

## CHAPTER 8

# TURNOVER TAX

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## 8.1 INTRODUCTION

Part IV of Chapter II of the Income Tax Act deals (in sections 48 to 48C) with the *Turnover Tax* payable by Micro Businesses. The tax came into operation on 1 March 2009 and applies in respect of all years of assessment commencing on or after that date.

The benefits of being registered as a micro business are that the business is taxed on a turnover basis at a very low rate. The profits are not subject to normal tax. This means that it is not necessary to record trading stock at the year-end. It is also not necessary to keep a record of expenses. The business is also taxed on a receipts basis, not on accruals. Therefore the amount of debtors does not affect the tax calculation.

### **Learning objectives**

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By the end of the chapter, you should be able to:

- Determine whether a person meets the definition of a micro business
- Consider whether it would be an advantage for that person to register for turnover tax

- Give an overview of the basics of registration and deregistration
- Calculate taxable turnover and tax payable
- Understand how turnover tax interacts with other taxes

## 8.2 THE INCOME TAX ACT

The provisions of the Income Tax Act dealing with the turnover tax for micro businesses are as follows:

- Section 48 states that the definitions in section 1 and the Sixth Schedule apply to Micro Businesses (unless the context requires another meaning).
- Section 48A states that the tax is known as the turnover tax, in respect of the ‘taxable turnover’ of a registered micro business (for a year of assessment).
- Section 48B states that the rates of tax must be fixed annually by Parliament. The rates apply until they are changed, and are not necessarily amended annually. The rates of tax to be levied on the taxable turnover of a registered micro business are currently as follows:

Turnover	Tax Liability
On the first R150 000	0%
R150 001 to R300 000	1% of each R1 above R150 000
R300 001 to R500 000	R1 500 + 2% of the amount above R300 000
R500 001 to R750 000	R5 500 + 4% of the amount above R500 000
R750 001 to R1 000 000	R15 500 + 6% of the amount above R750 000

- Section 48C includes the following transitional provisions:
  - If an amount is received and included in a registered micro business’s taxable turnover, it cannot be taxed again in a period that the business is not registered as a micro business.
  - If an amount accrues to a registered micro business, and would have been included in that business’s taxable turnover had it been received by the micro business, then if it is received at a time when the business is no longer registered as a micro business, only 20% of the amount will be included in that taxpayer’s taxable income for the year of assessment in which it is received.
  - Where a registered micro business is deregistered, its trading stock on that date is included as opening stock at the beginning of that year of assessment, since it did not receive a deduction when the stock was purchased.

## 8.3 THE SIXTH SCHEDULE

The Sixth Schedule deals with the detail of the turnover tax.

Natural persons, companies, and close corporations can qualify as micro businesses. The main requirement is that the ‘qualifying turnover’ for a year of assessment must not exceed R1 million. Trusts cannot qualify as micro businesses.

### 8.3.1 QUALIFYING TURNOVER

Qualifying turnover is defined in paragraph 1 of the 6<sup>th</sup> Schedule as

- the total receipts
- from carrying on business activities
- excluding any amount of a capital nature
- excluding any amounts exempt from tax in terms of the following sections:
  - 10(1)(y) - certain Government grants and Government scrapping payments
  - 10(1)(zA) - export rebates from the Department of Trade & Industry
  - 10(1)(zG) - film subsidies from the State
  - 10(1)(zH) - certain amounts received from the State (SMEDP, etc)

Note that qualifying turnover is different from taxable turnover. It is merely a way of working out whether the person qualifies as a micro business. If, for example a capital receipt pushes the person's receipts over R1 million, it does not affect his registration as a micro business.

**Example – Qualifying turnover v taxable turnover**

Co X commenced trading on 15 June 2013. Its total receipts for the period from 15 June to 28 February 2014 were R775 000, including R30 000 that it received on the disposal of some equipment used in the business.

