Draft IN

- A qualifying entity with a year of assessment ending 28 February started trading activities on 15 August 2014. Gross income for the period 15 August 2014 to 28 February 2015 amounted to R15 million. The qualifying entity acquired a machine contemplated in section 12E(1A) on 1 August 2014 and commenced using it on 15 August 2014.

- The period of trade from 15 August 2014 to 28 February 2015 < 12 months
- Therefore reduce the gross income limitation
- Entity has traded for 6½ months, however under section 12E(4)(a)(i) part of a month must be treated as a full month
- Therefore, deemed to be 7 months
- R20 million × $\frac{\text{number of full months traded}}{\text{12 months}}$
- = R20 million × 7 / 12 = R11,67 million
- Therefore, gross income > apportioned limit
- Therefore, cannot register as SBC

Example of investment income Draft SARS IN

- A close corporation conducts two trades, namely, selling imported kitchen equipment and operating a small guesthouse. The guesthouse offers accommodation on a bed-and-breakfast basis. Guests can, however, request dinner at an additional cost. Gross income consisted of the sale of kitchen equipment of R10 million, accommodation at the guesthouse of R4 million and supply of dinner meals of R400 000.

Solution

- Gross income for the year of assessment is R14 400 000 which means it has not exceeded the gross income limitation of R20 million.
- Total receipts and accruals (other than those of a capital nature) and capital gains = R14 400 000 + Rnil = R14 400 000.
- The provision of serviced accommodation at the guesthouse gives rise to rental income from immoveable property which is “investment income” as defined.
- The gross income from the sale of kitchen equipment and the provision of dinner meals is not investment income.
- Therefore, investment income = R4 million.
- Investment Income / Total receipts and accruals (other than those of a capital nature) and capital gains = R4 000 000 / R14 400 000 × 100 = 27,8%.
- The 20% limitation has been exceeded.
- The business cannot qualify as a SBC

What is a personal service?

- Any service in the field of accounting, actuarial science, architecture, auctioneering, auditing, broadcasting, consulting, draftsmanship, education, engineering, financial service broking, health, information technology, journalism, law, management, real estate broking, research, sport, surveying, translation, valuation or veterinary science, if
  - (i) that service is performed personally by any person who holds an interest in that entity; and
  - (ii) that entity does not throughout the year of assessment employ three or more full-time employees (other than any employee who is a holder of a share in the entity, as the case may be, or who is a connected person in relation to a holder of a share in the company or a member), who are on a full-time basis engaged in the business of that company, co-operative or close corporation of rendering that service

How can a business be exempted from the “personal service” rule

- An entity must employ at least 3 full time employees who are
  - engaged on a full-time basis in the qualifying entity’s business of performing the relevant service;   AND
  - not holders of shares in or members of the qualifying entity; AND
  - not connected persons in relation to a holder of shares in or a member of the qualifying entity.

- Must these employees be directly involved in the service rendering the income?

Section 12E

Lower **of:**

- **Actual cost**
- **Cost in arm's length transaction**

1.

- Deduct full cost in the year that the asset was brought into use, if
  - Plant / machinery used in process of manufacturing; **AND**
  - Used for the first time by that taxpayer; **AND**
  - Brought into use on / after 1 April 2001

2.

- 50/30/20, if
  - Acquired under agreement signed by every part on / after 1 April 2005; **AND**
  - Would have qualified for s11(e) or 12B

- Taxed at a lower rate
- Could you elect to rather apply another write-off?
- What if an asset is acquired for no consideration? E.g. donation?

SBC tax rates

2017

Taxable income	Tax rates
R0 – R75 000	0%
R75 001 – R365 000	7% of taxable income above R75 000
R365 001 – R550 000	R20 300 + 21% of taxable income above R365 000
R550 001 and above	R59 150 + 28% of taxable income above R550 000

2018

Taxable income	Tax rates
R0 - R75 750	0%
R75 751 - R365 000	7% of the amount above R75 750
R365 001 - R550 000	R20 248 + 21% of the amount above R365 000
R550 001 and above	R59 098 + 28% of the amount above R550 000

S12E and moving costs

A manufacturing asset qualifying for the 100% allowance is moved:

- In year 1 of use?
- In year 2 of use?

A non-manufacturing asset qualifying for the 50/30/20 allowance is moved:

- In year 1 of use?
- In year 2 of use?
- In year 3 of use?

Example – SARS Draft I/N 9

- ABC (Pty) Ltd (ABC) manufactures kitchen kettles which are sold on the local market. ABC acquired and started using a machine in its manufacturing process on 30 August 2014. Its year of assessment ends on 30 September.

- During its 2015 year of assessment ABC met the requirements under section 12E(4)(*a) and qualified as an SBC.*

- ABC cannot claim an allowance under section 12E(1) because ABC was not an SBC in the 2014 year of assessment when it first brought the machine into use. In addition, in 2015 even though ABC was an SBC, the machine was not brought into use by ABC for the first time in that year. However, in the 2014 year of assessment, an allowance may be claimed for the machine under section 12C if the requirements of that section are met.

Example – SARS Draft I/N 9

- ABC (Pty) Ltd (ABC) acquired a machine during its 2014 year of assessment ending on 28 February 2014. The machine cost R200 000. ABC started using the machine on 31 March 2014.
- ABC met the requirements of an SBC in its 2014 year of assessment but did not meet the requirements in its 2015 year of assessment.

- *Result:*
- ABC cannot elect to claim a deduction under section 12E(1A) because it was not an SBC in the year when it first brought the asset into use. ABC may be able to claim a deduction under section 11(e) in its 2015 year of assessment taking into account the period of use.