

TAX COMPLIANCE BURDEN FOR SMALL, MEDIUM AND MICRO ESTABLISHMENTS IN THE BUSINESS SERVICES INDUSTRY

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Abstract

The aim of this study is to determine whether the size of a business, classified as small, medium or micro establishment (SMME), has an impact on its management of the compliance burden placed on it by taxation laws. A survey was conducted amongst small, medium and micro establishments in the business services sector in Gauteng province, South Africa. The study finds that the majority of SMMEs in the business services sector outsource their tax responsibilities due to lack of skills and time. Also, the significance of taxation inputs for making business decisions and preferences for administrative relief measures varies according to the size of the organisation.

JEL E62, H25, L11

1 Introduction

This study focuses on the impact taxation has on the administration and management of small business services establishments in Gauteng. The rationale for research into small establishments in the business services sector lies in the following:

- In the 2005 Budget Review, the Minister of Finance announced further taxation changes to recognise the services sector for its prominence in stimulating growth, and stated that small business tax relief measures would also be extended to small, medium and micro establishments (SMMEs) in the services sector (National Treasury, 2005).
- Lionel October, deputy director-general of the Department of Trade and Industry presented the government's new Small Enterprise Development Strategy at the end of 2005. According to October's presentation, some of the objectives of the revised strategy are to:
 - create an enabling environment for small enterprises;
 - create sustainable jobs in the small business sector;

- improve coordination of government initiatives for supporting the small business sector; and
- increase small businesses' contribution to the GDP (SEDA, 2005).

- The South African Revenue Service (SARS) has launched a wide-ranging programme of measures to support small business. This study evaluates some administrative measures aiming to reduce compliance cost and provide a more enabling environment for small businesses (Deloitte & Touche, 2005).

It is clear therefore that small business tax surveys are not only important in the support of national accelerated and shared growth strategies and sustainable development, but also in the development of skills. Such research is of major importance in understanding current and future tax issues anticipated to shape the business services tax environment.

2 Background

The selection of the population used in the survey considered three aspects, namely:

- the size of the organisation to be surveyed;

- the sector of the economy being investigated; and
- the region selected.

The motivation for each of these selections, which were SMMEs, business services and Gauteng, will be discussed below.

2.1 Small, medium and micro enterprises (SMMEs)

In terms of the National Small Business Act 102 of 1996, as amended, small businesses can

be classified as micro-, very small, small or medium enterprises, following a complex set of thresholds. Table 1 provides an extract of the classification in terms of the National Small Business Act for the business services that are included in this study.

Medium, small (small and very small) and micro establishments in the finance and business services sector are included in the study. Business services establishments in the informal economy (non-VAT registered establishments) are excluded from the study.

Table 1
Classification of micro-, very small, small or medium enterprises

Sector or subsector in accordance with the Standard Industrial Classification (SIC)	Size or class	Total full-time equivalent of paid employees	Total annual turnover (Rm)	Total gross asset value (fixed property excluded) (Rm)
		Fewer than:	Less than:	Less than:
Finance and business services	Medium	200	26,00	5,00
	Small	50	13,00	3,00
	Very small	20	3,00	0,50
	Micro	5	0,20	0,10
Community, social and personal services	Medium	200	13,00	6,00
	Small	50	6,00	3,00
	Very small	20	1,00	0,60
	Micro	5	0,20	0,10

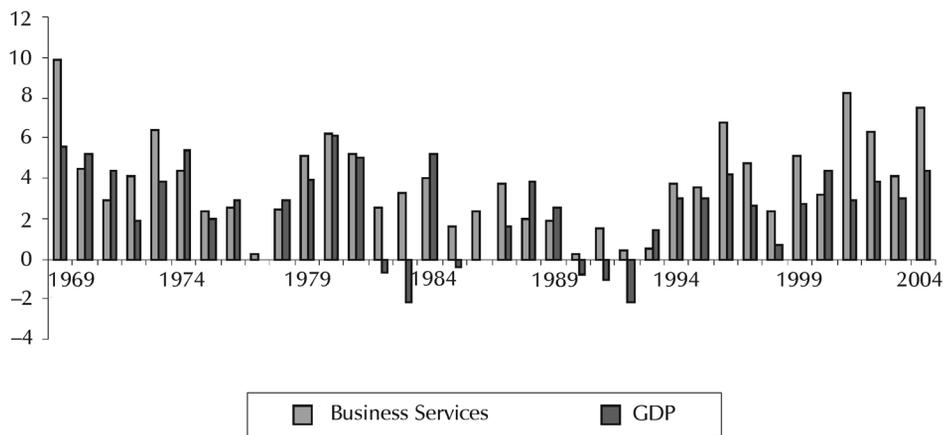
Source: National Small Business Act 102 of 1996

Of the three criteria prescribed in the National Small Business Act, i.e. total number of full-time employees, total annual turnover and total gross asset value, used to categorise businesses as micro, small, very small or medium, the number of employees is often the most effective, as it is generally the easiest to ascertain and can be compared across all sectors except agriculture. Accordingly, this study applies "employment" figures to classify businesses as small, medium and micro establishments.