- Co X's qualifying turnover is R745 000, since qualifying turnover excludes capital receipts.

### 8.3.2 QUALIFYING TURNOVER LIMIT

The turnover limit for qualifying turnover is proportionately reduced if the person carries on business for less than 12 months in the year. This is done by taking into account the number of full months that business was *not* carried on (Paragraph 2 of the 6<sup>th</sup> Schedule).

**Example – Qualifying turnover**

Co X commenced trading on 15 June 2013. Its turnover for the period from 15 June to 28 February 2014 was R745 000. Does its turnover qualify it to be registered as a micro business?

*Limit:* R1 000 000

*Proportional limit:*  $R1\ 000\ 000 - (1\ 000\ 000 \times 3/12) = R750\ 000$

The 3/12 is based on the three full months that a business was not carried on. In other words, if a micro business is carried on for part of a month, then this is used to calculate the limit, which may also be calculated as follows:

- 15 June to 28 February is 8,5 months. Therefore use 9 months (treating part of a month as a full month if the calculation is done this way around). Therefore  $9/12 \times R1\ \text{million} = R750\ 000$ .

The result of the formula (whichever way it is done) is that Co X's turnover is within the limit for the 2014 year of assessment.

### 8.3.3 TAXABLE TURNOVER

Paragraph 5 of the 6<sup>th</sup> Schedule states that the taxable turnover of a registered micro business consists of:

- revenue amounts received during the year of assessment
- from carrying on business activities
- in the Republic
- including amounts described in paragraph 6 (see 8.3.4)
- excluding amounts described in paragraph 7 (see 8.3.5)
- less any amounts refunded to any person by that registered micro business in respect of goods or services supplied by that registered micro business to that person during that year of assessment or any previous year of assessment.

There is no definition of 'business activities' in the Act. In this regard the precedent laid down in the many tax cases has to be examined. 'Revenue amounts' are those amounts that are not of a capital nature. This concept is discussed in detail in Chapter 2.

### 8.3.4 INCLUSIONS IN TAXABLE TURNOVER

Paragraph 6 states that the following amounts are included in taxable turnover of a registered micro business:

- For all micro businesses: 50% of all receipts of a capital nature from the disposal of:
  - immovable property used mainly for business purposes (other than trading stock)
  - any other asset used mainly for business purposes (other than any financial instrument)
- For companies and close corporations: 100% of investment income as defined (excluding dividends and foreign dividends)

**Example – Taxable turnover**

Mr Y left his job and started his micro business on the 1 March 2013. His turnover for the year to 28 February 2014 was R800 000. He therefore qualifies to register as a micro business.

He converted his garage into business premises at a cost of R100 000. The garage made up 10% of the total property, which had cost R1 200 000 in 2005. The property was his primary residence.

He sold the property on 5 January 2014 for R2,3 million. Mr Y also sold some equipment used in the business on 2 February 2014 for R30 000.

Calculate Mr Y's taxable turnover and the tax payable. Assume that the capital gain on the primary residence (after specific exclusions but before the annual exclusion) amounts to R18 000.

*Solution*

Business taxable turnover		R800 000
50% on disposal of asset used mainly for business purposes		15 000
Total taxable turnover (subject to turnover tax)		<u>R815 000</u>
Tax per tables		<u>R19 400</u>
Capital gain on disposal of property	R18 000	
Less: Annual exclusion (limited to)	<u>(18 000)</u>	
Taxable income		-
Total tax		R19 400

In contrast to the equipment, the property was not used mainly (i.e. more than 50%) for business purposes. It is therefore excluded from the calculation of the taxable turnover of the micro business and would be taxed separately, although in this case the capital gain is Rnil.

