Revision of Small Business Corporation ('SBC') tax relief

Sonja Frank

On 17 July 2014, the National Treasury released the draft Taxation Laws Amendment Bill ('TLAB') which aims to give effect to the various tax proposals announced in the 2014 budget speech. In the TLAB for 2014, the revision of the Small Business Corporation ('SBC') tax regime was proposed.

A "Small Business Corporation" is defined in section 12E of the Income Tax Act, No 58 of 1962 as the following as:

- any close corporation or cooperative or any private company as defined in the Companies Act, No 71 of 2008 (thus excluding trusts, sole proprietors and partnerships); and
- of which all shareholders are at all times during the year of assessment natural persons; and
- where the gross income for the year of assessment does not exceed R20 million per annum; and
- no shareholder holds any interest in any other close corporation, cooperative or private company; and
- less than 20% of the income is investment income or personal service income.

An enterprise which complies all with the abovementioned requirements can opt for the SBC tax regime to apply to their enterprise. The SBC regime implies that a SBC is not taxed at the flat company rate of 28%, but rather at a progressive tax rate, which is much more favorable than the flat rate of 28%.

The Davis Tax Committee has recently released an Interim Report on Small and Medium Enterprises: Taxation Considerations (Report). This Report provides that the current lower tax rates for SBC's are not effective and do little to support the objective of small business growth.

According to the Report, the current regime is not beneficial to SBC's with zero taxable income despite such SBC's having the same tax compliance burden as profitable SBC's. The current SBC regime furthermore only provides relief to 50,000 enterprises and in some instances enterprises which were not originally intended as beneficiaries. The Report further contends that over 50% of SBC's have an annual turnover of less than R1 million. Therefore, it seems that the turnover tax regime is a more suitable regime for these enterprises.

In order to mitigate the concerns raised in the Report, the TLAB proposes to replace the reduced rate SBC regime with an annual refundable compliance rebate (RCR). SBC's will be taxed at 28% and not according to the progressive rate. Enterprises with a turnover of between R1 million and R20 million that are tax-compliant, with regard to tax returns and liabilities, will be entitled to receive an annual refundable tax rebate of R15,000. As this rebate is refundable, enterprises in a tax loss position are also eligible to receive it.

SBC's have indicated that tax compliance costs however remain a major problem. In light of this, the RCR regime was introduced to reward the tax-compliant SBC's and to compensate them for the additional costs incurred in achieving tax-compliant status.

This is illustrated by an example in the Draft Explanatory Memorandum on the TLAB which provides:

Example
Small business corporation B has a taxable income of R1,000,000.

SBC Regime:

Under the current SBC regime (R1,000,000 – R550,000) x 28% = R126,000 + R59,451 Tax liability = R185,451

RCR Regime:

Under the proposed RCR regime R1,000,000 x 28% = R280,000 (tax) - R15,000 (rebate) Tax Liability = R265,000

Under the proposed RCR regime, the tax liability of the SBC will therefore be higher than its tax liability under the current SBC regime.

The proposed amendments will come into operation on 1 January 2016 and will apply in respect of years of assessment commencing on or after that date.

David Badenhorst from our Stellenbosch office may be contacted at 021-882 8140 and david@exceed.co.za for any questions in this regard.