2.2 Business services sector

Figure 1 is based on data from the data mining system of the South African Reserve Bank (SARB) and Statistics South Africa. It is notable that for the past decade, the annual real growth of the business services sector has outpaced the real GDP growth of the economy as a whole. The real growth of the business services sector was 6.3 per cent in 2002, 4.1 per cent in 2003 and 7.5 per cent in 2004 (SARB, 2006). This provides further justification for studying the business services industry. In fact, the share of the business services industry in the total economy has increased by approximately five percentage points between 1980 and 2004.

Figure 1
GDP and business services growth performance (per cent), 1969-2004



Source: SARB, 2006

2.3 Gauteng region

According to the Department of Trade and Industry (2004), Gauteng is the leading province in South Africa for both formal and informal business. Gauteng accommodates 46.7 per cent of all formal SMMEs and 26.9 per cent of all informal SMMEs, with KwaZulu-Natal in second place with 12.6 per cent of all formal SMMEs and 25.3 per cent of all informal SMMEs.

SARS maintains a database of the number of business services establishments registered for levy payments in terms of the Skills Development Act 97 of 1999, by employment size and province. The database clearly indicates that most registered business services employers, namely 54.4 per cent, are based in Gauteng (SARS, 2003).

On the basis of this distribution of business activities, Gauteng was selected as the focus of the study and, more specifically, the formal sector in Gauteng.

3

Research objectives

The reasons for conducting a tax survey confined to the business services industry of Gauteng in particular are evident from the background to

the study provided in the previous section. The objectives of the study are to:

- determine how business services establishments of different sizes manage and administrate the taxes, duties and/or levies for which they are responsible;
- determine the significance of tax inputs and the usage of tax advice in business decisions in business services SMMEs; and
- assess business services establishments' preferences for various tax measures to reduce the administrative burden of managing tax matters, and determine whether different measures are preferred by the various categories of SMMEs.

4

Research methodology

The research methodology used to construct a model able to meet the primary research objectives of the study is explained in this section.

4.1 Sample population

The sample population consisted of micro (1-20 employees), small (21-50 employees) and medium (51-200 employees) business services establishments operating in Gauteng. Financial

managers, general managers, accountants and owners of business services SMMEs were targeted as sample elements / respondents.

4.2 Data collection methodology

Interviewer-administrated telephonic interviews were used to collect data from the sample of business services SMMEs operating in Gauteng. This method was supplemented with a self-administrated approach for respondents preferring to receive the questionnaire by fax and complete and return it again also by fax.

4.3 Sample

The Bureau of Market Research (BMR) Register of Business Services Establishments (BMR, 2004) was used as sample frame. To ensure that only micro, small and medium business services establishments operating in Gauteng were selected from the sample frame, all foreign elements, for example large business services establishments (200+ employees), were removed from the database.

A systematic disproportionate stratified sampling approach was used to select 200 business services SMMEs. This sampling method ensured that a systematic sample from the micro, small and medium business services subgroups was selected. The disproportionate sample approach was required because a large proportion of business services establishments located in Gauteng are micro establishments. The BMR Business Services Register confirms that at least 85 per cent of business services establishments operating in Gauteng can be classified as micro establishments. The disproportionate approach ensured that at least a minimum of 30 small and 30 medium

business services establishments were included in the sample.

To meet the objectives of the study, an interviewer-administrated paper-based questionnaire was designed. Questions to meet the objectives of the study were formulated in consultation with role players such as the National Treasury and SARS. Questions to elicit both closed-ended and open-ended responses were included. Various data capturing and verification procedures were followed to ensure the accuracy of the data.

4.4 Validity of the data

In total, 130 responses were received, which represents a response rate of 65 per cent for the survey. Sample surveys are subject to error and mainly yield estimates but no precise values. Sample error occurs when the selected sample does not perfectly represent the population. The formula for allowable sample error is:

$$\sigma_{\bar{x}} = \frac{E}{z}$$

where E = allowable error and z = number of standard deviation units that will yield the desired level of confidence (90 per cent level of confidence). Taking the potential sample error into account, a confidence interval that will probably contain the population parameter can be stated.

Table 2 shows the interval estimate for the total population based on a 90 per cent level of confidence for selected research variables investigated in the survey. It is clear, for example, that the figure for business services micro establishments that outsource their capital gains tax responsibilities is between 24.8 per cent and 19.3 per cent.

Table 2
Interval estimates for selected research variables

Research variable	Sample statistic (per cent)	Interval estimate (per cent)	
		Lower	Higher
Outsourcing capital gains tax functions (micro)	20.4	19.3	24.8
Burden to comply with tax regulations has increased substantially over past three years (micro)	34.8	27.8	30.7

Handling SDL* internally (small)	57.6	47.0	68.2
Burden to comply with tax regulations has increased substantially over past three years (small)	49.2	38.5	59.9
Handling SDL* internally (medium)	92.0	83.0	100.0
Burden to comply with tax regulations has increased substantially over past three years (medium)	16.0	4.0	28.0

* Skills development levies

5

Taxation requirements for business services SMMEs

5.1 Tax implications for the different establishment types

Income tax (also referred to as normal tax) is levied in terms of section 5(1) of the Income Tax Act 58 of 1962 on the taxable income received by or accrued to any person during the specific year of assessment. Calculating the taxable income of the person depends on the nature of activities and legal form of the relevant taxpayer. There are basically two broad categories of taxpayers; the first category includes persons taxed directly on the income received (for example, a sole trader or partnership) and the second category includes those cases where the business is taxed and not the individual (for example, companies and close corporations). Trusts are also taxed as separate legal persons, but due to the complexities surrounding trusts, they fall outside the scope of this study.