**8.3.5 EXCLUSIONS FROM TAXABLE TURNOVER**

Paragraph 7 states that the following amounts are excluded from the taxable turnover of a registered micro business (which means that these amounts are not taxed at the special tax rate for micro businesses):

- For natural persons - *Investment income* (see 8.3.6 below for the definition of investment income). All these amounts are included in the individual's normal gross income. Note that for companies and close corporations that are registered micro-businesses, all investment income (excluding dividends and foreign dividends) must be included in the entity's taxable turnover.
- Amounts exempt from tax in terms of 12P.
- Any amount *received* by the registered micro business where that amount accrued to it prior to its registration as a micro business, and that amount was subject to tax in terms of the normal provisions of the Income Tax Act.
- Any amount received from any person by way of a refund in respect of goods or services supplied by that person to that registered micro business.

**8.3.6 INVESTMENT INCOME**

Paragraph 1 of the Sixth Schedule sets out the definition of 'investment income'. It includes the following:

- Rental on immovable property. Rental on movables is not included.
- Dividends and interest.
- Proceeds from the disposal of financial instruments.
- Royalties, annuities and similar income.

### 8.3.7 PERSONS THAT DO NOT QUALIFY AS MICRO BUSINESSES

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Paragraph 3 of the 6<sup>th</sup> Schedule sets out the circumstances under which a person does not qualify as a micro business. If any one of the following applies, the person cannot register his or its business as a micro business.

- **Natural persons**

- The person has shares or has any interest in the equity of any company or close corporation
  - at any time during the year of assessment.
  - certain shareholdings are permitted – see 8.3.8 below.
- More than 20% of that person's total receipts during that year of assessment consist of income from the rendering of a professional service.
- The person is a personal service provider at any time during the year of assessment.
- The person is a labour broker without an exemption certificate at any time during the year of assessment.
- The total of the following amounts exceeds R1,5 million over a period of three years (being the current tax year and the last two tax years), or a shorter period than three years if the person was a registered micro business for such shorter period:
  - receipts from the disposal or sale of immovable property used mainly for business purposes; and
  - receipts from the disposal of any other capital asset used mainly for business purposes.

- **Company or close corporation**

In addition to the restrictions that apply to natural persons, a company or close corporation cannot register as a micro business if any of the following apply:

- The company or close corporation cannot be a registered micro business if the year of assessment does not end on the last day of February,
- or if any of the shareholders is a person other than a natural person (or the estate of a deceased or insolvent person) at any time during the year of assessment,
- or if any of the shareholders has an interest in the equity of any other company or close corporation – at any time during the year of assessment – certain interests are permitted, however (see below).
- The company cannot be a registered micro business if it is a tax-exempt Public Benefit Organisation (PBO) – per section 30 of the Income Tax Act.
- The company cannot be registered as a micro business if it is a tax-exempt Recreational Club – per section 30A of the Income Tax Act.
- More than 20% of that company's total receipts during that year of assessment consist of investment income and income from the rendering of a professional service.

- **Partnerships**

A person who is a member of a partnership cannot register as a micro business if:

- Any of the partners is not a natural person, or
- The person is a partner in more than one partnership at any time during the year of assessment, or
- The qualifying turnover of the partnership for that year exceeds the R1 million per annum limit.

### 8.3.8 PERMITTED SHAREHOLDINGS AND INTERESTS

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An individual who wishes to register his business as a micro business cannot hold shares in any other company or close corporation. Similarly, in order for a company or close corporation to be registered as a micro business, its shareholders or members cannot hold shares in any other company or close corporation.

This is to prevent businesses from being split into different companies to keep the turnover (per company) below the R1 million threshold in order to take advantage of the lower tax rate for micro businesses.

The following shareholdings are permitted (whether the shares are held by a natural person who is a micro business or a shareholder in a micro business, or a company or close corporation which is a micro business) in terms of *paragraph 4* of the Sixth Schedule:

- shares in a listed South African company – para (a) of the definition of ‘listed company’
- shares in a portfolio of a collective investment scheme – para (e) of the definition of ‘company’
- shares in a sectional title body corporate, a share block company, or similar entity – per section 10(1)(e)
- shares in a venture capital company – per section 12J
- less than 5% of the shares or interest in a social or consumer co-operative or a co-operative burial society (or similar co-operative or society)
- less than 5% of the shares or interest in a primary savings (or savings and loans) co-operative bank as defined in the Co-operative Banks Act, 2007 (Act No. 40 of 2007), that may provide, participate in or undertake only banking services as described in section 14(2)(a) or (b) of that Act
- shares in a Friendly Society as defined in the Friendly Societies Act (25 of 1956)
- shares in a company, close corporation, or co-operative, if the company, close corporation, or co-operative –
  - has not during any year of assessment carried on any trade; and
  - has not during any year of assessment owned assets with a total market value of more than R5 000
- shares in a company, etc. which has taken the steps set out in section 41(4) to liquidate, wind up or deregister. If the company, etc. withdraws or invalidates these steps, the permission falls away.

### 8.3.9 PROFESSIONAL SERVICES

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If more than 20% of a person’s total receipts during the year of assessment consist of income from the rendering of a professional service (together with investment income in the case of a company), that person cannot be a registered micro business. The list of professional services is set out in the definitions in paragraph 1 of the 6<sup>th</sup> Schedule, i.e. –

“**professional service**’ means a 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 a professional person owns shares in a company that is a micro business, it seems that as long as the company does not render a professional service, it can register as a micro business if it satisfies the other requirements of the Schedule.

### 8.3.10 REGISTRATION AS A MICRO BUSINESS

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If a person meets the requirements for registration, he may elect to be registered as a micro business before the beginning of the year of assessment or such later date as the Commissioner may prescribe in the Government Gazette. For the 2013 year of assessment, this date was specified as 29 June 2012 (Government Gazette 35228). If he starts a micro business during the year, he may elect to be registered within 2 months of starting the business. In either case, the Commissioner will register him from the beginning of the year of assessment. (Paragraph 8 of the 6<sup>th</sup> Schedule)

If a micro business voluntarily deregisters or is compelled to deregister, it may not again be registered as a micro business (paragraph 8(3)).

### 8.3.11 DEREGISTRATION AS A MICRO BUSINESS

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There is voluntary deregistration and compulsory deregistration.

Paragraph 9 states that a business may elect to be deregistered before the beginning of a year of assessment or during a year of assessment. If it is voluntarily deregistered during a year of assessment, deregistration is effective from the beginning of that year of assessment.

A registered micro business cannot voluntarily deregister unless it has been registered for at least three years (of assessment).

Paragraph 10 deals with compulsory deregistration and states that the business has 21 days to tell the Commissioner that it no longer qualifies for registration (for example, if the business acquires non-permitted shareholding).

As far as turnover is concerned, the business must notify the Commissioner even if it thinks (based on reasonable grounds) that its turnover will exceed the R1 million limit for the year. If the Commissioner thinks that the increase in turnover will be temporary or nominal, he may direct the micro business to remain registered.

If the Commissioner determines that a micro business should be deregistered, he does so from the beginning of the next month. This means that the business still qualifies as a micro business for the month that the conditions for registration no longer apply.

### 8.3.12 TAX PAYMENTS – MICRO BUSINESS

A micro business is not subject to the provisional tax requirements in the 4<sup>th</sup> Schedule. Paragraph 11 of the 6<sup>th</sup> Schedule sets out that the micro business must pay tax twice a year (interim payments), i.e.

- Within the first 6 months (by 31 August) it must estimate its taxable turnover for the year and pay tax on half of its taxable turnover. The estimate cannot be less than the taxable turnover for the previous year unless the Commissioner accepts a lower estimate.
- By the end of the year (by 28 or 29 February) it must estimate its taxable turnover again, calculate the tax, and pay this tax (less the amount already paid at the end of the first six months of the tax year).

Interest is payable on late payments at the prescribed rate.