The procedure for determining the taxable income of the different enterprise types is summarised in Annexure A. As no trusts are included in the survey they are not included in the annexure. It is important to note that a close corporation is included in the definition of a company in terms of section 1 of the Income Tax Act 58 of 1962, thus any reference to companies includes close corporations.

5.2 Direct and indirect taxes

Taxes can be divided into two groups, namely direct and indirect taxes. For business services establishments, this income tax classification

is important in determining how much tax an establishment pays. In this section, the income tax classification of business services SMMEs will firstly be investigated. This will be followed by an outline of the various other direct and indirect taxation requirements with which business services SMMEs have to comply. Non-compliance with these rules as a result of lack of proper administration or management may lead to penalties and interest being charged, which could be detrimental to businesses.

5.2.1 Income tax

The Income Tax Act 58 of 1962 provides details of the different components that are used to calculate taxable income and tax liability. A taxpayer's annual tax liability is calculated on the basis of the annual tax return that that taxpayer must submit. The information in the tax return is used to calculate the taxpayer's taxable income for the year of assessment. This amount is then multiplied by the appropriate tax rate depending on the business services SMMEs taxation classification. The following tax rates can be applied to a business services SMME depending on the legal structure of that SMME:

- A sole proprietor or each individual partner of a partnership is subject to tax on his/her taxable income at progressive rates ranging from 18 per cent to 40 per cent; and
- Companies and close corporations pay tax at a flat rate of 29 per cent on their taxable income for the year of assessment (except in the case of a small business corporation or personal services company – refer to the next sections) and 12.5 per cent secondary tax on companies on the net amount of dividends declared (SARS, 2006).

5.2.2 Small business corporations

To support the development of small and medium enterprises a graduated company tax rate structure for incorporated small and medium size enterprises was introduced in 2000 and is reviewed on a regular basis (Manuel, 2000; 2005; 2006) In 2001 another major concession was introduced, allowing the immediate write-off of all plants and machinery used in a process of manufacture or similar process in the year they are brought into use for the first time. An accelerated write-off allowance for depreciable assets (other than manufacturing assets) acquired on or after 1 April 2005 is also available at 50 per cent of the cost of that asset in the tax year during which that asset was brought into use for the first time, 30 per cent in the second year and 20 per cent in the third year (Income Tax Act 58 of 1962).

To enjoy these concessions, companies and close corporations must comply with the following requirements:

- The shareholders or members must be natural persons and must hold the entire shareholding/members' interest of the company/close corporation;
- Shareholders or members may not hold any shares or interest in the equity of any other company (with limited exclusions);
- The gross income of the corporation for the year of assessment must not exceed R14 million;
- Not more than 20 per cent of the total of all receipts and accruals and all capital gains of the corporation may consist collectively of investment income and income from rendering a personal service – a small business corporation which is engaged in the provision of personal services will still qualify for the relief if at least four full-time employees are employed throughout the year of assessment; these employees should be engaged in the business of the small business corporation rendering that service on a full time basis; and
- The company/close corporation may not be an employment company (i.e. a labour broker without an exemption certificate or a personal service company) (SARS, 2006).

The first important aspect of these requirements to consider is the requirement that small and medium size enterprises be incorporated. Figure 2 provides the enterprise form of the participants in the survey to show how many of them trade in the form of a company or close corporation.

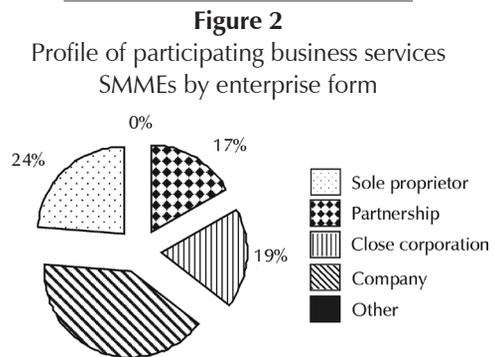
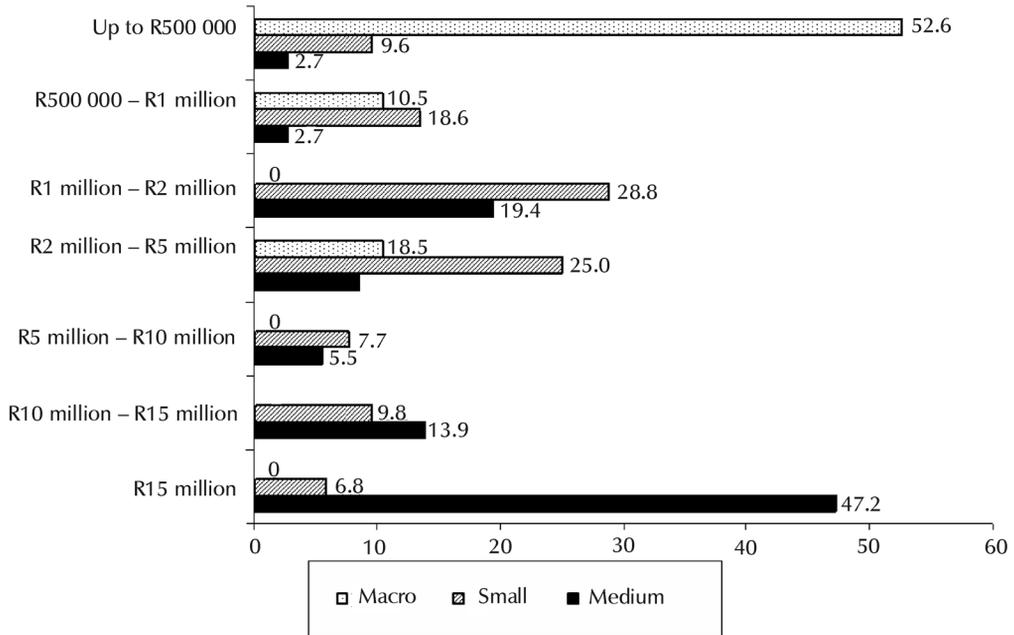


Figure 2 shows that more than half of the participating establishments are close corporations and companies (59 per cent) that might qualify for the small business corporation concessions based on legal form. The sole proprietors (17 per cent) and partnerships (24 per cent) will thus however not qualify for any of the concessions.

The next important consideration of the small business corporation definition is the annual turnover of a company. Statistics South Africa's *Integrated Business Register* (2004) classifies entities registered with the Companies and Intellectual Property Registration Office (CIPRO) by turnover. This register shows that almost half the CIPRO-registered active entities are micro enterprises, and almost 90 per cent are either micro or very small. On the basis of the information provided, small, medium and micro enterprises, which form the basis of the study, comprise almost 99 per cent of the total number of companies registered in 2004. (Statistics South Africa, 2004) The annual turnover of respondents participating in the survey is shown in Figure 3.

Figure 3
Business services SMMEs by turnover category

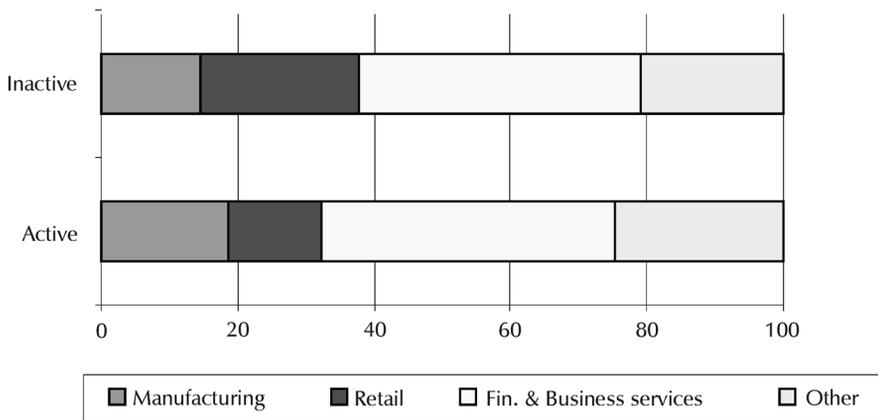


Based on current legislation, all micro and most small establishments will comply with the turnover requirements of the small business corporation definition.

Having complied with the legal form and turnover requirements, the next important

requirement for business service SMMEs relates to personal services. The following section analyses personal services in a business service environment.

Figure 4
Distribution of registered corporations by industry, 2004



Source: Statistics South Africa, 2004

5.2.3 Personal service entity

A company defined as a personal services entity will not be entitled to the concessions granted to small business corporations, although the company will be defined as a micro, very small, small or medium enterprise in terms of the National Small Business Act 102 of 1996 (as amended).

Statistics South Africa classifies service establishments as those who derive 50 per cent or more of their turnover from services rendered (Statistics South Africa, 2005). One of the factors considered in selecting the business services sector was the number of corporations involved in the business services sector. Figure 4 provides a more detailed overview of corporations registered with CIPRO by subsector.

Figure 4 reflects the relative importance of the finance and business services industry in particular, with 43 per cent of all active firms being financial and business services establishments.

The survey included the following finance and business services industries according to the Standard Industrial Classification of all Economic Activities (SIC) (SIC code in brackets):

- Renting of machinery and equipment (85),
- Computer and related activities (86),
- Research and development (87),
- Legal; accounting, bookkeeping and auditing activities; tax consultancy; marketing research and public opinion research; business and management consultancy (881),
- Architectural, engineering and other technical activities (882),
- Advertising (883) and
- Business not elsewhere classified (e.g. labour recruitment and provision of staff; investigation and security activities; building and industrial plant cleaning; photographic activities; packaging activities) (889) (Postma, Dorfling & Van Wyk, 2004).

Based on the SIC activities included in the survey, a number of establishments can be

classified as personal service companies therefore disqualifying them from the benefits granted to small business service corporations.

The Fourth Schedule of the Income Tax Act 58 of 1962 defines a personal service entity as a company where services are rendered on behalf of that company to a client of that company personally by any person who is a connected person in relation to that company and:

- That connected person would be regarded as an employee of that client if that services were rendered by that connected person directly to the client;
- That connected person or that company is subject to the control or supervision of that client as to the manner in which or the hours during which the duties are performed in rendering that service;
- The amount paid or payable in respect of that service consists of or includes earnings which are payable at regular intervals, daily, weekly, monthly or other intervals; or
- More than 80 per cent of the income of that company consists of amounts directly or indirectly received from one client (Stiglingh, Venter & Hamel, 2006).