If the year-end estimate is less than 80% of the actual taxable turnover for the year when it is finally determined, an 'additional tax' of 20% of the shortfall in tax is payable.

The Commissioner has the power to waive all or part of this additional tax if he is satisfied that the estimate was not deliberately or negligently understated, and was seriously made based on the information available to the taxpayer.

#### Example – Additional tax

Co F is registered as a micro business. Its taxable turnover for the year is R625 000. It paid interim tax on an estimated turnover of R300 000 for the year. Its additional tax is therefore as follows:

80% of R625 000 =	<u>R500 000</u>
Tax on R500 000 =	R5 500
Tax on R300 000 =	<u>(1 500)</u>
Shortfall	<u>R4 000</u>
Additional tax: R4 000 x 20% =	R800

Paragraph 12 states that where the micro business does not make an estimate, or the Commissioner is not satisfied with its estimate, he can estimate the taxable turnover and issue an assessment for the tax due. If he does this, the 20% additional tax is not payable.

### 8.3.13 CONNECTED PERSONS – MICRO BUSINESS

If the Commissioner is of the view that a connected person carries on business activities that should properly be regarded as part of the activities of the micro business, and that one of the main reasons for the connected person carrying on the business activities is so that the micro business does not exceed the turnover limit, then the Commissioner may include the turnover of the connected person in the turnover of the micro business (paragraph 13 of the 6<sup>th</sup> Schedule).

**Example – Connected persons**

Mrs S carries on a business of selling flowers. Her turnover for the year is R800 000. The S Family Trust (of which Mrs S is a beneficiary) also sells flowers in the same area. An independent person works for the trust, but the trust's profits will eventually be paid to Mrs S or her immediate family. The trust's turnover for the year is R400 000. Mrs S and the Trust are connected persons because she is a beneficiary of the trust. The trust was formed and carries on part of the business so that Mrs S does not have a turnover of more than R1 million for the year.

As the conditions set out in paragraph 13 are met, the Commissioner may add the turnovers together. If the Commissioner applies paragraph 16, as the total is R1,2 million, Mrs S will be deregistered as a micro business.

**8.3.14 RECORD KEEPING – MICRO BUSINESS**

Paragraph 14 states that a registered micro business must retain a record of—

- (a) amounts received by that registered micro business during a year of assessment;
- (b) dividends declared by that registered micro business during a year of assessment;
- (c) each asset of that registered micro business as at the end of a year of assessment with a cost price of more than R10 000; and
- (d) each liability of that registered micro business as at the end of a year of assessment that exceeded R10 000.

**8.4 EXEMPT INCOME – MICRO BUSINESS**

Section 10(1)(zJ) exempts from tax any amount received or accrued to or in favour of a 'registered micro business', from carrying on a business in the Republic of South Africa. This is necessary in order to prevent double taxation, because the turnover is taxed.

If a natural person is registered as a micro business, the following amounts are not exempt under this section because they are not included in the taxable turnover of the micro business:

- Investment income
- Remuneration as defined in the Fourth Schedule (salaries, wages, etc)

**8.5 DIVIDENDS TAX – MICRO BUSINESS**

A shareholder in a registered micro business which is a company or close corporation is exempt from the Dividends Tax to the extent that the aggregate amount of dividends paid by that registered micro business to its shareholders during the year of assessment in which that dividend is paid, does not exceed R200 000 – section 64F(h).

**8.6 CAPITAL GAINS TAX – MICRO BUSINESS**

Paragraph 57A of the 8th Schedule states that a registered micro business will not be subject to capital gains tax, and may not deduct any capital loss which arises on the disposal of any asset if it is part of the micro business.

Capital assets are only treated as part of the micro business if used *mainly* for business purposes.

Note that this paragraph must be read with paragraph 3 of the 6<sup>th</sup> Schedule that states if the receipts from the sale of such assets exceeds R1,5 million over a period of three years or less, the person does not qualify to be registered as a micro business when this limit is exceeded.