An SMME classified as a personal services entity will not only not qualify as a small business corporation but will also pay income tax at an increased rate of 34 per cent (Income Tax Act 58 of 1962).

The definition does however have an important exclusion if the entity employs more than three full-time employees who are engaged on a full-time basis in the business of such a company of rendering any such service, other than any employee who is a shareholder or member of the company or is a connected person in relation to such person.

Of the respondents included in the survey, just more than a third (or 46 of the 130) were micro establishments (1–20 employees), 45.4 per cent were small (21–50 employees) and 19.2 per cent were medium (51–200).

Table 3 profiles the participating business services SMMEs according to number of employees.

Table 3

Profile of participating business services SMMEs by number of employees

Characteristics	SMME category		
	Micro	Small	Medium
Average number of full-time staff	8	27	108
Average number of full-time administrative staff	4	7	12

As discussed previously, almost all small and micro establishments will qualify as small business corporations in terms of the turnover rule. However, micro establishments will have to satisfy the criterion for the minimum number of employees before they are eligible for this tax benefit.

Because of the important contribution of business services to the South African economy, which was mentioned above, and in response to various industry representatives approaching the government about the cash flow hardships that the personal services entities regime has imposed on small businesses, the government has proposed certain amendments to the Income Tax Act No 58 of 1962 to limit the scope of the personal services entities (National Treasury, 2006).

The proposed amendments are:

- To limit the personal services entity regime to situations where the client controls or supervises how the work is performed, but only if that work is performed at the client's premises; should the client thus control and supervise work performed by the entity on a limited basis, i.e. not all the work is done at the client's premises, the company will no longer be deemed to be a personal services entity;
- The third criteria for a personal services entity as stated above will be deleted; a client will now be allowed to make regular payments to an entity providing a service, as this is normally due to administration rather than an employee/employer relationship; and
- The last proposed amendment reduces the number of full-time employees to three or more instead of four and more (National Treasury, 2006).

5.3 Other direct taxes

- **Capital gains tax:** A capital gain arises when the proceeds from the disposal of an asset exceed the base cost of that asset. A capital loss occurs when an asset is disposed of and the base cost of that asset exceeds the proceeds of that asset. For individuals, only 25 per cent of the net capital gain, after deducting the annual exclusion, is included when calculating the tax payable. For companies and close corporations, only 50 per cent of the net capital gain on the disposal of assets is included in the taxable income. Capital gain forms part of an SMME's taxable income (SARS, 2006).

Compliance: Capital gains and losses must be declared in the income tax return for the tax year in which the asset is disposed of (Stiglingh *et al.*, 2006). For any costs incurred, the base cost documentary proof must be kept and provided on request (De Koker, 2005).

- **Secondary tax on companies (STC):** Section 64B of the Income Tax Act 58 of 1962 stipulates that STC is payable by all South African resident companies on the dividends (including deemed dividends) which the company declares to its shareholders. STC is not part of the normal tax payable by a company and must be separately calculated. STC is calculated as follows: 12.5 per cent of the net amount of the dividend. (Stiglingh *et al.*, 2006)

Compliance: STC is payable on the last day of the month following the month in which the dividend is declared. Non-payment or late payment will lead to interest and penalties being charged (Clegg & Stretch, 2005).

- **Provisional tax:** Those taxpayers earning income not classifiable as remuneration (as defined) are normally required to pay provisional tax. Provisional tax is a method to pre-pay the tax that is due for the year of assessment. The provisional tax is paid biannually (Venter, Hamel & Stiglingh, 2006).

Compliance: SMMEs earning an income of more than R10 000 must register within 30 days as provisional taxpayer (SARS, 2005a). Three provisional tax payments must be made during the year, the first within six months of the commencement of the year of assessment, the second before the last day of the financial year and the third normally within six months of the end of the year of assessment. Each payment must be accompanied by the appropriate tax return providing detail of the payment. The third provisional tax payment is voluntary and can be made by companies or close corporations whose taxable income exceeds R20 000. Non-payment will lead to interest being charged. Non-payment or late payment of any of the other payments will lead to interest and penalties being charged (SARS, 2004a).

- **Employees' tax:** Employees' tax refers to the tax that the employer withholds from his/her employees at the end of each pay period (Venter et al., 2006).

Compliance: Any business that pays remuneration to employees that exceeds the tax threshold must register within 14 days of becoming an employer. (Venter et al., 2006). The employer must complete and submit a monthly return (EMP201). The return and the payment must be made within seven days of the end of the month in which the tax was withheld (SARS, 2005b). At the end of the year the employer must issue each employee with an employee's tax certificate (IRP5) (Silver & Klein, 2005). It must also submit an annual reconciliation (IRP501) to the local SARS branch office, within 60 days of the end of the tax year (Clegg, 2004).

5.4 Indirect taxes

- **Value added tax (VAT):** VAT is an indirect tax levied in terms of the VAT Act 89 of 1991. VAT must be included in the selling price of every taxable supply of goods and/or services made by a vendor. In determining the VAT liability, the vendor must subtract all the input tax claimed from the output tax charged. Should the output tax exceed the input tax, the vendor has to pay the excess to SARS. Should the input tax exceed the output tax, the vendor will be entitled to a refund from SARS (SARS, 2006).

Compliance: A person with taxable supplies of more than R300 000 (excluding VAT) must register as a vendor for tax purposes (De Koker & Kruger, 2004). Every vendor is registered for a specific tax period, depending on the size of the business. The tax period may vary from one month to four months. The VAT returns (VAT 201) and any VAT due to SARS must be filed and paid before the 25th of the month following the end of the tax period (Tustin et al., 2005). A supplier must furnish a recipient with a tax invoice within 21 days of a request to do so (SARS, 2004b). If there is a change in the conditions of sale a debit or credit note should be issued (Brettenny, 2005). Late payment or submission of a VAT return could lead to interest and penalties being charged.

- **Skills development levies (SDL):** The levy is calculated as a percentage of the earnings of the employees (SARS, 2006). The levy is payable to the sectoral SETA which is concerned with the development of skills in that sector (Warren, 2004). With certain exceptions, every employer, as defined in the Fourth Schedule to the Income Tax Act 58 of 1962, is liable for SDL (Skills Development Levies Act 9 of 1999).

Compliance: SDL contributions are payable on a monthly basis, on or before the seventh of the month following the month to which the SDL contributions accrue. SDL contributions are normally submitted with PAYE and UIF on the EMP201 form (Skills Development Levies Act 9 of 1999).

- **The Unemployment Insurance Fund (UIF):** The Unemployment Insurance Fund insures employees against the loss of earnings due to termination of employment, illness and maternity leave. A monthly contribution has to be made by the employer (1 per cent) and the employee (1 per cent) based on the earnings of the employee (SARS, 2006).

Compliance: The Unemployment Insurance Contributions Act 4 of 2002 requires employers who are registered with SARS for purposes of employees' tax or skills development levies to pay their UIF contributions to SARS. Those who are not required to register with SARS must pay their UIF contributions over to the Unemployment Insurance Commissioner (Unemployment Insurance Contributions Act 4 of 2002). UIF contributions are payable on a monthly basis, on or before the seventh of the month following the month in which the UIF contributions accrue (SARS, 2005b).

- **Custom and excise duties:** Custom duty is a consumption tax levied on imported goods and is usually calculated as a percentage on the value of the goods. Excise duty is a consumption duty levied on certain locally manufactured products (SARS, 2006).

Compliance: Goods imported, documents relating to the importation, including the transport document and suppliers' invoices, must be produced if required by a customs controller (Corbin & Cowell, 1994).

- **Transfer duty:** Transfer duty is levied on the purchase price payable for the acquisition of fixed property. Transfer duty is levied at a progressive rate of 0 per cent to 8 per cent depending on the value of the property acquired and the legal form of the purchaser (SARS, 2006).

Compliance: Transfer duty must be paid to the Commissioner within six months of the date of the transaction (Transfer Duty Act 40 of 1949).

- **Donations tax:** Donations tax is a tax imposed on persons who want to donate their assets

in order to avoid normal income tax on the income derived from those assets and/or estate duty when those assets are excluded from their estates (Jordaan et al., 2006).

Compliance: Donations tax must be paid to the Commissioner within three months of the date upon which the donation was made. The payment must be accompanied by a return on the form prescribed by the Commissioner (Venter et al., 2006).

- **Stamp duty:** Stamp duty is levied on instruments such as leases of immovable property and unlisted marketable securities at different rates (SARS, 2006).

Compliance: The instrument must be signed at the time of execution thereof or at the latest within 21 days of execution thereof (Goodall, Jacobs & King, 2004).

5.5 Conclusion

From the discussion in this section it is clear that there are many legal requirements that SMMEs must meet. Correctly applying the legislation and complying with relevant timeframes place a major burden on SMMEs. Considering that micro business services establishments only have on average three full-time administrative employees and medium-sized business services establishments only have 12 full-time administrative employees, most SMMEs will find it difficult, not only to comply with the requirements but also to keep up to date with changes.

6

Analysis and interpretation of research findings

This section provides an analysis of the tax survey conducted among business services SMMEs in Gauteng during the period November 2005 to January 2006.

6.1 Corporation profile

Table 4 profiles the participating business services SMMEs according to selected characteristics.

Table 4
Profile of participating business services SMMEs by selected characteristics

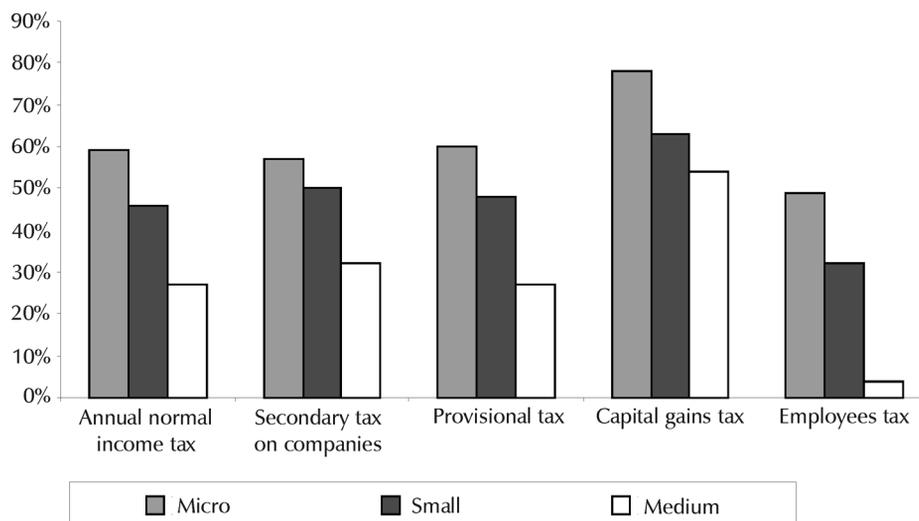
Characteristics	SMME category		
	Micro	Small	Medium
Average number of years in operation	11	15	19
Average number of full-time staff	8	27	108
Average number of full-time administrative staff	4	7	12
Percentage of full-time administrative staff dealing with tax matters	45 per cent	34 per cent	35 per cent