When a sale of a capital asset pushes the business over the R1,5 million threshold, the gain is still free of capital gains tax, because it is only in the next month that the business is deregistered as a micro business (per paragraph 10(2) of the 6<sup>th</sup> Schedule).

**8.7 VAT – MICRO BUSINESS**

A micro business may register voluntarily as a VAT vendor. Due to the fact that its turnover does not exceed R1 million, it is not obliged to register.

Section 78A of the VAT Act provides that if a person deregisters as a micro business, and then registers as a VAT vendor, he has to account for VAT on amounts received after he becomes a vendor, even if the supply was made when he was a micro business. This is because those receipts will not have been included in the taxable turnover of the micro business.

In addition, any VAT paid on expenditure incurred while the person was a micro business cannot be claimed as input tax after registration. This restriction does not seem to apply to capital assets purchased (if a deemed input may be claimed in terms of section 18(4)(b) of the VAT Act).

## 8.8 CONCLUSION

Turnover tax may significantly reduce the administrative burden on a taxpayer. It also may have a tax benefit, depending on the taxpayer's taxable turnover in comparison to his, her or its taxable income.

In order to pay turnover tax a taxpayer must meet the criteria for registration, and must register as a micro business.

## 8.9 END OF CHAPTER EXAMPLES

### Example 1 – Company registered as a micro business

Quicktoo (Pty) Ltd it expects its receipts and expenses for the year of assessment ending 28 February 2014 to be as follows:

Turnover of micro business	R 750 000
Proceeds on sale of surplus business assets	R300 000
Interest received	14 000
Rental from fixed property	<u>60 000</u>
	<u>R 1 124 000</u>
Running costs of micro business	R 200 000
Repairs to fixed property	<u>11 000</u>
	<u>R 211 000</u>

- a) Does Quicktoo's turnover qualify it to be registered as a micro business?  
 b) Assuming Quicktoo is registered as a micro business, calculate its total tax for the year.

a) *Qualifying turnover*

Qualifying turnover	R824 000
Qualifying turnover excludes capital amount of R300 000.	
Qualifying turnover is below the limit of R1 000 000. Quicktoo therefore qualifies as a micro business.	

b) *The tax paid by Quicktoo will be as follows:*

Revenue receipts	R 824 000
50% of proceeds on disposal of capital assets	<u>R150 000</u>
Taxable turnover	<u>R 974 000</u>
Tax per table	R 28 940

Investment income is included in the turnover of a micro business that is not a natural person. Together with income from the rendering of a professional service, it may not exceed 20% of total receipts.

### Example 2 – Individual registered as a micro business

Mr S (who is 40 years old) is registered as a micro business. His receipts for the year of assessment ended 28 February 2014 are as follows:

- Turnover of micro business	R 690 000
- Interest received	29 800
- Salary	300 000
- Rental from fixed property	<u>60 000</u>
	<u>R1 079 800</u>

His expenses and costs are as follows:

- Running costs of micro business		R 200 000
- Pension fund contributions		15 000
- Medical aid contributions for Mr S and his wife		9 600
- Repairs to fixed property		<u>11 000</u>
		<u>R 235 600</u>

Calculate the tax paid by Mr S for his 2013 year of assessment.

*Tax calculation*

Salary		R 300 000
Interest received	R 29 800	
Interest exemption	<u>(22 800)</u>	7 000
Rental income	R 60 000	
Repairs	<u>(11 000)</u>	49 000
Pension fund contributions of R15 000, limited to		
- 7,5% of R300 000 = R22 500		
- R1 750		<u>(15 000)</u>
Taxable income		<u>R 341 000</u>
Tax per tables		R 78 600
Less: Primary rebate		(11 440)
Less: Medical credit rebate		
- R460 x 12		<u>(5 520)</u>
		R 61 640
Tax on R690 000 turnover of micro business (per table)		<u>13 100</u>
Total tax		<u>R 74 740</u>