Table 4 shows that participating SMMEs are fairly experienced, reflected in their average number of years in operation. The mature status of participating SMMEs was very encouraging for purposes of collecting objective and reliable data. The data confirms the government's view that the SMME sector should be targeted for future growth. The information indicates that the longer a business is in operation, the larger it becomes and the more people it can employ. For example, an average micro businesses that had been in existence for 11 years employs eight full-time staff members while medium businesses that have been operating for 19 years employ an average of 108 full-time staff. It should therefore

be a priority to ensure that as many of the micro and small establishments as possible grow to become medium organisations. The analysis also shows that almost half the administrative staff of micro establishments deal with tax matters, compared to only a third in the case of small and medium establishments.

There seems to be a correlation between the size of an establishment based on employee figures and size based on turnover. The more employees an establishment has, the bigger its turnover. The information also clearly indicates that the government is targeting the correct section of the sector in terms of small business corporations.

Figure 5
Establishments outsourcing their direct tax liabilities



6.2 Management and administration of taxation functions

The research model was constructed to determine which taxes/duties/levies are managed and administrated by SMME business services establishments internally and which are outsourced. Figure 5 indicates the percentage of establishments liable for various direct taxes that elect to outsource the responsibility for these taxes to a third party.

It is clear from Figure 5 that the size of an establishment has a direct impact on its

ability to administer and manage different tax functions internally. As can be seen from Table 4, the larger the establishment, the more administrative personnel it can appoint. This therefore increases the business's capability for handling the function internally. It is also clear that employees' tax functions are generally performed internally, irrespective of the size of the establishment, possible due to the routine nature of this tax function compared to the other tax functions.

Table 5
Outsourcing the responsibility for indirect taxes/duties/levies

Responsibility for taxes/duties/levies	Micro (per cent)	Small (per cent)	Medium (per cent)
Value-added tax (VAT)	50.0	33.9	8.0
Customs and excise duties	21.7	10.2	12.0
Stamp duties	30.4	22.0	12.0
Unemployment Insurance Fund (UIF) levies	41.3	33.9	8.0
Skills development levies (SDL)	28.3	33.9	8.0
Workmen's compensation levies	26.1	15.3	4.0
Regional Service Council levies (RSC)	53.0	40.0	43.0

In relation to indirect taxes, it is clear that medium establishments are better positioned to manage the functions as they outsource considerably fewer responsibilities than do small and micro establishments. This can be illustrated by the fact that 50 per cent of micro establishments outsource their VAT functions compared with 33.9 per cent of small establishments and only 8 per cent of medium establishments.

It is interesting to note that the tax function that is outsourced by most SMMEs is Regional Service Council levies. The government's decision (Manuel, 2006) to repeal these levies and not to replace them with any other tax should bring welcome relief to SMMEs.

To better understand the reasons for outsourcing tax functions and responsibilities by SMMEs, respondents were asked to identify

the main reason why they outsource these functions. The reasons provided for outsourcing the functions are provided in Table 6.

Of the reasons cited for outsourcing tax functions, lack of time to handle these functions internally is mentioned as a major factor by all three categories of SMMEs. Besides time, lack of adequate tax skills to handle functions internally is a further reason for outsourcing tax functions.

Due to the ever-changing nature of taxation, a great deal of time is required to keep up to date with changes and it is very difficult to find staff with appropriate tax skills. Table 6 confirms that the changing nature of taxation is one of the major challenges facing SMMEs. It could therefore be expected that establishments would invest in training and updating their

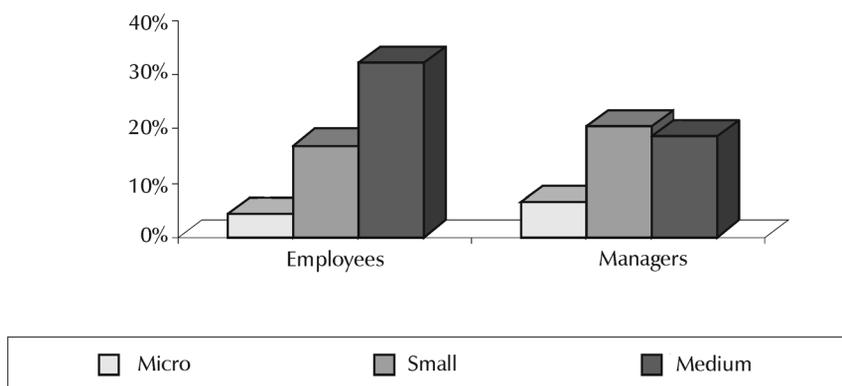
employees to ensure compliance with the latest requirements and utilisation of new incentives. However, according to Figure 6, this is not the case. Figure 6 indicates the percentage of

SMMEs that perform tax functions internally and that have invested in training for their employees in the past.

Table 6
Reasons for outsourcing tax functions

Reason	SMME category		
	Micro (per cent)	Small (per cent)	Medium (per cent)
Unskilled tax staff	32.6	28.8	12.0
Cheaper to outsource	23.9	18.6	4.0
Time factor	43.5	30.5	24.0

Figure 6
Investment in staff taxation training



It is clear from Figure 6 that very limited investment is made to support the tax training needs of employees and managers.

6.3 Value of tax inputs/advice on effective management of the business

It is interesting to note that 35 per cent, 49 per cent and 16 per cent of micro, small and medium establishments respectively believe that the burden of complying with government tax regulations has increased substantially over the past three years. The research model is

therefore useful in determining the value of tax inputs/advice/information to SMMEs in coping with this burden through planning, survival and income/expense management.

It is clear from the analysis presented in Table 8 that business services SMMEs hardly use tax inputs/advice/information for management and planning purposes. This suggests that SMMEs either do not have the required skills to utilise tax inputs as a strategic management tool, or that they do not see the potential advantages of an effective tax information system to support business planning and strategising.

Table 8
Value of tax inputs/advice/information

Statements	SMME category		
	Micro (per cent)	Small (per cent)	Medium (per cent)
Tax functions are only performed because they are compulsory	39.1	30.5	24.0
Inputs from tax staff/division/consultants are used for short-term tactical business planning	10.9	1.7	20.0
Inputs from tax staff/division/consultants are used for long-term strategic planning	10.9	18.6	28.0
Tax knowledge support effective management of income/expenses	17.4	8.5	12.0
Information provided by tax advisors is important for the survival of the establishment	26.1	20.3	28.0

The most logical reasons for the low level of utilisation of tax inputs/information could be that tax functions are viewed as compulsory activities or that the tax functions are handled by outside consultants whose mandate probably does not include the supply of tax related information but merely dealing with tax responsibilities on behalf of SMMEs.

Another factor that could determine whether taxation contributes to the management of a business could be the person/department responsible for managing the tax functions. Respondents who perform tax functions internally were asked to indicate whether the tax functions are the responsibility of top management of the establishment or a financial/accounting department. Only 27 per cent of micro, 21 per cent of small and 28 per cent of medium establishment indicate that top management is responsible for tax functions. This could thus be a contributing

factor to why taxation is not seen as an input in business decisions.

6.4 Tax measure preferences

During the last couple of years, the National Treasury and SARS have introduced a number of initiatives to support the SMME sector. These initiatives include a reduction in the number of VAT returns that need to be submitted by small business corporations and the provision of an accounting software package. In this study respondents were asked to indicate which of a range of possible options to reduce tax compliance burdens they would prefer. A preference index was compiled to assess the preferences for the various tax measures presented to the SMMEs. This index was compiled by allotting multiplying values to each of the rating options: not preferred = 0; preferred = 50; and highly preferred = 100.

Table 9
Preference index for tax measures by SMME category

Tax measures	Micro (Index)	Small (Index)	Medium (Index)
Higher VAT thresholds	55	36	22
Filing returns for VAT less often	61	43	28
Filing returns for employees' tax less often	58	36	24

Special simplified tax regime for SMMEs	59	66	57
Reduced penalties/interest charges for SMMEs	75	81	82
SARS 'help desk' to provide information/assistance	76	79	80
Reduced tax rates for SMMEs	65	78	66

It is interesting to note that the majority of respondents did not select a reduction in the rate of tax paid as their first choice. Both small and medium business services establishments selected a reduction in the penalties and interest charged as their preferred option. The reason for this selection can be found in the number of administrative staff employed by the establishments. In Table 6, respondents indicated that lack of time was the main reason for deciding to outsource their tax responsibilities; this being the case, they probably also find it difficult to complete the functions retained internally in a timely manner. The second support measure selected was the establishment of a SARS helpline; in this regard, SARS must be congratulated for recently establishing SMME support desks at their branches. However, based on the responses received from the survey, the existence of this support function is either not properly communicated to SMMEs or is not complying with the requirements of SMMEs.

7 Conclusion

The government's accelerated and shared growth strategy has identified the SMME sector as an important economic role player in creating wealth and job opportunities in South Africa. Due to the cost impact of taxation on an SMME, not only in the form of actual taxes but also possible interest and penalties, the design of appropriate tax management strategies is fundamental to the survival of SMME. This study finds that, due to the complexity of tax legislation and lack of time and skills, the majority of business services SMMEs outsource various tax functions. The study finds that the larger the establishment becomes, the better it is equipped to perform these functions internally. The results of the survey indicate that the longer

an establishment exists, the more it shows growth in its turnover and also in the number of people it employs. Considering the objectives of the accelerated and shared growth strategy, special attention should be given to support SMMEs in the early years of their existence.

Generally, tax inputs are not considered as an important factor when making business decisions. The survey indicates that the value of tax advice decreases as establishments grow from micro to small businesses and then increases as they grow further to become medium-sized businesses. The reason for this could be that, at the start of a new business, the different tax implications are important for that business, as non-compliance could be fatal. As the business grows, the initial tax problems have been dealt with and the management's concern regarding the future of the business decreases. However, as the business becomes larger, taxation again become important in attempts to increase the business's profits. It is suggested that improving tax skills and knowledge among SMMEs will lead to more effective management of taxation functions, which may ultimately result in cost savings and help to ensure the long-term survival of the establishments.

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